CONSOLIDATION OF PUBLIC FINANCES IN BELGIUM: AN EXAMPLE OF APPLICATION OF EUROPEAN NORMS IN A STATE WITH A FEDERAL STRUCTURE

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I. The institutional reform of 1988 to 1993

The last institutional reforms which took place at the beginning of the 1990s[1] constituted a decisive step in the process of the federalisation of Belgium which has continued to evolve since its beginnings in 1970 right up to the present day[2]. These took place in a context of consolidation of public finances: cutting the public deficit and fighting the snowball effect were the central issue in Belgian budgetary policy at that time, even before the commitments that were undertaken by European countries in the context of the Maastricht treaty.

1. Aims of institutional reform

The fundamental purpose of State reform is to respond to the increased demands for autonomy from the federated bodies. The process of federalisation, as in many federal States, tends to transfer the allocation functions of public authorities to the federated bodies and to keep at the central level those matters which are linked to public sovereignty (justice, the army, law enforcement etc.) and redistribution (social security, including health care).

Three specific objectives can be attributed to the laws passed from 1988 to 1993: the finalisation of the process of Belgian federalisation which had been initiated in 1970, the extension of the scope of competencies of the federated authorities, the gradual adaptation of the

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1 Special Laws of 8 August 1988 concerning institutional reforms intended to augment the competence of the federated bodies; on 12 January 1989 on the Brussels institutions; on 16 January 1989 concerning the financing of the Regions and Communities, supplemented by the Special Act of 16 July 1993 setting up the federal structure of the State.

2 New stipulations concerning the redistribution of competencies and funds between the various levels of power were covered by a Special Law which should be put to the vote in 2001.

ratios for the distribution of financial resources between the federated bodies.

- *Finalisation of the process of federalisation in Belgium which had been initiated in 1970*

The creation of the Brussels Capital Region and the other Community institutions for the Brussels Region (Law of 1989) and then the subdivision of the province of Brabant between the three Regions (Law of 1993) have defined the current federal structure of Belgium. The country comprises three Communities (Flemish, French and German) on the one hand and three Regions (Flanders, Wallonia and Brussels Capital) on the other. The Communities assume responsibility for cultural matters and everything that can be personalised and/or share these areas with the Federal government, and the Regions assume and/or share responsibility for matters linked to the occupation of the land and supervision of local authorities. Each body has its own parliament (called a Council) and a government. From the beginning, however, the Flemish Community and the Flemish Region merged and therefore only have one Council and one Government.

- *The extension of the scope of the powers of the federated authorities*

The new powers transferred to the Communities in 1989 essentially relate to education. For the Regions, it was infrastructure policy and transport (except the railways), management of the Funds of the municipalities and provinces, unemployment alleviation programmes and restructuring of national sectors (iron and steel, textiles, shipbuilding). The personnel and buildings needed to exercise these powers were also transferred to the federated bodies. Overall the reform has virtually quadrupled the total budget managed by the Communities and the Regions. In 1993 the sharing of competence between the federal authority and the federated bodies was further extended to include the following areas: international relations (in their areas of competence) and foreign trade, the environment, agriculture and scientific policy.

- *The adaptation of the distribution ratios for financial resources between federated bodies*

The law provides for a period of 10 to 11 years for a gradual transition from the situation as it was in[3] to the new distribution ratios. Eventually the Regions will share the funds allocated to them in proportion with their contribution to the national personal income tax (P.I.T.) revenues[4]. The same criterion will be used for the distribution of funds attributed to the Communities (apart from the German Community, which is separately financed by a grant) for areas of competence other than education. In the case of education, the distribution ratio observed at the outset (56.5% for the Flemish Community and 43.5% for the French Community) will gradually reach the respective levels of 57.55% and 42.45% which is the estimate made at the time of the proportions of the population aged less than 18. From 2000 onwards they will be distributed in proportion with the recorded school population.

2. *Method of financing for federated bodies as stipulated in the laws of 1989 and 1993*

2.1 *The sources of financing*

The sources of financing for the federated bodies may be divided into five categories.

- Shares of the tax revenue levied by the federal authority account for almost 90% of the funds of the Regions and Communities identified in the law in 1989 (cf. point 2.2). The Regions may levy supplements (additional centimes) or grant discounts (from 1994) on these taxes[5], but the Communities have not been given the right to do this.
- Regional taxes (registration duties and inheritance tax, real estate withholding tax, taxes on gaming and betting, leisure equipment or drinks) and, from 1993, Community taxes (radio and television licence

[3] Before 1989 the distribution took into account the relative contribution to the personal income tax and also the number of inhabitants and the size of the territory.

[4] A supplement, the national solidarity intervention, is nevertheless provided for those Regions in which the personal income tax per inhabitant is lower than the national average.

[5] After consultation between the Federal Government and the executives of the Regions and without prejudice to the rights of the municipalities to levy additional centimes.

fees)[6], which amount to 8% of the funds identified. The federated authorities have more autonomy in this area. The law provides for the possibility, on a case by case basis, of altering the levels of duty, the exemptions or even the taxable basis.

- The grants from the federal government, which amount to less than 3% of the funds provided by the Law, while this was the essential means of financing before 1989[7].
- The other revenues specific to the Regions and Communities, such as, for example the taxes on water and the environment or revenue from property tax. These funds increased from 0.4% of GDP in 1989 to 0.9% in 1999 (figures from the national accounts for 2000).
- The loans, which are not only envisaged by the Law as a source of financing for the Regions and Communities but are actually required from the beginning of the 1990s, by the transitional mechanisms put in place by the law (see below).

2.2 The shares of tax revenue allocated

The Special Financing Act of 1989 stipulates that the funds transferred will be taken from VAT and personal income tax (P.I.T.). The shares of VAT are destined solely for the Communities and correspond to the financing of their new powers in the area of education. The proportions of P.I.T. which are allocated finance the other powers of the Communities and all the powers of the Regions. The law not only defines the total amount of funds to be attributed to the Regions as a whole on the one hand and the Communities on the other, but also the distribution of these funds between them individually. The method of calculation, which is used, has changed over time, particularly in the case of the funds taken from P.I.T. During the first 10 years, i.e. during the transitional period, these were covered by five different calculation rules, depending on the type of powers with which they are linked. From the year 2000 onwards, i.e. in the definitive regime, only two types of mechanisms will exist, one of them for funds levied from VAT, and the other for all funds levied from P.I.T.

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[6] Initially in the law of 1989, the radio-TV license fee was defined as shared non-fiscal revenue.

[7] These relate to financing of programmes to get unemployed people back into work (Regions), university education provided to foreign students (Communities), the "main morte" (Brussels Region) and also the financing of the German Community and the Joint Community Committee.

We should make it clear at the outset that the shares of taxation which are allocated, both from P.I.T. and from VAT, are independent of the overall amount of these revenues. Only the distribution of P.I.T. between the Regions or between the Communities is important, since this constitutes the criterion for the sharing of funds between each of them and, combined with the distribution of the population by region, it determines which region(s) will be the beneficiary or beneficiaries of the solidarity intervention.

The calculation of the shares of tax to be allocated as stipulated in the law takes into account the amount of change in the consumer price index and the growth in real terms of the gross national product for the budgetary year in question. The law stipulates, however, that "while awaiting the definitive setting of these parameters, the adaptation takes place on the basis of the parameters for the previous year", with the understanding that a rectification process will take place in the following year. This stipulation gives rise to differences, which are sometimes considerable, between the funds which are payable or "transferable" in a given year and the funds actually granted, since these parameters fluctuate considerably from one year to another. The retrospective analysis carried out in this section considers the revenue due to each body and is based on the parameters for the current year.

2.2.1 The definitive regime

From 2000 onwards the total of the shares of revenue from personal income tax allocated to the Regions on the one hand and the Communities on the other corresponds to the funds transferred during the previous year[8] - except the solidarity intervention - adjusted in accordance with the change in the average consumer price index, and real growth in the gross national product for the year.[9] The distribution between the three Regions or the two Communities of the total obtained in this way is in proportion with their contribution in relation to the total revenue from personal income tax. The Region or Regions in which the amount of tax per inhabitant is lower than the national average also receive(s) the solidarity intervention, which is the product of 468 BEF at 1990 prices - indexed on

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8 I.e., in 2000, the funds granted to each of the federated bodies at the end of the transitional period.

9 According to the Law of 16 July 1993; initially the Law of 1989 linked the adaptation to the level of *nominal GNP growth*.

the basis of the average consumer price index - multiplied by the number of inhabitants.

The total of the share of VAT revenue to be transferred to the Communities is calculated in the same way as during the transitional period (see below). Its distribution has, however, been adapted "since the 1999 budgetary year, in accordance with the number of pupils, based on the objective criteria determined by law" (art. 39 §2 of the Law of 1989)[10].

2.2.2 The transitional period

The essential aim of these 10 “intermediate” years from 1989 to 1999 was to organise *in a progressive way* the redistribution of funds between each of the entities to arrive at the application of the definitive rules defined above. The Law of 1989, however, also aimed to reconcile the extension of the powers of the federated bodies with the desire to preserve the consolidation of all the country’s public finances.

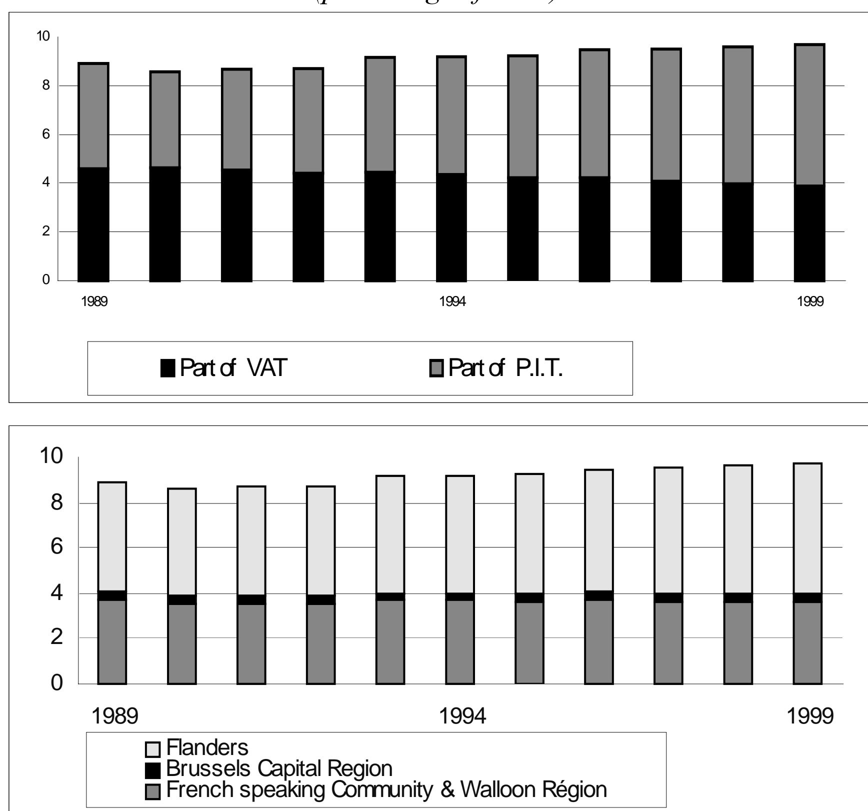
Though, the mechanisms that were put in place gave rise to an increase in the funds available to the Communities and Regions of 0.8% of GDP between 1989 and 1999, which was actually due to a significantly larger increase in the shares of P.I.T., 1.5% of GDP, and a fall in the share of VAT, by 0.7% of GDP (cf. figure 1). In other words, the real average annual rate of growth in terms of the amount of funds transferred was 2.9% for 10 years or, taking into account the fall in 1990, 3.4% for 9 years, of which 6.5% for the share of P.I.T. and 0% for the share of VAT. Without going into detail on the technical aspects of the financing laws, which are extremely complex, we will try to ascertain the origins of this considerable growth.

Shares of VAT allocated to the Communities

The Law of 1989 states the value of the amounts to be transferred to each Community in 1989 and then stipulates that their development will be adjusted in line with the retail price index from 1990 onwards. These theoretical amounts, however (which are also called base amounts) were first reduced by 3.6% in 1989 and then, subsequently and for an indefinite

[10] The precise modalities governing the definition of this new distribution ratio were defined in the Law of 23 May 2000 and were only applied from the 2000 budgetary year.

Figure 1
Transitional period: shares of tax due to the Communities and the Regions
(percentage of GDP)



period (even beyond the transitional period), they are corrected by an adjustment factor which reflects the assumed change in the school population. This corrective factor has always been slightly lower than one. The change in the shares of VAT transferred, which we should remember are intended to finance the powers transferred in the area of education, have therefore tended to be limited to the growth in inflation, which accounts for their significant fall as a percentage of GDP. *The law therefore initially obliged the Communities to take drastic consolidation measures or to resort to borrowing*, even if only to finance recurring expenditure on wages and teachers' salaries.

Shares of personal income tax allocated to the Regions and the Communities

As in the case of shares of VAT, the value of the amounts to be transferred to each Region and each Community in 1989 are stated explicitly in the law, which also stipulates that their development, from 1990 onwards, is in line with the retail price index. For 20% of these basic amounts, however, the payment is transferred to the following years in the form of perpetual annuities (including capital and interest) spread over a period of 9 to 10 years. In this way the law therefore also imposed an *obligation to borrow* on the federated bodies, but this was essentially a situation of *preliminary financing* to the extent that the swelling of annuities over the years quickly reduced the theoretical level of “forced” borrowing (from 20% in 1990 to 11% in 1994 and 0% in 1998). This mechanism, like the one put in place for shares of VAT, expresses the Government’s desire to make the federated bodies take part in the consolidation of public finances in the country. The application of this mechanism alone would have reduced the share of P.I.T. in 1999 virtually to their 1989 level as a percentage of GDP, after the fall at the beginning of the period.

However, the progressive distribution of funds between the bodies in order to reach the new distribution ratios in 1999, gave rise to an increase in the total amount of tax transferred of 1.0% of GDP over 10 years. Indeed, for the regional or Community powers that already existed before the Law of 1989[11], the legislature wanted to prevent the situation where another body (the one whose funds were previously proportionally higher than its contribution to national P.I.T.) would have less funds than before the law came into force. Reconciliation of this concern with the progressive application of the new distribution ratios required a progressive increase in the total amount of funds financing the existing powers.

Finally, in view of the financial difficulties encountered by the federated bodies (particularly the Communities) during the first few years, the Law of 16 July 1993 increased the funds to be transferred[12]. The shares of P.I.T. allocated to the Communities were increased by 4.5 billion in 1993. Then, from 1994 onwards, the rate of growth in all the funds coming

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[11] And for the funds of the municipalities, but excluding other new powers (e.g. teaching).

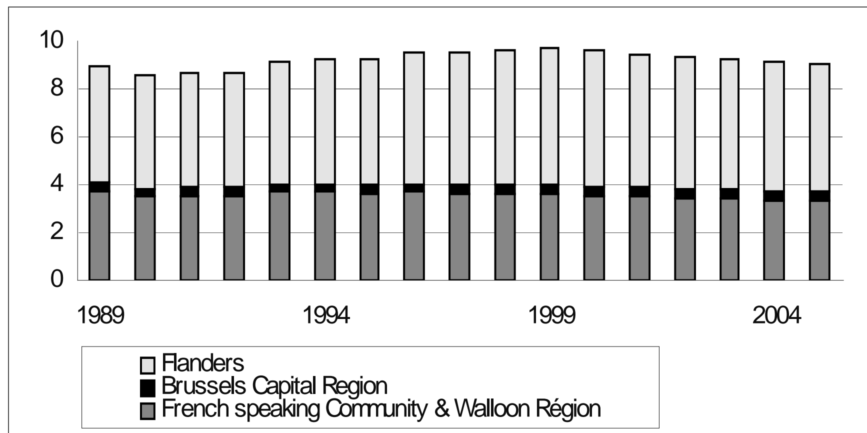
[12] Beyond the cost of the new powers transferred (agriculture and missions for the Province of Brabant).

from P.I.T., both in favour of the Regions and the Communities, was progressively adapted in line with the growth in GNP at constant prices. Following this, the shares of P.I.T. transferred increased by a further 0.4% of GDP between 1993 and 1999.

Figure 2

Share of taxes to be transferred until 2005

(percentage of GDP)



Differentiated development for each body

These overall developments do, of course, cover different situations in each body.

The increase of 0.8% of GDP in the share of tax allocated to the Communities and the Regions as referred to above is located solely in Flanders (Community and Region), with the funds allocated to the French Community and the Walloon Region falling by 0.1% of GDP and those of the Brussels Capital Region remaining virtually unchanged[13]. Between 1989 and 1999 the average annual rate of growth in resources due was 3.7% for Flanders, 1.8% for the bodies in the South of the country and 3.0% for the Brussels Capital Region.

[13] Rise of 0.76% in GDP in total, of which 0.83 for Flanders, 0.03 for Brussels and a fall of 0.10 for the bodies in the South of the country.

2.2.3 Contrast between the transitional period and the definitive period

The mechanisms set out in the Financing Act indicate a change in 2000. The rate of real growth in funds to be transferred to the federated bodies actually becomes significantly lower in the definitive regime than it was during the transitional period. As an illustration, assuming an average GNP growth rate of 2.6% per year at constant prices[14], they would fall by 0.6% of GDP between 1999 and 2005 following an average real growth rate of 1.5% per year, which is clearly lower than the rate during the previous 10 years (2.9%). The reduction would be even greater for Flanders: 1.6% instead of 3.7% previously.

3. Control mechanisms set out in the Laws of 1989 and 1993

Although the law gives financial autonomy to the Communities and Regions, while extending the resources and powers delegated to the federated bodies it has at the same time imposed a number of stipulations intended to safeguard the economic and monetary union of the country, price stability and the consolidation of public finances as a whole. These are mainly compulsory co-ordination mechanisms between levels of power and the creation of a body for the "monitoring" of financing needs.

3.1 Controls in relation to fiscal flexibility

The Regions can levy additional centimes or grant reductions on personal income tax. The law does, however, state that prior consultation is required between the Federal Government and the Executives of the Regions. Furthermore, a maximum percentage can be fixed if necessary by Royal Decree (Art. 9 of the Law of 1989). None of the Regions have made use of this opportunity during the transitional period, but this aspect of financing legislation is being highlighted at present because the extension of the fiscal autonomy of the Regions is an important focus of the new special draft law for 2001[2].

[14] Cf. "Perspectives Economiques 2000-2005", Federal Planning Bureau, April 2000.

3.2 *Controls in relation to borrowing arrangements*

Both the Regions and the Communities are able to issue debt on their own account or for the public interest bodies that depend on them. They must, however, submit the conditions and the calendar for possible public debt in Belgian Francs for approval by the Minister of Finance. This approval is also necessary for debt issued outside Belgium. In the case of private loans, on the other hand, the federated authorities are only obliged to inform the Minister of Finance.

3.3 *Controls in relation to the amount of debt*

We have seen that the mechanisms of the Financing Act already required the federated bodies to borrow funds, particularly during the first few years, even in the event of zero growth in their expenditure in real terms. On the other hand, the law does not impose any direct constraints on the growth and actual nature of their expenditure. Taking into account the revenue allocated by the law, the actual level of the deficit and the debt owed by each body is the result of its own budgetary policy, and each one assumes its own financial responsibility.

In order to remove any excess, however, the legislature has nevertheless decided to set up a Council of "the wise" to carry out a monitoring role and to make recommendations. It has created a *"Financing needs of public authorities" section* within the Higher Finance Council (C.S.F.). This section issues a report each year on the financing requirement of the public authorities; it can issue an opinion on the opportunity of limiting the borrowing capacity of a public authority, at the initiative or at the request of the Minister of Finance. Where applicable, such a limitation may be imposed by a Royal Decree for a maximum of two years (Art. 49 art. 6 and 7 of the Law of 1989).

In order to fulfil its mission, the section has made efforts to define, for each year since 1989, "intermediate" norms for the rate of growth in spending and deficits for each public authority, not only for each of the Communities and Regions, but also for the Federal government and Social Security authorities. These norms were dictated from the beginning by the fundamental aim of reducing the levels of indebtedness in the long term for all public administrations and eliminating any snowball effect. This aim was supplemented over the years by the need for Belgium to meet the budgetary criteria of the Maastricht Treaty, and then the Stability and

Growth Programme of the European Union. Clearly they have been adapted each year in accordance with the economic context and the budgetary achievements of the previous year.

4. The norms defined by the Higher Finance Council for each of the Communities and Regions

4.1 During the transitional period

The Higher Finance Council (C.S.F.) has been aware of the different ways in which the funding of the federated bodies was developing before and after the year 2000 as a result of the Financing Act (more or less pronounced depending on the case, see above), and has wished to preserve their long-term budgetary autonomy. It has therefore taken as its objective the stabilisation of the level of indebtedness15 of each federated body at the beginning of the definitive phase, i.e. in 2000. It then worked out, for each body, the real growth rate in primary expenditure which, when applied every year, allows each of these bodies to reach this target without any major leaps. This norm, used in accordance with a criterion of "neutrality between periods" was intended to avoid the series of possible budgetary slippages followed by drastic restrictions and the appearance of the snowball effect. This growth rate is clearly different for each body in accordance with its initial level of indebtedness and the growth in its revenue during the transitional period, and it is updated each year in accordance with the real results from the previous years. The deficit recommended by the section for each federated body, year after year, therefore follows on from these parameters. Following the reform of 1993, which further accentuated the difference between the growth of revenue before and after 2000, particularly in Flanders, the section, with the agreement of this Community, has extended the horizon established for stabilising its level of indebtedness to 2010 instead of 2000. This has the effect, as compared with the other solution, of reducing the recommended average rate of growth in expenditure but it avoids a sudden drop in 2000.

We should point out that the recommendations of the CSF relate to parameters which are close to the budgetary data (corrected primary expenditure and maximum admissible deficits) and do not refer to concepts from the national accounts. In fact these do not exist analysed by

[15] Defined with reference to revenue, in the absence of precise regional and community GDP figures.

Community or by Region. The national accounts only (since 1995) provide a consolidated account of the operations of all the Communities and Regions.

4.2 From 2001…until 2010

In its annual report in June 1999, the Higher Finance Council updated the norms in relation to the Communities and the Regions, taking into account on the one hand the new context of national budgetary policy following Belgium's participation in European Economic and Monetary Union and, on the other hand, the respective financial situation of the federated bodies in 2000. At the end of the transitional period the discounted budgetary balance for all the Communities and Regions is zero, but it actually covers contrasting situations; the maximum admissible balances recommended by the CSF for 2000 are negative for the Walloon Region (-6.2 billion), the French Community (-4.6 billion) and the Brussels Capital Region (-2.7 billion) but there is a large surplus for Flanders (+14.4 billion).

For each of the Bodies with a deficit, the Higher Finance Council is maintaining the budgetary objective of achieving budgetary equilibrium in 2010 at the latest, along with a constant reduction in their level of indebtedness. As in the past, it works from this target to obtain a "constant" growth rate for primary expenditure between 2001 and 2010 and then a recommended development for the deficit.

For Flanders, whose budgetary equilibrium has been exceeded by a wide margin since 2000, the Higher Finance Council considers it desirable that it should keep its budget at least structurally in balance. Nevertheless it stresses that, continuing to draw inspiration from the scenario seen during the transitional period (which implies a stabilisation in levels of indebtedness in 2010, albeit at a lower level than in 2000), Flanders should reduce its surplus more gradually to reach equilibrium in 2010 and would therefore make a greater contribution towards reducing the national level of public indebtedness.

In parallel with this, in the context of the political demands for national budgetary stability, the Higher Finance Council recommends that each federated body should work out an internal multiannual Stability Programme, for a period at least covering the period of Belgium's Stability Programme, and considers it desirable that the National Accounts Institute

(Institut des Comptes Nationaux) should draw up individual public accounts for each Region and Community.

II. The European fiscal rules and their application in Belgium

1. Fiscal criteria in the Maastricht Treaty (7 February 1992)

The budgetary convergence criteria set out in the Treaty on European Union cover, on the one hand, the level of the deficit as a percentage of GDP (defined in the terms used by the ESA, the European System of Integrated Accounts, i.e. excluding loans granted and participating interests) and on the other, the level of indebtedness. These two criteria apply to all public administrations. In order for a country to be able to become a member of Economic and Monetary Union (E.M.U.), its deficit must be equal to or less than 3% of GDP or must in any case be approaching this reference value, having fallen substantially and consistently. Its level of indebtedness must be less than or equal to 60 percent or must have been reduced sufficiently and must be approaching the reference value at a satisfactory rate. The cut-off date was originally scheduled for the end of 1996, but it was postponed to the end of 1997, while the Ecofin Council decided that the third phase of construction of Monetary Union would begin on 1 January 1999.

2. Budgetary targets of the Pact for Stability and Growth (Amsterdam, 17 June 1997)

The (future) Member States of E.M.U. undertake, from 1999 and for the whole duration of their membership, to avoid excessive deficits (higher than 3% of GDP) and to respect the medium-term objective of maintaining a healthy budgetary position, close to equilibrium or with a surplus, which allows them to face normal fluctuations in the economic climate while keeping the deficit within the limits of the reference value. They have set out their medium-term objectives and their interim annual objectives in a programme of convergence and undertake to take corrective action whenever they have information indicating significant slippage, either actual or forecast, against these targets. Apart from the preventative measures issuing warnings where there is a risk of slippage, financial sanctions are also stipulated (deposit to the Commission without interest, not reimbursed if no correction takes place after 2 years).

Both the Maastricht Treaty and the Stability Pact recognise only one interlocutor for each country, namely the central government, even if the objectives apply to the whole of the public finances, and hence all the public authorities in a country. They therefore impose an obligation on each Member State to organise the efforts between its various levels of authority.

3. Application of European budgetary norms in Belgium

The budgetary criteria imposed by Europe for access to Monetary Union have only reinforced the policy of consolidation of public finances which Belgium has imposed upon itself since 1982. The Belgian Government has therefore subscribed to the target of a 3% deficit in 1996, since this criterion also prevented the risk of restarting the snowball effect even in unfavourable economic circumstances, made it possible to create room for manoeuvre in the medium term and, in the long term, to ensure financing for the expenditure caused by demographic ageing by accelerating the process of reducing indebtedness.

a. *The first Belgian convergence plan*, submitted in *June 1992*, describes the way in which the Government was expecting to achieve this objective. First of all it decided to set up a major emergency programme that same year (measures amounting to 135 billion) to achieve an overall deficit of 5.7% of GNP in 1992, i.e. a primary surplus of 5.1% of GNP, since the interest burden amounted to 10.8% of GNP. Starting from here, the convergence plan defined a normative linear path to reach a deficit of 3% in 1996, consisting of a primary surplus of 7%, with interest charges reduced to 10% of GDP. Sharing of the consolidation effort between different levels of authority is also mentioned, but the plan does not impose any additional effort on the federated bodies beyond compliance with the norms recommended to them by the C.S.F. (see section I.4. above) which should improve their primary balance by 0.6% of GNP between 1992 and 1996. Due to the constraint caused by the need to stabilise the financial balance for local authorities, the remainder of the improvement in the global primary surplus, namely 1.3% of GNP in four years, is the responsibility of Social Security and the Federal authorities.

   Three norms have been defined in order to achieve this ambitious aim:

   - unitary elasticity of fiscal revenue as a proportion of GDP,

- zero growth in real terms in overall primary expenditure by the federal authorities, with a particularly strict norm for stabilisation in nominal terms of the national defence budget, transfers to Social Security and ongoing subsidies to public enterprises,
- financial equilibrium in social security which, in view of the non-indexation of the federal contribution, allows average maximum growth in expenditure in real terms of 1.6 percent.

The plan also gives a new mission to the "Financing requirement" section of the Higher Finance Council: to issue an opinion each year on the implementation of the convergence plan and, in the event of slippage, to estimate the corrections that need to be made.

b. From *April 1993* onwards, the Government had to *update the convergence plan* because, instead of the deficit of 5.7% of GNP scheduled for 1992, it was necessary to cope with a net financing requirement of 6.9% of GDP, broken down into 11.2% of interest charges and only 4.3% of primary surplus. This deterioration was partly (0.4%) due to statistical updates (utilisation of the GDP as defined by the ESA, in accordance with the norms of the Maastricht Treaty as a denominator) but above all due to a less good economic climate than forecast (0.6%) and a rise in interest rates (0.2%). Reformulation of the intermediate targets for the years from 1993 to 1996 also had to take into account the major deterioration of the GDP forecasts for 1993 (GDP growth of only 0.5%[16]). Hence, while maintaining the same norms as before, the Government has implemented a series of supplementary measures, mostly structural, for a total of 110 billion, during the budgetary control process in spring 1993. A new series of measures, the Global Plan, was then decided upon at the end of 1993, taking effect from 1994 onwards.

c. *Belgium's new convergence programme*, which was submitted on *19 December 1996*, covered the year 1997 since the budgetary convergence targets had in fact been postponed by one year by the European authorities. It also defined the new budgetary norms for the years from 1998 to 2000. Regular monitoring of actual figures and corrective measures taken each year since 1993 had made it possible to reduce the deficit to 3.4% of GDP in 1996, which is slightly below the target. The Government took a further series of measures covering 80

[16] Which ultimately turned out to be negative: -1.5%.

billion to reach a deficit of 2.9% in 1997, including 5.8% of primary surplus and 8.6% of interest charges.

For the following years the Government defined *new budgetary norms*, taking into account, on the one hand, the conclusions of the European Summit in Dublin in relation to the future Stability Pact concerning a structural budgetary balance close to equilibrium in the medium term and also the situation in the Belgian public finances, which was characterised by a very high level of indebtedness and also by a primary surplus significantly higher than in the other European countries.

- For the *Federal authorities and Social Security* (Entity I), the Government undertakes to *stabilise the primary surplus at the* - high - *level forecast for 1997* (5.3% of GDP) between 1998 and 2000. This new norm, which is less strict than the preceding ones to the extent that it allows growth in primary expenditure equal to the growth in nominal GDP (with revenue at an unchanged proportion of GDP), but still guarantees the continuation of the process of reducing indebtedness to the extent that any potential reduction in interest charges as a percentage of GDP will be allocated to the reduction of the deficit. In order to deal with the fluctuations in the economic climate, the new convergence programme also stipulates that this primary surplus from Entity I *may increase if GDP growth is higher than its structural evolution but up to a maximum of 5.7% of GDP*[17]. Three economic scenarios were marked out for the years from 1998 to 2000. As a result, the application of this norm would give rise to a net financing requirement (BNF) for all public administrations of between 1.1% and 1.6% of GDP in 2000.
- For the Communities and the Regions, the previous targets continued to be applicable: compliance by all of them with the specific norms recommended by the Higher Finance Council, should reduce their net financing requirement to equilibrium from 1999 onwards.
- The local authorities are obliged to respect the equilibrium rule in their ordinary budgets.

[17] By applying economic bonus rules defined by the “financing requirement” section of the CSF, according to which the primary surplus norm for Entity I should increase by half the difference between real GDP growth and 2% (which is presumed to be the potential growth) to “neutralise” the effect of growth.

d. The *Stability programme 1999-2002 for Belgium* was filed *on 18 December 1998*. The budgetary results for 1997 and 1998 (with a net financing requirement of 1.9% of GDP in 1997 instead of 3 percent) actually allowed Belgium to become one of the first 11 member countries of EMU. Belgium has therefore committed itself "definitively" to "comply with a budgetary position close to equilibrium or in surplus in order to allow the automatic stabilisers to operate during periods of economic slow-down and to guarantee the sustainability of its public finances on a lasting basis".

   The norms that are selected correspond to those in the last convergence plan, the target of a primary surplus of 6% of GDP for all public administrations (of which 5.3% for Entity I) becoming the new anchoring-point for budgetary policy. The stability programme also adapts the rule concerning the use of economic bonuses. Considering that the GDP growth trend for Belgium is 2.3 percent from 2000, the Government stipulates that the spontaneous rise in the primary surplus resulting from a rise in GDP above this level must be allocated partly to reducing the deficit (i.e. at a rate of at least one-third if the expected growth is from 2.3 to 2.7%, or in full if the growth is higher than 2.7 percent).

e. The *Stability Programme for 2000-2003,* submitted *on 23 December 1999* confirms the norm for stabilisation of the primary surplus at about 6% given a neutral economic climate and supplements it by the desire to reach equilibrium in the financing balance in 2002 in a "prudent" macroeconomic context (2.5% of GDP growth on average) and a limited surplus (0.2% of GDP) in 2003. It stipulates the contribution expected from authorities on different levels.

   - While respecting the new norms defined by the "Financing Requirement" section of the Higher Finance Council (see section I.4.b), the financial balance of the Communities and Regions must be in balance from 2000 to 2003 and their primary surplus must be stabilised around 0.4% of GDP.

- The accounts of local authorities must have a balance which is slightly in surplus (0.15% of GDP)[18] in 2000 and 2001, and it must subsequently be at equilibrium.
- The net financing requirement of Entity I will be brought to equilibrium in 2002 and a surplus in 2003, thanks to the fall in interest charges and the increase in the primary balance.

III. The consolidation of public finances during the 1990s

The historical data on public finances used in this section come from the latest annual accounts published in 2000. The methodology used to work out the national accounts has been changed significantly due to the new accounting rules introduced by EUROSTAT, the statistics bureau of the European Communities. Belgium has been applying the ESA95 rules since 1999 and the components making up the public accounts have been altered with retroactive effect.

The four levels of public authority defined in the national accounts (federal authority, social security, federated bodies and local authorities) are arranged into two groups below: Entity I, on the one hand, which consolidates the accounts of the federal and Social Security authorities, and Entity II, which consolidates brings together the operations of the Regions and Communities and those of the local authorities. Apart from the benefit of simplification, this presentation is justified in Belgium on the basis of the close financial and even decision-making relationships linking together the individual parts of each of these two Entities.

After a brief comparison between the results of public finances achieved by Belgium between 1992 and 1996/1997 and the targets from the successive convergence plans, we will look more specifically at the relative contribution from the various levels of power towards the improvement of public finances between 1991 and 1999. Initially, the following graphs will make it possible to situate the Belgian public finances over the last decade in the context of its evolution during the past 30 years.

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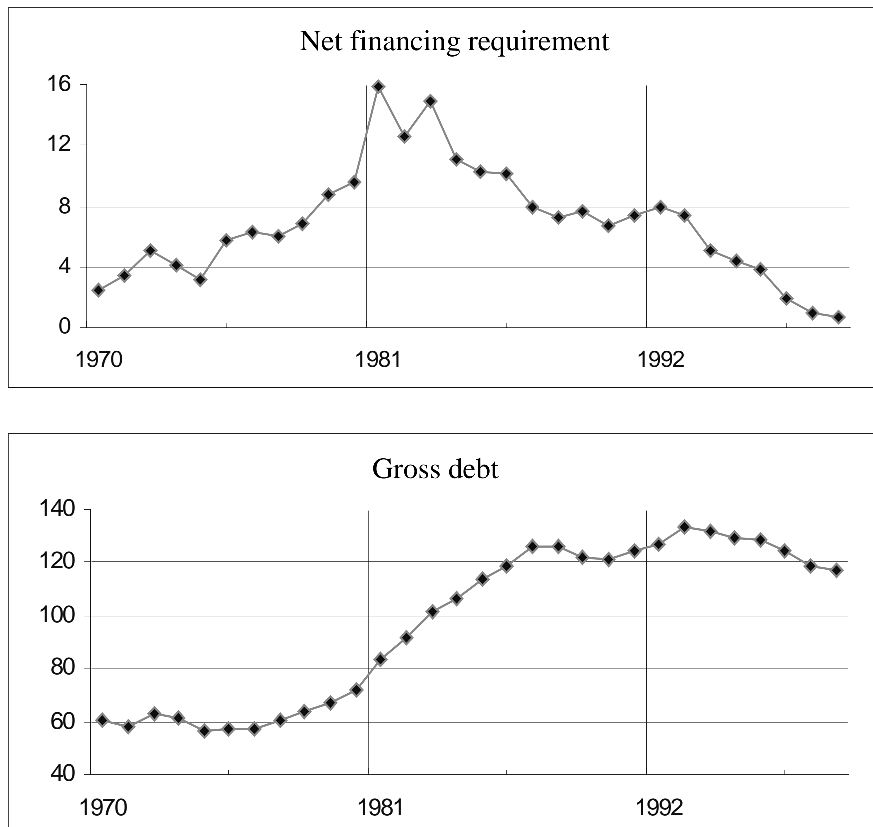
[18] For more than 20 years a fall has been observed in investment by local authorities after the municipal elections, which most recently took place in 2000.

1. Norms in convergence plans and realisation of the "Maastricht target"

According to the latest annual accounts, the net financing requirement of the public authorities is valued at 8% of GDP in 1992 (instead of 7% of GDP according to the data set out in ESA79, the point of departure for the convergence plan updated in 1993), 3.8% in 1996 and 1.9% in 1997. This reduction by 4.2% of GDP between 1992 and 1996 was achieved thanks to the improvement in the primary surplus of 1.9% of GDP and also by the fall in the interest charge by 2.3% of GDP.

Figure 3
Synthetic overview of Belgian public finances from 1970 to 1999
(percentage of GDP)



As shown by Table 1 below, the contribution of the fall in interest charges to the consolidation was 0.5% of GDP more than what was forecast in the scenario of the convergence plan updated in 1993, mainly thanks to the significant fall in market interest rates from 1992 onwards. The improvement in the primary balance, on the other hand, is 0.3% of GDP less than the target. It is also the result of very different developments in the constituent parts. With an average annual growth rate of 1.7% at constant prices, the share of GDP accounted for by primary expenditure has therefore increased by 0.8% while, according to the first convergence plan, it was expected to fall by 1.9% of GDP, with a real average growth rate of 1.25%. Revenue, on the other hand, increased significantly, by 2.7% of GDP. These divergencies can be accounted for largely by the decline in economic growth in comparison with the expectations that were prevalent when the convergence plans were drawn up (cf. table 2). Average annual GDP growth at constant prices was only 1.3% between 1992 and 1996, instead of the 2.5% expected in the 1992 plan and 1.9% in the updated 1993 plan. The GDP deflator was also found to be lower than internal inflation, following a deterioration in the terms of trade. In order to reach the target imposed by the Maastricht Treaty, the Government had to resort to a number of measures, particularly tax increases. The elasticity ex post of tax revenue actually reached 1.85 between 1992 and 1996 (4.0 for the single year 1993).

Table 1 also shows that, at the end of the improvement in the net financing requirement (BNF), each of the Entities exceeded the targets in the Convergence Plan, and this was a result of the lowering of interest charges for Entity I and an improved primary balance for Entity II.

2. Contribution of the levels of authority towards the consolidation during the 1990s

The analysis covers the evolution of public finances between 1991 and 1999. In view of the staggering of the transfer of resources relating to investment to the Regions from 1989 to 1991 and the statistical problems inherent in setting up new relationships between the federal authority and the federated bodies, it is actually preferable, in a study focusing on the contribution from authorities at different levels towards the evolution of public finances, to eliminate the first three years of the institutional reform from the scope of the analysis.

Table 1

Actual consolidation and targets in convergence plans

	Variations			
	1992-1996			1992-1997
	Convergence plans		Observed	Observed
	From 1992	From 1993		
Revenue	0.0	N/a	2.7	3.1
Primary expenditure	-1.9	N/a	0.8	0.1
Primary balance	1.9	2.2	1.9	2.9
- Entity I	1.3	N/a	1.1	2.0
- Entity II	0.6	N/a	0.8	0.9
Interest charges	-0.8	-1.7	-2.3	-3.1
Net financing requirement	2.7	3.9	4.2	6.1
- Entity I	2.2	3.4	3.5	5.1
- Entity II	0.5	0.5	0.7	1.0

Table 2

Macro-economic developments observed and hypotheses for convergence plans

	Average growth rates - variations			
	1993-1996			1993-1997
	Convergence plans		Observed	Observed
	From 1992	From 1993		
GDP (GNP in Plan 92)	5.8	5.0	3.4	3.7
Volume	2.5	1.9	1.3	1.7
Deflator	3.2	3.1	2.1	2.0
Inflation	3.2	3.1	2.2	2.1
Implicit interest rate (change)	-0.3	-0.8	-2.1	-2.4

Over the whole period under consideration, the improvement in the overall balance of public finances (6.7% of GDP) mainly comes from Entity I (5.7% of GDP), primarily thanks to the fall in interest charges (by 4.1% of GDP), 4.0% of which at the level of Entity I). Since the vast majority of Belgian public debt is owed by the federal authorities, it is this level that benefits (or suffers) from fluctuations in interest rates. The fall in interest rates seen during the 1990s has therefore benefited Entity I, particularly since it has been accompanied by modernisation in the methods of debt management used by the federal administration. Even though the change in interest charges also reflects the rationalisation of the individual Entities (indirectly, through public debt), their respective contributions towards the consolidation of public finances are mainly perceived through their participation in improving the primary surplus.

The increase by 2.6% of GDP in the primary balance between 1991 and 1999 comes 1.7% from Entity 1 and 0.9% from Entity II. Overall it gives rise to an increase in revenue of 2.9% of GDP, while primary expenditure rose by only 0.3% of GDP but the contribution from these components to the primary balance for each Entity is fundamentally divergent. Entity I reduced its expenditure by 0.7% of GDP and its revenues increased by only 1.0% of GDP; on the other hand expenditure by Entity II increased by 1% of GDP, but its revenue increased even more, by 1.9% of GDP.

2.1 Revenue

The increase in revenue for all public administrations amounting to 2.9% of GDP is lower than the sharp increase in fiscal revenue (3.6%) as a result of the reduction of Social Security contributions and other revenues (-0.4% each). The reduction in non-fiscal or parafiscal revenues, which consist mainly of real estate revenues, are linked to their very nature: indeed, except in the case of exceptional revenues, they tend to increase more slowly than GDP. On the other hand the reduction in contributions as a percentage of GDP mainly comes from cuts implemented by the Government since 1994 (the Global plan) to create jobs and encourage business competitiveness. Other Government measures - in the opposite direction - have also contributed towards the sustained increase in fiscal revenue. Due to the very unfavourable economic context during the first few years of the Convergence Plan, achieving the budgetary target set out in the Maastricht Treaty required many fiscal adjustments such as the

Table 3

Evolution of the public finances for each Entity from 1991 to 1999 (*)

	Level as % of GDP						Change as % of GDP			Growth rate		
	1991			1999			1999-1991			Real annual average		
	Total	Ent.I	Ent.II	Total	Ent.I	Ent.II	Total	Ent.I	Ent.II	Total	Ent.I	Ent.II
1. Net financing requirement (-) or contribution (+)	-7.4	-6.8	-0.6	-0.7	-1.1	0.4	6.7	5.7	1.0			
2. Interest charges	11.3	10.6	0.7	7.2	6.5	0.6	-4.1	-4.0	-0.1	-3.6	-3.9	0.4
3. Primary balance	4.0	3.8	0.1	6.5	5.5	1.0	2.6	1.7	0.9			
External (A-B)	4.0	4.3	-0.4	6.5	6.0	0.5	2.6	1.7	0.9			
Balance of internal transfers (A'-B')	-	-0.5	0.5	-	-0.5	0.5	-	0.0	0.0			
A. External revenue	44.0	31.9	12.1	46.9	32.8	14.0	2.9	1.0	1.9	2.9	2.4	4.0
1. Fiscal	27.4	15.9	11.5	30.9	17.7	13.3	3.6	1.7	1.8	3.6	3.4	4.0
2. Parafiscal	14.9	14.9	0.1	14.5	14.5	0.0	-0.4	-0.4	0.0	1.7	1.7	
3. Other external revenues	1.7	1.1	0.6	1.4	0.7	0.7	-0.3	-0.4	0.1	-0.1	-3.5	4.5
A'. Transfers rec'd from the other Entity	-	0.2	0.7	-	0.1	0.6	-	-0.1	-0.1	-	-4.9	0.4
A". Total revenues by Entity	-	32.1	12.8	-	32.9	14.6	-	0.9	1.8	-	2.4	3.8
B. Primary final expenditure	40.0	27.6	12.5	40.3	26.9	13.5	0.3	-0.7	1.0	2.2	1.7	3.1
Non-discretionary	*2.2*	*2.2*	-	*2.4*	*2.4*	-	*0.2*	*0.2*	-	*3.1*	*3.1*	-
1. Unemployment benefits	2.1	2.1	-	1.9	1.9	-	-0.2	-0.2	-	1.1	1.1	-
2. GNP contribution to the EU	0.1	0.1	-	0.5	0.5	-	0.3	0.3	-	19.3	19.3	-
Discretionary	*37.8*	*25.4*	*12.5*	*37.9*	*24.5*	*13.5*	*0.1*	*-0.9*	*1.0*	*2.1*	*1.6*	*3.1*
1. Investments by local authorities	0.7	-	0.7	0.9	-	0.9	0.2	-	0.2	5.1	-	5.1
2. State pensions	1.6	1.4	0.1	1.7	1.6	0.1	0.2	0.2	0.0	3.4	3.5	2.5
3. Other	35.6	23.9	11.6	35.3	22.9	12.4	-0.3	-1.1	0.8	2.0	1.5	2.9
B' Transfers to the other Entity	-	0.7	0.2	-	0.6	0.1	-	-0.1	-0.1	-	0.4	-4.9
B" Total primary expenditure by sector	-	28.3	12.7	-	27.5	13.6	-	-0.8	0.9	-	1.7	3.0

(*) Interest charges, like real-estate income, are net of interest paid between different public administrations. The taxes allocated to the European Union are not included. Capital disposals are included in revenue, but sales of goods and services are still under operating costs (<0). Pensions from Entity II which are payable by the federal authorities are treated as final expenditure for Entity I: in relation to the national accounts, they are therefore taken from transfers from Entity I to Entity II and final expenditure by Entity II.

increase in indirect tax rates, the suspension of the indexation of personal income tax scales or the introduction of new taxes: the supplementary crisis contribution and the special social security contribution. The elasticity of total fiscal revenue therefore reached 1.4% between 1991 and 1999, of which 1.6 from 91 to 93, 1.4 from 94 to 97 and 1.2 from 98 to 99[19].

From 1991 to 1999, the revenues of Entity I increased by 1.0% of GDP and the revenues of Entity II increased by 1.9%. This distribution, which was unfavourable to Entity I, is mainly due to the fact that it alone has borne the cut in contributions and the fall in non-fiscal and parafiscal revenues. The change in its fiscal revenue, however, (1.7% of GDP) is also lower than the change in Entity II (1.8% of GDP).

- Of the change in the fiscal revenue of Entity II, 0.3% comes from local authority taxes. These mainly consist of surcharges (on personal income tax and real estate withholding tax) and they have benefited indirectly from tax-raising measures in these areas. The fiscal revenue of the Communities and the Regions has increased by 1.5% of GDP. This consists of 1.1% of GDP for the share of P.I.T. (1.7%) and VAT (-0.7%) allocated to them and 0.2% of GDP for regional taxes (basically the net radio and TV license fee and registration duties). It is also necessary to stress the increase in their own fiscal revenue (not circumscribed by the Financing Act) of 0.2% of GDP (which corresponds to an average annual growth rate of 22.6% at constant prices). The federated bodies themselves have also implemented a discretionary increase in taxes.

- The fiscal revenue of Entity I consists of the difference between the taxes which it levies and what is allocated to Entity II in accordance with the law. By defining a very high rate of growth for fiscal revenue transferred to the Communities and the Regions until 1999 and only creating a very tenuous link between this process and economic activity (cf. section I), the 1989 institutional reform obliged Entity I on its own to deal with the effects (both negative and positive) of the

[19] The table in the appendix breaks down the variations and the average growth rates in table 3 into three sub-periods: 1992-1993, 1994-1997 and 1998-1999. Between 1991 and 1993 the average annual GDP growth rate was zero due to the economic crisis in 1993, but it was 2.5% and 2.6% during the following sub-periods. It was from 1994 onwards that the special law of July 1993 had an effect on the resources available to the Communities and Regions. And 1998 and 1999 benefited from the meeting of the "Maastricht" target in 1997. It should also be noted that the first and last sub-period identified here were two years prior to municipal elections (in 1994 and 2000).

economic climate on fiscal revenue and to carry out the consolidation that is necessary in order to achieve the Maastricht targets. We should also state that within Entity I, the change in fiscal revenue amounted to 1.9% of GDP for social security, but it was negative (-0.1% of GDP) for the federal authorities, mainly due to the increase in alternative financing of Social Security (1.4% of GDP between 1991 and 1999), which is intended to compensate for reductions in social security contributions.

2.2 *Primary expenditure*

In order to compare the behaviour of the two Entities in terms of primary expenditure, it is necessary to "eliminate" expenses over which the authorities have little or no decision-making power. From this point of view, two categories of expenditure which are payable by Entity I can be identified from table 3: unemployment benefits and also the GNP contribution towards the financing of the European Union: the change in these is mainly[20] the result of economic activity, either through the change in the unemployment rate or on the basis of the calculation rules defined by the European Union. Between 1991 and 1999, unemployment expenditure fell by 0.2% of GDP (in fact from 1994 onwards, after a significant rise from 1991 to 1993, cf. table in the appendix) and the GNP contribution towards the financing of the EU rose by 0.3% of GDP. Without these two elements, "discretionary" primary expenditure rose by only 0.1% of GDP overall, with a change in opposite directions in the two Entities: a fall of 0.9% in Entity I and a rise of 1% of GDP in Entity II.

Amongst the items of discretionary expenditure which are not influenced by economic activity, it is useful to pick out two components that might bias the analysis of the possible impact of State reform on the evolution of expenditure: these are investment by local authorities and state pensions. Investment by local authorities has developed in a rather specific cyclical way for many years in the sense that is linked to the cycle of local elections. In the period under review, the 0.2% rise in these investments was due to the fact that the previous year (1999) was the year before an electoral year, while 1991 fell between two election years. (see also table in the appendix). As for State pensions, they are paid by the federal

[20] Although unemployment benefits have also been the object of specific restrictive measures; for a very detailed analysis of the discretionary and non-discretionary aspects on expenditure due to under-employment (and on all elements of the primary balance) cf. Savage R. (2000).

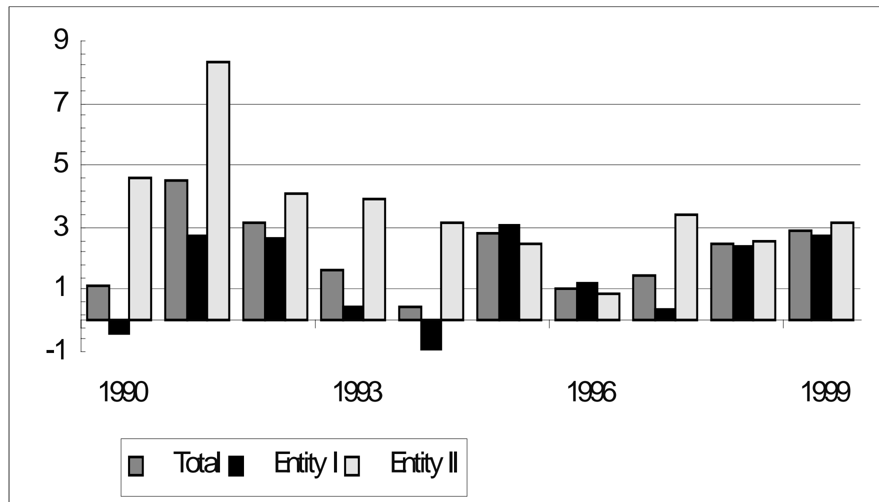
authorities alone (apart from a minimum share, 0.1% of GDP, which is payable by local authorities) while they also, and even as a majority, involve those who have worked for the federated bodies[21] or for the local authorities (subsidised education). The increase in these is also 0.2% of GDP.

Apart from these factors, it is clear from table 3 that primary expenditure by Entity I fell by 1.1% of GDP over eight years, while expenditure by Entity II rose by 0.8%. The real average growth rate has been 1.5% for Entity I and 2.9% for Entity II.

Figure 4

Annual evolution of expenditure for each Entity from 1990 to 1999

Rate of growth in discretionary expenditure at constant prices (line B.3 in table 3)



[21] In order to prevent an “excessively” generous policy on the part of the federated bodies in terms of wages having a damaging effect on the federal budget once their civil servants reach retirement age (since the level of their pensions is largely determined by the level of the final salary), a “responsibility contribution” towards the federal authorities was introduced in 1994. This has, however, only been very limited until 1999.

It should be noted, however, that the divergent development of these items of expenditure by the two Entities has become less severe in recent years: while the average real growth rate between 1991 and 1993 was 1.6% for Entity I and 4.0% for Entity II, and then 0.9% and 2.5% respectively between 1993 and 1997, they came closer together in 1998 and 1999 at a rate of 2.6% for Entity I and 2.9% for Entity II (see also the table in the appendix).

It does, therefore, seem that since the realisation of the "Maastricht" target, the degree of constraint in terms of primary expenditure has been slackened for Entity I.

2.3 Conclusions

It is clear from the analysis set out above that it is Entity I which has made the consolidation efforts necessary to meet Belgium's budgetary targets.

It has not only taken some important measures in the area of revenue to support employment and competitiveness (reducing contributions) while ensuring legal financing of the federated entities and the financial equilibrium of the social security sector (through adjustments in various withholding taxes) but at the same time it has limited the growth in its own expenditure, particularly on social benefits (mainly at the expense of Social Security) and public service operating costs (salaries and net purchases of goods and services).

Entity II on the other hand, which is already benefiting from the strong revenue growth guaranteed by the Financing Act, has further increased its own taxes without achieving any apparent savings in expenditure. In particular it is surprising to note the difference between the real growth rate in operating costs in relation to those of Entity I, which was 2.6 as an annual average rather than 0.9%, both for wages and salaries (2.4 rather than 1.3) and for other costs (4.0% instead of zero growth).

This observation is an immediate consequence of the modalities of the institutional reform which has taken place since the beginning of the 1990s. This does not mean, however, that no consolidation measures have taken place within federated Bodies, but it is impossible to clarify this point on the basis of the national accounting data which is currently available, since the accounts are not analysed by Community and Region.

It can be supposed, however, that the federated bodies whose funds are increasing most slowly, in particular the French Community, which is primarily responsible for education, have consequently adjusted the growth in their expenditure because they have all met the recommendations concerning the deficit set out by the “financing requirement” section of the Higher Finance Council (CSF).

What is more, despite more “spending-oriented” behaviour, Entity II has exceeded its target of improving the primary surplus that was assigned to it by the Convergence Plans (cf. point 1 above). Should it be concluded from this that the target was not ambitious enough, or in other words that the norms recommended by the CSF could have been more constrained view of the need for consolidation due to the poor economic climate during the first years of the convergence plans?

In any case, the deed is done now, since the transitional period of the Financing Act which predetermined the (high) rate of growth in the funds made available to all the federated bodies in a way that was virtually independent of economic activity, came to an end in 1999. From now on Entity I will share more with Entity II (as regards the share of personal income tax transferred) the effects - both positive and negative - of economic growth on fiscal revenue. It would, of course, be desirable for an increased sharing of responsibilities in the area of anti-cyclical policy to be linked to a new stage in Belgian federalism in order to ensure that the structural public finance targets set out in the Pact for Stability and Growth are met.

IV. The Stability Pact and the budgetary policy of the federated bodies: new questions

Budgetary policy in Belgium is going to face some others challenges. The Pact for Stability and Growth requires the Member States to maintain a structural balance which is either in equilibrium or in surplus. There are two aims to this recommendation.

On the one hand, it is necessary to create sufficient room for manoeuvre in order to pursue a policy that can cope with the cyclical evolution of the economy, without going beyond the deficit threshold of 3 percent of GDP, and to avoid the situation where it is necessary to respond to economic setbacks in a pro-cyclical way.

On the other hand, it is also appropriate to reduce public debt in order to release funds to finance the ageing of the population after 2010.

The Federal Government has produced its stability programme in a way that takes these two aims into account. Based on a cautious spending and public revenue forecast based on a growth trend of 2.5 percent per annum, there is some room for manoeuvre, part of which will be allocated to increasing the budgetary surplus while the other part will be used mainly to reduce the tax and parafiscal burden and to "refinance" the Communities, most of whose funds have so far only been indexed to prices.

In this context, two new questions arise. On the one hand there is the question of the "golden rule", and on the other hand there is the management of the budgetary policy of the federated bodies through the economic cycle.

As regards the golden rule, it is appropriate first to make two comments:

- First of all, net public investment (after deducting the amount of depreciation) has been either negative or close to zero for a number of years during the period of consolidation. The need to catch up with the accumulated backlog is becoming more and more pressing, particularly when the budgetary situation is positive.
- Secondly, this need is further accentuated by the fact that the majority of public investment is within the competence of the regions, and certain regions will reach a low level of indebtedness quite quickly.

On the other hand, the faster reduction in the level of indebtedness is still a priority, particularly in view of the question of ageing. It is also necessary to meet the target set out in the Stability Pact. Consequently, if we wish to authorise financing at the regional level by borrowing the amount of net investments, it will be necessary for the federal authorities to compensate for the regional deficits by maintaining a structural surplus. In order to share the burden of the overall structural deficit between the Regions, co-ordination of all budgetary policy should be based on net investment ceilings.

In formal terms, the justification for the compensation by the federal level for an authorisation to maintain a structural deficit on the part of the Regions can be found in the need to form a reserve fund for ageing, the

cost of which will fall to the federal level, which is responsible for the redistribution function. In this way it would be possible to compensate for investment expenditure, whose burden should be spread in future by means of reserves intended for pre-financing of future expenditure on pensions and healthcare.

In the Belgian situation, the question of sharing the overall constraints between federated bodies can only take place on the basis of rules which are clear and considered to be fair. In political terms it would be impracticable to use any concepts of larger or smaller investment requirements in each Region. What is more, the classification of expenditure under the heading of "investment" will lead to debate. On the other hand, it is possible to draw some inspiration from the Maastricht constraints and to determine a maximum regional structural deficit which is compatible with the overall objective of the Stability Pact and with the compensation provided by the federal sector. Such co-ordination is possible, but it does raise some delicate questions in relation to arbitration between investment, fiscal reform, reducing indebtedness and financing ageing. So far we can see that in order to avoid these difficult areas of arbitration, which also create the risk of slippage, the recommended target is structural equilibrium for all the entities.

Stabilisation

While remaining true to its commitment to the Stability Pact, the Belgian Government determines the budgetary target for all administrations each year taking into account automatic stabilising mechanisms. In principle the allocation of the effect of the stabilising mechanisms ought to take place pro-rata in accordance with the revenue received at different levels of authority. This does not happen, however.

In the first place, the financial resources transferred to the Regions are calculated on the basis of data from previous years[22]. This mechanism creates cyclical changes in financing resources and regional expenditure which are not in accordance with the automatic stabilising mechanisms.

[22] The new special draft law to be voted in 2001 modifies this rule. The macro-economic parameters which have provisionally been used to estimate the funds to be transferred will be based on the forecast of the economic budget for the current year and no longer on the parameters seen during the past year.

Secondly, the budgetary balance of the local authorities follows a political cycle which is based on the dates of elections.

As a result, in order to pursue a policy of stabilisation, the federal government should compensate for these contradictory developments, which may represent very significant amounts. The process of considering this question is now beginning. The most widely accepted line of thought is to regulate the growth in expenditure at various levels of authority in accordance with the objective of a structural balance, which lightens the load of federal stabilisation policy. The use of stabilisation funds or "rainy day funds" suggested by Balassone & Franco in this book and used in the United States may supplement this prior co-ordination procedure in relation to expenditure by the various levels of authority, but it cannot replace it. Their role is not to pursue the policy of macro-economic stabilisation, but to ensure that cyclical deficits are compensated for by cyclical surpluses over the whole cycle.

Annex: Variation of the public finances for each Entity (per sub-period)

	1991-1993						1993-1997						1997-1999					
	Level as % of GDP			Growth rate real annual average			Level as % of GDP			Growth rate real annual average			Level as % of GDP			Growth rate real annual average		
	Total	Ent. I	Ent. II	Total	Ent. I	Ent. II	Total	Ent. I	Ent. II	Total	Ent. I	Ent. II	Total	Ent. I	Ent. II	Total	Ent. I	Ent. II
1. Net financing requirement	0,0	0,5	-0,5				5,4	4,3	1,1				1,3	0,9	0,3			
2. Interest charges	-0,2	-0,3	0,1	0,3	-0,3	9,9	-3,1	-3,0	-0,1	-5,9	-6,2	-1,8	-0,9	-0,8	-0,1	-2,7	-2,6	-4,2
3. Primary balance	-0,1	0,2	-0,3				2,3	1,3	1,0				0,4	0,2	0,2			
External (A-B)	-0,1	0,2	-0,4				2,3	1,3	1,0				0,4	0,1	0,3			
Balance of internal transfers (A'-B')	-	0,0	0,0				-	0,0	0,0				-	0,0	0,0			
A. External revenue	1,5	0,9	0,6	2,8	2,5	3,6	1,0	0,2	0,9	2,8	2,3	3,9	0,3	-0,1	0,4	3,2	2,7	4,4
1. Fiscal	1,1	0,6	0,5	3,1	2,8	3,5	1,9	1,0	1,0	3,9	3,7	4,2	0,5	0,2	0,3	3,7	3,4	4,2
2. Parafiscal	0,5	0,5	0,0	2,8	2,8	-0,7	-0,8	-0,8	0,0	0,8	0,9	-32,7	-0,1	-0,1	0,0	2,4	2,4	-12,3
3. Other external revenues	-0,1	-0,2	0,1	-2,4	-8,2	7,3	-0,1	-0,1	0,0	0,7	0,3	1,1	-0,1	-0,1	0,1	0,6	-6,3	8,7
A'. Transfers rec'd from the other Entity	-	0,0	0,0	-	0,8	2,9	-	-0,1	-0,1	-	-16,8	-1,6	-	0,0	0,0	-	17,2	1,7
A". Total revenues by Entity	-	0,9	0,6	-	2,5	3,6	-	0,1	0,8	-	2,2	3,6	-	-0,1	0,4	-	2,8	4,3
B. Primary final expenditure	1,6	0,7	1,0	3,1	2,3	5,0	-1,3	-1,1	-0,1	1,4	1,1	1,9	-0,1	-0,2	0,2	2,8	2,4	3,4
Non-discretionary	0,3	0,3	-	8,7	8,7	-	-0,1	-0,1	-	1,5	1,5	-	-0,1	-0,1	-	1,0	1,0	-
1. Unemployment benefits	0,2	0,2	-	6,5	6,5	-	-0,2	-0,2	-	-0,5	-0,5	-	-0,1	-0,1	-	-0,9	-0,9	-
2. GNP contribution to the EU	0,1	0,1	-	37,0	37,0	-	0,2	0,2	-	16,0	16,0	-	0,1	0,1	-	9,9	9,9	-
Discretionary	1,3	0,3	1,0	2,8	1,7	5,0	-1,2	-1,1	-0,1	1,4	1,1	1,9	0,0	-0,1	0,2	2,9	2,6	3,4
1. Investments by local authorities	0,3	-	0,3	18,8	-	18,8	-0,3	-	-0,3	-5,2	-	-5,2	0,2	-	0,2	14,1	-	14,1
2. State pensions	0,1	0,1	0,0	4,9	4,1	12,6	0,1	0,1	0,0	3,3	3,7	0,2	0,0	0,0	0,0	2,1	2,6	-2,6
3. Other	0,9	0,2	0,7	2,4	1,6	4,0	-1,0	-1,2	0,1	1,4	0,9	2,5	-0,1	-0,1	0,0	2,7	2,6	2,9
B' Transfers to the other Entity	-	0,0	0,0	-	2,9	0,8	-	-0,1	-0,1	-	-1,6	-16,8	-	0,0	0,0	-	1,7	17,2
B" Total primary expenditure by sector	-	0,7	1,0	-	2,3	5,0	-	-1,2	-0,2	-	1,1	1,7	-	-0,2	0,2	-	2,4	3,5
GDP in constant prices				0,0						2,5						2,6		

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