COMPARATIVE FISCAL FEDERALISM:
COUNTRY REPORT BELGIUM[1]

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1. GOALS OF THE SYSTEM ACCORDING TO EXISTING LEGAL ORDER AND/OR TRADITION

Six constitutional reforms adopted between 1970 and 2015 transformed Belgium from a unitary state into a fully-fledged federal state. This complex federation shows many peculiarities. One of them is the coexistence of two types of federated entities covering distinct, yet partially overlapping territories: the Communities and the Regions. The Belgian federation is also structured around two main poles, as a result of the linguistic divide between Dutch- and French-speakers. It is centrifugal as well, as an ever-growing body of competences is being devolved from the central – or, as we know it today, the "federal" – level to the federated entities (Deschouwer, 2012).

Through these successive waves of State reforms, the Belgian Communities and Regions acquired significant political, legal, and financial authority: according to Eurostat's most recent data, federated states (institutional sector S1312) managed 19.3% of the country's gross domestic product (GDP) in 2019. This represented almost 40% of the total resources collected by Belgian public authorities . According to these sources, the federated entities' level of revenue is even the highest of the whole continent, placing Belgium ahead of Spain (14.9% of GDP) and Germany (13.9% of GDP), well above the average for the European Union (EU 27: 5.7% of GDP) and the euro area (6.7% of GDP).

The financial framework for Belgium's federated entities is enshrined in the Special Law of 16 January 1989 on the financing of the Communities and the Regions (hereafter referred to as "the Special Financing Law" – SFL), whose foundations are laid down in Articles 175 to 178 of the Belgian Constitution. The SFL sets the degree of financial and tax autonomy effectively enjoyed by the component units of the Belgian Federation, as it defines how financial resources are allocated, both vertically (i.e. between the federal government and the federated entities) and horizontally (i.e. among the federated entities). It therefore represents the cornerstone of Belgium's fiscal federalism and, by extension, an essential feature of the material economic Constitution in such a highly federalised country. That also explains the relevance of its study in the context of this book.

The last constitutional reform, negotiated in 2011 and finetuned in 2013, thoroughly reshaped the SFL according to several principles rooted in political demands. Tax autonomy and 'responsibility' were meant to increase, whereas on the other hand sufficient use should still be made of need-based criteria to distribute grants. This balance between responsibility and compensation will be further discussed below. Other principles entailed taking into account the specific socio-economic position of Brussels, and the sustainability of public finances, without structurally underfunding the regional entities. On all these accounts the sixth constitutional reform was fairly successful (Decoster & Sas, 2013).

2. EVOLUTION OVER TIME AND MAJOR BONES OF CONTENTION

In terms of public finance, most State reforms intended to meet pressing demands for greater financial autonomy, which particularly emerged from Flanders. This almost uninterrupted devolution of competences and financial resources to the federated entities was among others politically justified by a desire to improve the management of public funds so as to increase the legitimacy of the institutional framework in the eyes of citizens. Three layers of financial

legitimation have cumulatively been put forward in the history of Belgium's fiscal federalism (Piron et al., in press): vertical financial autonomy (since 1970), horizontal fiscal responsibility (since 1989) and, finally, tax autonomy (especially since 2001).

2.1 *First round of reforms (1970-1988)*

Initially, corresponding to the 1970-1988 period, the devolution of competences and financial means aimed to respond to divergent cultural, linguistic and economic preferences and priorities throughout the country. As of this transition phase towards a genuine fiscal federalism framework, the newly created federated entities gradually received broad (vertical) financial autonomy – i.e. the power to define their own expenditure autonomously. The Communities and the Regions were granted the authority to vote their budget annually, as well as full autonomy in the allocation of their resources (Arts. 175(2), 176(2) and 177(2) Const.). The latter nevertheless heavily depended on central grants (Stienlet, 1993). The law of 9 August 1980, passed by ordinary majority, allocated five sources of funding to the Communities and the Regions, namely: grants from the national budget (1), transfers of the proceeds of centrally-collected taxes (2), non-tax revenues related to their competences (3), loans (4) and a general taxing power, stemming from Article 170(2) of the Constitution (5).[2]

However, the scope of the Communities' and Regions' autonomous taxing power has been strongly restricted in practice. Indeed, Article 170(2), second subparagraph of the Belgian Constitution establishes the primacy of federal tax law over regional and community tax decrees.[3] On this basis, the *ordinary* law of 23 January 1989[4] set up a *non bis in idem* principle in the field of taxation, according to which the federated entities are not allowed to levy taxes in matters already taxed by the federal level of government. Throughout the 1980s, various Flemish politicians and academics were more generally prompt to denounce the limited extent of the federated entities' taxing powers. According to some calculations, the latter amounted to only 3% of total regional revenues, a situation which illustrated their "almost total dependence" (Van Rompuy & Heylen, 1986: 225) to the central government in this respect.

2.2 *Second round of reforms (1989-2000)*

A second period started in 1989. Since then, debates regarding the financial organisation of the federal system have markedly extended to the horizontal allocation of resources, i.e. the criteria according to which sharing the resources allocated by the federal government among the federated entities. This issue has led to a trade-off between financial "responsibility" and solidarity. The concept of financial responsibility refers to the idea that an entity should "reap the

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[2] Art. 1 Special law of 9 August 1980 on institutional reforms (O.G. 15 August 1980).

[3] This provision states that "the law determines, with respect to the taxes referred to in the first subparagraph, the exceptions that are proved to be necessary".

[4] Art. 1 Law of 23 January 1989 relating to the tax competence referred to in Article 110(1-2), of the Constitution (O.G. 24 January 1989).

fruits" of its economic dynamism. It is portrayed as a "fair return" principle,[5] i.e. the reward of supposedly audacious economic and tax policies. Such discourse strongly resonates with the Flemish side, as it clearly gives an advantage to the northern part of the country. This distribution method indeed favours entities whose residents are better-off, hence contribute more to public revenue. French-speaking politicians, who represent less prosperous territories and citizens, insist for their part upon the need for adequate financial solidarity among all the component units of the Belgian federation.

The SFL, as adopted in January 1989, paved the way to a genuine model of fiscal federalism in Belgium. The fact that intergovernmental financial relations are organised through a special majority law is politically significant as this legal instrument was originally designed as a minority protection mechanism in the field of institutional matters. It indeed conveys a "locking in" logic, which the SFL extended to fiscal arrangements. In practice, any amendment to the federated entities' financing system requires the support of a two-third majority in each House (the House of Representatives and the Senate), but also of a majority in the two (French and Dutch) linguistic groups that compose them.[6] From a formal legal perspective, this special majority requirement represents the main reason to define the SFL as a crucial component of Belgium's material economic Constitution.

The SFL introduced two new main financing mechanisms for the federated entities: federal grants collected out national tax incomes and the devolution of additional taxing power to the Regions (Installé & Peffer, 1988; Moesen et al., 1988). Firstly, most competences transferred to the federated entities in the 1988-1989 State Reform were funded by annual grants paid out the two main taxes collected by federal administrations: the personal income tax (PIT) and the value-added tax (VAT). These grants, whose "basic amount" was pegged to the price index, were distributed according to two distinct rationales. On the one hand, the competences devolved to the three Regions (the Walloon Region, the Flemish Region and the Brussels-Capital Region) were funded by PIT grants, allocated on the basis of their relative share in PIT revenue. The adverse consequences of this so-called "fair return" criterion were nevertheless partly compensated by an explicit equalisation scheme introduced at the behest of the Francophones. This mechanism, known as the "national solidarity contribution", aimed to increase the resources of Regions where the PIT revenue per capita was lower than the national average (Art. 48 SFL).

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[5] This expression elicits M. Thatcher's famous quote: "I want my money back". It means it is considered "fair" for an individual, region or country to receive an amount of expenditure equivalent to the payments it makes.

[6] The special-majority law is defined as follows in Art. 4(3) Const.: "a law passed by a majority of the votes cast in each linguistic group in each House, on condition that a majority of the members of each group is present and provided that the total number of votes in favor that are cast in the two linguistic groups is equal to at least two thirds of the votes cast".

On the other hand, the financing of the two largest Communities (the French and Flemish Communities) almost exclusively rested upon federal VAT- and PIT grants.[7] The distribution of both grants was based on distinct methods of calculation. A "VAT grant" was designed for financing education policy, which then absorbed approximately 80% of Community expenditure. It was allocated according to the financial "needs" of both Communities, estimated on the basis of their school pupils' ratio (Art. 39 (2) SFL). This noticeable derogation from the "fair return" principle has generally been depicted as an *implicit* solidarity mechanism between Communities, justified by the argument that "a (Francophone) child is worth just as much as a (Flemish) child". By contrast, the Communities do not benefit from any explicit solidarity mechanism, as the latter has solely been provided for the Regions – even though a share of Community competences has also been funded by PIT grants allocated according to the "fair return" criterion.

Secondly, the SFL devolved additional taxing power to the Regions – but not to the Communities. It indeed partially transferred revenue-raising powers to regional authorities over seven taxes, the proceeds of which were previously transferred by the federal authority. These are: the tax on gambling and betting, the tax on automatic amusement devices, the tax on the opening of drinking establishments, inheritance duties, the real estate tax, registration fees on real estate transfers, and the road fund tax on automobiles. The Regions were – to some extent – allowed to modify the basis, the tax rate and the exemptions from these "regional taxes"; they were also empowered to take over their collection. Given their lack of a territorial basis on the bilingual territory of the Brussels-Capital Region, the two main Communities are *de facto* devoid of such taxing autonomy. Their respective share of PIT revenues and school pupils in that Region is therefore calculated by an established 80/20 distribution key (Arts. 38(4) and 44(2) SFL).

The entry into force of the SFL submitted the French Community to foreseeable financial distress. However, its Flemish counterpart did not experience the same situation: since the merging of Flemish regional and community institutions, their financial resources have also been pooled (Art. 1(3) SFL). At the request of French-speaking political parties, the so-called "Saint-Michel agreements" (1992) provided for a refinancing of federated entities – in exchange for the devolution of new competences, as requested by Flanders by means of *quid pro quo*.[8] As this refinancing proved scarce, a new round of institutional bargaining began at the turn of the century. It was concluded by the Lambermont agreements (2001), which marked the transition to a third stage in the history of Belgian fiscal federalism. Since the early 2000s, endeavours to improve public finance management have resulted in transferring growing tax powers to the Regions. These new revenue-raising powers are supposed to enable them to tie more effectively their resources with their policies – even though this situation also increases the likelihood of interregional tax competition.

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[7] The financing of the smaller German-speaking Community is governed by the (ordinary) law of 31 December 1983 on institutional reforms for the German-speaking Community (O.G. 18 January 1984), regularly amended in order to be (broadly) aligned with the financing mechanisms of the other two Communities.

[8] Special law of 16 July 1993 completing the federal structure of the State (O.G. 20 July 1993).

2.3 FIFTH STATE REFORM (2001)

In financial terms, the fifth State reform of 2001 was based on two elements. The first was a new refunding of the Communities in order to resolve the underfinancing of the French Community. In addition, regional tax autonomy was increased at two levels. On the one hand, the Regions received new tax instruments: radio and television licence fees, vehicle registration fees and the Eurovignette (which was replaced by a so-called "kilometre charge" on trucks in 2016). On the other hand, their prerogatives on regional taxes were also harmonised. As a result, regional governments now have complete jurisdiction over all regional taxes. Accordingly, they can autonomously set the basis of, the rate of and the exemptions on these regional taxes; they are also entitled to collect their proceeds in full.[9]

The fifth State reform also extended the Regions' competence in terms of PIT. It enabled them to collect general (proportional) surcharges and allow general (lump sum or proportional) relieves on the PIT levied on their territory, as well as to implement general tax relieves and increases in line with their competences. However, this taxing power was strictly circumscribed: the Regions could not reduce the progressiveness of the PIT, nor engage in unfair tax competition. In addition, such surcharges or relieves could not exceed a margin set to 6.75% of federal PIT revenues raised on their territory.

Despite this reform, the main Flemish political parties further advocated for greater regional tax autonomy through the 2000s. They emphasised the need to strengthen federated entities' "responsibility" during the community negotiations that took place in 2007-2008 and resumed after the June 2010 elections. This highly polysemic term, which blends tax, political, economic and fiscal aspects, is crucial in debates over the financing of the Communities and the Regions. In such discourse, increasing the Regions' *tax responsibilities* by granting them direct access to part of the PIT (or even corporate tax) is supposed to increase the *political accountability* of regional representatives *vis-à-vis* citizens. Indeed, the latter would then be allowed to express their preferences not only on fiscal policy (the allocation of public expenses), but also on tax policy (the collection of revenues). From an *economic* perspective, the concept of responsibility refers to curbing (positive and negative) spill-overs between political authorities. Expressed in its purest form, it implies that political entities only bear the consequences of their own policies, without carrying the weight of (or benefiting from) decisions adopted by other (levels of) government(s). Finally, when it comes *fiscal* aspects, the responsibility principle upholds a strictly linear relationship between regional economic performances and regional resources. In particular, it supports amplified recourse to the "fair return" criterion to distribute financial means among federated entities.

Drawing on French philosopher Émilie Hache (2007), one could nevertheless rephrase the rhetorical question "who may not want to be responsible?", dear to neoliberals as well as advocates of greater regional taxing powers, and ask instead: "who really has the means to exercise such responsibility?" In this sense, the issue at stake in the long-lasting conflict between

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[9] Art. 6 Special Law of 13 July 2001 concerning the refinancing of the Communities and extension of the tax powers of the Regions (O.G. 3 August 2001).

the Flemish and the Francophones comes down to tracing the origins of the economic gap between Flanders and Wallonia – the assessment of Brussels' situation proving even more controversial. Does this situation stem from Francophone leaders' inappropriate choices? Or is this rather the result of economic, social, historical and demographic trends largely beyond their field of intervention?

2.4 Sixth state reform (2011-2015)

After eighteen months of community negotiations, a new institutional agreement was agreed upon in October 2011. The sixth State reform considerably altered the relative weight of Belgium's constituent authorities, by transferring competences worth more than €20 billion to the Communities and the Regions in areas such as family allowances, health care, labour market, tax expenditures, etc. When it came into force in 2015, Communities and Regions' resources respectively increased by approximately 50% and 20%. This broad devolution of competences went with a thorough revision of their financing system. The reform of the SFA did not only organise the funding of newly decentralised competences, but also revised the parameters used to fund the federated entities, and amended the equalisation scheme to eradicate the "perverse effects" regularly denounced by (Flemish) economists. Besides, a temporary transition mechanism was set to compensate for the positive or negative consequences of the new funding system (Title V/1 SFL). At the end of the whole bargaining process, a mechanism was eventually designed to involve the Communities and the Regions in public finance consolidation (see section 4 below).

The sixth State reform further decentralised taxing powers and increased regional tax autonomy. Concerning the financing of the Regions, the previous system of PIT grants, optionally complemented by surcharges and relieves on the PIT, was replaced by a system of regional piggy-back PIT (Title III/1 SFL). In practice, the Regions currently levy "extended proportional surcharges" of 33,257% on the federal PIT – which was reduced accordingly. In other words, about a quarter of overall PIT revenue was thus transferred to the Regions. Depending on their fiscal margins and tax policy goals, they are now allowed to define the rate of their surcharge autonomously and without any quantitative limit, as well as to implement relieves on their proportion of the PIT (Algoed & Denil, 2013: 249-255). They can even increase, but also decrease the progressiveness of the PIT – under given conditions. Besides, the Regions obtained exclusive taxing powers over a series of tax expenditures related to their competences, including property taxation (see also section 3).

Yet, this widening of regional tax autonomy also bears some contradiction, as it among others creates interference between federal tax policies and regional resources. Indeed, the "reduced federal PIT" is the sole basis for the calculation of regional surcharges. As a consequence, federal PIT reforms directly affect PIT surcharges actually collected by the Regions – which is one of their main revenue items.[10] Through this channel, *federal* decisions thus directly impact (i.e. increase or

[10] Such regional spillovers of federal tax policy are far from purely theoretical, as illustrated by the "tax shift" reform implemented by the federal government led by Charles Michel (2014-2018). This policy reduced social security contributions and the PIT for about €3.45 billion by 2020 to support employment (Simar,

decrease) *regional* financial resources, a position unseen since the creation of the SFL in 1989. The Regions willing to compensate for adverse fiscal consequences of federal tax policy are indeed entitled to increase their surcharges. Yet, this does not alter the actual primacy of the federal government in the field of direct taxation. Other features of this new "inter-federal" PIT management framework support this assertion. An example thereof is that the collection of the PIT – including regional surcharges – is kept at the federal level, as a competence of the Federal Public Service Finance. Moreover, the latter is also entrusted with estimating down-payments to be made to the Regions and calculating budgetary settlements between the federal and regional governments (Art. 54/1 SFL).

In spite of these limits, the growing regionalisation of the PIT nevertheless represents a noticeable step towards larger regional tax autonomy, on top of the wide range of regional taxes. As a consequence, regional authorities are nowadays endowed with significant tools to consolidate their own tax system, as well as their administrative capacity in this field.

3. FISCAL MECHANISMS AND THE DISTRIBUTION OF 'SUBSTANTIVE' COMPETENCES

As in most other federations, the financing of expenditure by regions and communities in the Belgian Federation is done in two ways. On the one hand, regional governments enjoy a certain degree of fiscal autonomy. A government is fiscally autonomous to the extent that it collects the revenue to finance its expenditure through its own taxes. The SFL defines which taxes are involved (e.g. registration duties, inheritance taxes and road tax), and also how this should be done in practice. We will discuss in section 3.1 why the SFL only grants fiscal autonomy to the regions.

On the other hand, regional authorities receive part of their resources from the federal level. These are 'federal grants'. What is important here is that these amounts are not fixed, but are indexed to inflation and often to economic growth as well. They can be seen as envelopes that get thicker as time goes by, and are allocated each year by the federal government to the regions and communities. For this allocation, fixed formulas are used, based on regional information that can vary over time. In what follows we will call these 'allocation criteria', and we will distinguish two types.

First, allocation criteria can be based on the tax revenues collected within one particular region, more specifically on personal income tax revenues (PIT). This is called the 'fiscal capacity' of a region. The tax allocation criterium itself is then a region's share in the total revenue of the personal income tax. This criterium has also been called the 'fair return' criterium, since a region indirectly gets back what it contributed. The higher its contribution to total tax receipts, the more favourable its allocation criterium is, and the larger the share of the endowment to which it is entitled. Because of the link with personal income tax, endowments to which this criterium applies are simply called 'PIT grants'. We will discuss why this type of criterium is used in section 3.2.

2016). In practice, the federal government unilaterally transferred about a quarter of this bill to the Regions, corresponding to the share of this tax that they have received since the sixth State reform.

Second, needs-based criteria take into account population numbers of all kinds, such as the number of pupils, elderly or young people within a region. For example, the more pupils within a community, the higher the need for education funding. By allocating the grant financing education according to a community's share of the total, national pupil population, such a need is met. We also explain why this type of financing is only applied to communities and cannot be described as 'consumption federalism' in section 3.2. The broader structure of the Belgian fiscal mechanisms in place in the old and the new system, will also become clear in the following paragraphs.

3.1 Degree of fiscal autonomy

Usually, the extent of fiscal autonomy is measured by calculating the share of own, regional taxes in the total regional revenues. Table 1 illustrates this approach for both the old and the new SFL.

The first line of this table shows the grants that the regions and communities received from the federal government under the old system. The second line shows how much the regions collected through their own taxes. The sum of the grants and the own tax revenues gives the total revenue, with which we calculate on the fourth line the extent of the fiscal autonomy under the old system. The second part of this table shows exactly the same calculation exercise, but for the new SFL.

In the rightmost column of the table, we show the result for all regions together. The first observation is that the fiscal autonomy in the new system has been increased considerably, by €12.6 billion. The total of €10.8 billion in regional tax revenues under the old SFL increases to €23.4 billion under the new financing law. If we express the fiscal autonomy in terms of the method described above, then the fiscal autonomy for the regions increases from 44.2% to 79.4%. This is an increase of 35.5 percentage points or more than two thirds (the 80% increase in the bottom line of the table). The extent of fiscal autonomy is now very high: the Flemish region obtains no less than 82.8%, and Wallonia and Brussels 74.1% and 74.8% respectively from their own taxes. Our conclusion is clear: the fiscal autonomy of the fiscally competent entity (the regions) has increased considerably and thus satisfies the first agreed basic principle for the amendment of the SFL with flying colours.

This significant increase was achieved by bringing personal income tax within the scope of regional taxation for the first time. Although the federal government remains responsible for determining the tax base, it will reduce its rates by about a quarter. The space will then be filled by the regional government, by levying a surcharge on the tax paid to the federal level. This regional surcharge can be modulated according to the taxable income. The SFL does impose restrictions in terms of possible erosion of the progressivity of the personal income tax, as well as in terms of disloyal tax competition.

OLD	Flemish Region	Flemish Comm	Flanders (Reg + Comm.)	Walloon Region	French Comm.	Brussels Region	Total (Regions)
Grants	7,8	16,0	23,8	4,6	10,1	1,4	13,8
Own taxes (a)	6,6		6,6	2,8		1,5	10,8
Total revenues (b)	14,4		30,4	7,4		2,9	24,6
Fiscal autonomy (a)/(b) in %	**45,5%**		**21,5%**	**37,6%**		**52,6%**	**44,2%**
NEW							
Grants	3,0	23,5	26,6	2,2	14,4	0,8	6,1
Own taxes (a)	14,6		14,6	6,3		2,5	23,4
Total revenues (b)	17,7		41,2	8,5		3,3	29,5
Fiscal autonomy (a)/(b) in %	**82,8%**		**35,5%**	**74,1%**		**74,8%**	**79,4%**
INCREASE							
in percentage points	37,3%		14,0%	36,6%		22,2%	35,5%
in percentages	**82,0%**		**65,2%**	**97,2%**		**42,2%**	**80,7%**

Table 1: Fiscal autonomy in the old and new SFL (comparison for 2019 in billion €)

But why then the persistent complaint that the fiscal autonomy is too low? The explanation lies in the Belgian federal framework itself. Since its conception in 1970, this has been a federalism 'sui generis' that cannot be reduced to, and therefore cannot be compared with, a classic territorially defined federalism (such as that of the Länder in Germany, or the States in the US). We have set up a structure in which territorially defined regions are interwoven with person-defined communities. But only the regions have their own tax instruments, because in this case one can identify the taxpayer on the basis of whether he or she lives in the region. This is much more difficult when it comes to property belonging to a community. Suppose the Flemish Community were to levy a tax. Like any tax, this is a compulsory payment (otherwise it is not a tax) which must therefore be paid by all members of the Flemish Community. Only: who are they in Brussels? It is impossible to identify a taxpayer at the community level, unless one were to introduce a 'sub-nationality' in Brussels, for example. It goes without saying that this is a political choice with very far-reaching consequences, of which the polarising and especially centrifugal forces for the federation will certainly not be the least. In any case, within the existing institutional and federal framework, it is not illogical that communities have no tax competence de facto.

This political choice does have far-reaching consequences for the extent of fiscal autonomy. In Table 1, the cells in the second and sixth rows remain empty for the Communities. They do not levy any taxes of their own, but are financed via grants (printed in italics in the table). This immediately explains the widely differing appreciations by different political actors of the extent of fiscal autonomy. When,

under the old SFL, we express the Flemish tax revenues of 6.6 billion compared to the total regional revenues of 14.4 billion, the fiscal autonomy of Flanders already amounted to 45.5%. If, on the other hand, we express it in terms of the combined income of the region and the community (6.6 out of 30.3 billion), it is only 21.5%. Is someone who refers to a fiscal autonomy of "only 20%" wrong? No, but he or she would do better to explain that this is not a discussion about numbers, but about a different political frame of reference.

The sixth state reform does not change the federal frame of reference of regions and communities. So, whoever wants to, can still produce a figure that points to a much lower fiscal autonomy for Flanders. Add the grants to the communities in the denominator, and the fiscal autonomy for Flanders is now 35.5% (which is still a considerable increase of two thirds compared to the former 20.6%). Only: whoever takes this position would make the discussion easier by not using figures. It would be better to openly explain to the citizenry why the communities have no tax competence, how taxes should be levied on a community-basis in Brussels, or why one is against a classical territorially defined federalism with only regions.

Apart from the size of the tax autonomy, the transfer of about a quarter of the income from the personal income tax to the regions is also an important element of the new SFL for other reasons. The progressivity of the personal income tax ensures that the revenues from this tax grow faster than GDP. For example, if GDP grows by 2%, the revenue from personal income tax may increase by 2.6%. This ratio (in this case 1.3) is called the elasticity. The estimate of this elasticity is uncertain and we will discuss in detail how we determined our elasticity in the appendix to this text. What is certain is that in the new system, the federal government will give a quarter of what is called the 'elasticity bonus' to the regions. Hence, the size of the elasticity plays a crucial role in the picture of winners and losers in the long run (i.e. when the economy grows). The higher the elasticity, the more beneficial the new SFL looks for the regions, and the less for the federal government. The lower the elasticity, the better it looks for the federal government. This was discussed extensively in earlier work (see Decoster and Sas, 2012).

In any case, by transferring only a quarter of the personal income tax to the regions, the fourth basic principle for the amendment of the SFL is also fulfilled. The viability of the federal state and the preservation of its fiscal prerogatives are assured, also with respect to the elasticity bonus.

3.2 DEGREE OF 'RESPONSIBILITY' VERSUS NEEDS

The demand for more responsibility was a second point that was particularly emphasised by the Flemish parties during the negotiations. Consequently, the principle also appears in the list of the 12 basic principles. In the media, the term quickly degenerated into a 'buzzword', and was often poorly, sloppily or even not described at all, because it was assumed that it came down to the same thing as fiscal autonomy. However, responsibility can be seen in a much broader sense, whereby fiscal autonomy need not even be present as a precondition.

In the best-case scenario, responsibility includes every possible instrument that holds governments accountable for the consequences of their policies. The reasoning here is that regional governments that themselves feel the (positive) consequences of good policy may also be more inclined to govern

better. After all, if we follow the theory of economic federalism, regional governments are better placed to meet local needs and preferences. Effective empowerment then ensures that such welfare-enhancing and adapted policies are indeed implemented. What we actually mean by such a good policy, how it manifests itself in practice, and how we can reward it, however, depends on jurisdiction. For this reason, responsibility will be interpreted differently depending on whether we look at the Regions or the Communities.

3.2.1 Regions

As mentioned earlier, the regions were granted economic powers from their creation in 1980. The idea was to tackle the different economic conditions in the three parts of the country, assuming that regional authorities are better positioned to assess differences in needs or preferences. This concerned powers such as employment, agriculture, the economy, public works, energy, transport (with the exception of the national railroads), town and country planning, foreign trade, etc. The powers newly transferred in the sixth state reform concerning the labour market or fiscal policy follow a similar logic. Thanks to the decentralisation of targeted labour tax deductions, for example, it will be easier to gear employment policy to the real labour market in each region (Flanders has more older and fewer younger job-seekers than the other regions). But also the transferred service vouchers or the employment plans play their role here. In short, given such competences, a good regional policy can be defined as all government policy that supports and stimulates the regional economy. However, the question remains how to measure and subsequently reward good policy.

It was during the third state reform in 1988 that, in the conception of the old SFL, it was first explicitly expressed that 'good policy' is a policy that promotes economic growth. Moreover, it was argued that economic growth is reflected in the growth of incomes, and thus of tax revenues. And so, it was further argued, per capita personal tax revenues are a good indicator of "good policy". That indicator is called regional fiscal capacity. Rewarding good policy then becomes simple: make the regional financing dependent on the fiscal capacity of the regions. This was done by distributing the allocations according to a region's share in the total income from personal income tax (the famous 'fair return' key as described earlier). An increase in fiscal capacity reflects higher regional growth and is rewarded with a higher allocation, while a decrease in fiscal capacity is 'punished' with a lower allocation. The underlying reasoning also implies that responsibilisation in this view consists of both fiscal autonomy on the one hand (i.e. the self-imposed taxes used to steer the economy), and the 'fair return' allocations on the other.

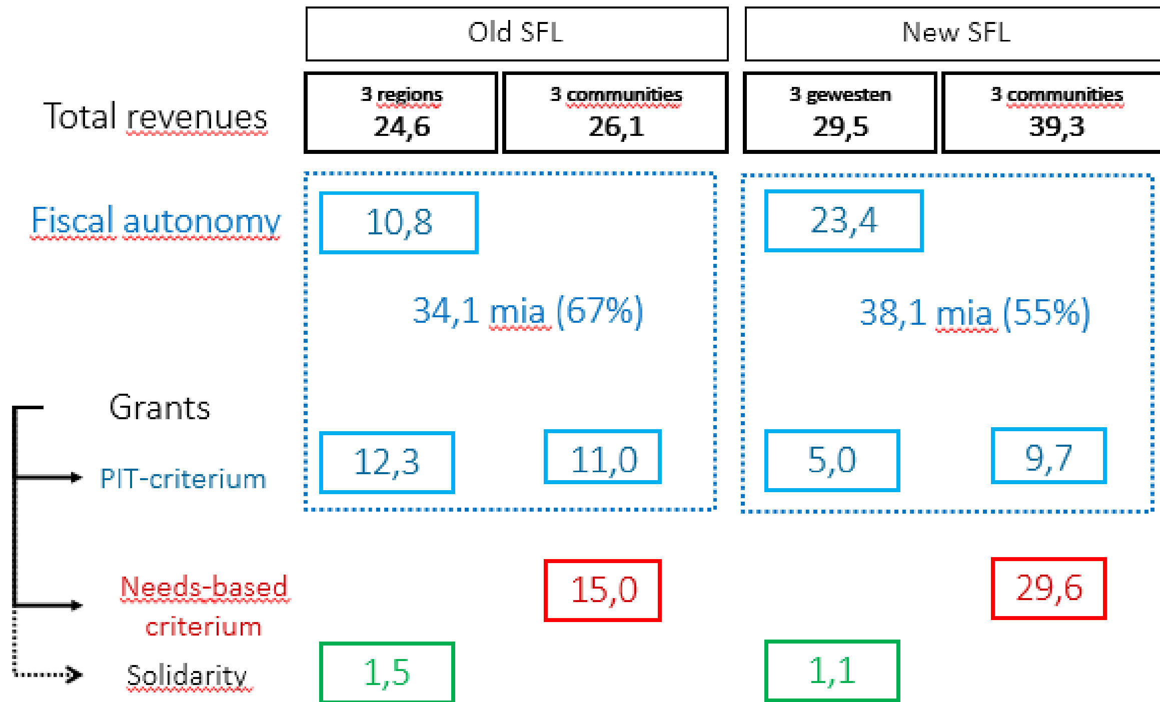

Figure 1: Overview the old and new SFL (comparison for 2019 in billion €)

The basic assumption that good policy also makes itself felt in regional growth and ditto income raises many questions. Are all the changes in regional growth really the result of policies under the government's own control? After all, globalisation largely limits regional governments' grip on their economies. And is our understanding, both theoretical and empirical, of how a government actually behaves sufficiently well-founded to reliably estimate the magnitude of the incentive effect on government policy? Is personal income tax revenue the most appropriate indicator of regional growth? Regional employment rates or job creation might be better measures of regional growth, and above all, they are much easier to link to actual policies. Unfortunately, such questions are beyond the scope of this text, so we will here limit ourselves willingly to the starting point described above, based on fiscal capacity. This works directly via fiscal autonomy, and indirectly via the 'fair return' criterium of the grant allocations.

If we look at the regional financing in the new SFL from this angle in figure 1, it immediately becomes apparent that the increased fiscal autonomy has no direct effect on responsibility. In fact, in relative terms the amount of grants and fiscal autonomy decreases, as can be seen in the blue quadrants, from 67% of total revenues to 55%. This is because the regionalised PIT replaces the regional grants that already followed the 'fair return' rule, of about 12 billion €. An increase in responsibility is therefore to be sought in the resources that finance the newly transferred powers for labour market and fiscal/tax relief expenditures. This new allocation, amounting to €5.3 billion in 2019 and representing, alongside the revenues from fiscal autonomy, the major flow of funds to the regions, is indeed distributed according to the 'fair return' criterium. Thus, also for the new competences, the regional funding is largely linked to regional growth, which will lead to a 5.3 billion increase in responsibility in *absolute* terms.

In Table 3, we show this sharp increase in responsibility in a different way. The first line shows the amounts per capita that are currently spent on the newly transferred labour market competences. The second line shows the allocation (again in € per capita) that the regions have to finance the transferred competences in the new system.

Since the new allocation is distributed on the basis of fiscal capacity ('juste retour'), it is higher per capita for the Flemish Region (€450) than for Wallonia (€338) and Brussels (€298). However, lower economic growth and the resulting higher unemployment rate mean that current expenditure is higher in Wallonia and Brussels. In other words, the regions were forced to face facts from 2015 onwards. For those regions where the current expenditure on labour market policy is higher than what they contribute to the federal treasury, the budgetary scope will be significantly reduced under the new system. If the Brussels and Walloon regions do not succeed in getting their regional economy on track from 2025 onwards, when the transition mechanism compensating for these differences starts phasing out, they will consequently pay a heavy price for it.

	Flemish Region	Walloon Region	Brussels Region
Current expenditures	382	450	515
New expenditures	412	338	298
Difference	30	-112	-217

Table 2: Fiscal autonomy in the old and new SFL (comparison for 2019 in €/capita)

3.2.2 Communities

As we explained earlier, and in contrast to the regions, the (cultural) communities have been based on the notion of 'language' since their establishment in 1970. Language is not linked to a territory but to the person. That is why the competences of the communities were interpreted from a different angle. Personal competences such as education, the use of languages, health policy (curative and preventive medicine), assistance to persons (youth protection, social assistance, family assistance, reception of immigrants, etc.) and culture (theatre, libraries, audiovisual media, etc.) were gradually transferred to the communities. The sixth state reform adds a large amount to these. Child benefits, but also aspects of elderly and health care were transferred, good for 12.9 billion € in 2019 all combined.

We explained how difficult it already is for the regions to define "good policy", let alone measure it. For the policies of communities, this exercise is even more difficult. For each authority, we can think of several factors that constitute good policy and that, moreover, have little to do with regional growth. For example, the extent to which health care is cost-effective, or adapted to local needs, cannot be measured simply by regional growth rates. In the long run, education may have an impact on growth, but again this does not seem to us to be a direct measure of the quality of education that, for example, also offers equal opportunities. How to measure and subsequently reward good education or health policies has never really been considered within the SFL. Yet, from 1989, one quarter of the community grants were allocated according to the 'fair return' criterium. The remaining funds are distributed according to so-called 'needs-based' criteria. The latter distribute the allocations

on the basis of population numbers of all kinds, such as the number of pupils, elderly people, young people, or the total population of a community.

There is a good reason to emphasise needs among communities. After all, the use of such a criterion expresses the political choice that an inhabitant of a federal country is entitled to the same services for certain things, regardless of the region he or she lives in or the community he or she belongs to. In the economic theory of federalism, this is called the 'horizontal principle of equality'. If we think that a Dutch-speaking young person deserves the same educational opportunities as a French-speaking one, we finance education on the basis of pupil numbers. A community with relatively more school-age children will then receive a larger share of the global envelope intended for education. The horizontal principle of equality is most often associated with personal matters. It is therefore not surprising that needs-based criteria, such as population numbers, are used to fund communities.

Besides, even if we do not exclude that there is still room for the communities to improve their accountability on the basis of clearly defined output factors, it is a widespread misunderstanding that the financing of needs is in itself at odds with responsible policy. Contrary to what is often claimed, community grants do not represent a 'consumption federalism', whereby the communities can spend as they wish and the federal state unconditionally bears all the costs. On the contrary, the communities are financed per head and cannot expect a cent more. What is more, when competences are transferred under the new system, these allocation amounts often did not correspond to the actual expenditure either.

4. CONTROL OF FINANCIAL STABILITY ACROSS LEVELS OF GOVERNMENT

It is one thing to create a legal framework prompting finance consolidation, yet it is quite another to ensure compliance with it. Two non-majoritarian institutions born out the federalisation of the country play a central role in Belgium's fiscal consolidation and stability: the "Public Sector Borrowing Requirements" Section of the High Council of Finance (hereafter referred to as "the Section") and the Constitutional Court.

The Section was created in 1989. The third State reform, which had just quadrupled the federated entities' financial resources, deeply altered the balance of fiscal power. The federal government – heavily dependent as it was on financial markets – feared trouble in "consolidating" Belgium's public finance due to potential shortage of budgetary coordination. It therefore created the Section to ensure intergovernmental fiscal coordination and protect fiscal orthodoxy. This advisory body is made up of twelve members, appointed by virtue of "their special competence and experience in the financial and economic field" (Art. 49(6) SFL) and distributed according to linguistic and institutional parity. The Section is thus composed of an equal number of Dutch-speaking and French-speaking members. Besides, six of them represent Entity I (made up of the Federal Authority and the Social Security), while six others sit on behalf of Entity II (made up of the Communities, the Regions and Local Authorities) (OECD, 2015).

The Section is responsible for issuing an annual opinion on the distribution of fiscal targets among governments. It proposes a budgetary trajectory, which serves as a starting point for negotiations

between representatives of each component unit of the Belgian federation. This takes place within the Inter-ministerial Conference on Finance and Budget, an informal coordination forum bringing together federal, regional and community Ministers of Finance and Budget. The agreements reached in this forum are subsenquently ratified by the Consultative Committee (Piron, 2013b). On its own initiative or upon request by the federal Minister of Finance or Budget, the Section can also issue an opinion on the advisability of restricting the borrowing capacity of one or more public authorities to "preserve the economic union and monetary union" and avoid "a structural deterioration of the borrowing requirements" (Art. 49(6) SFL).[11] However, it does not seem to have implemented this competence so far, probably because of the "massive political turmoil" (Coene & Langenus, 2013) this would undoubtedly create.

The Section has played a fundamental role in fiscal coordination within the Belgian federation. In the 1990s, it strongly supported the orthodox budgetary strategy which enabled Belgium to meet the "convergence criteria" set out in the Maastricht Treaty, hence to join the Eurozone. Even though its influence waned during the first decade of the 21st century, it nowadays assumes the role of translating European budgetary requirements within an ever more federalised Belgium. This is partly due to the closer monitoring of both national and regional fiscal policies carried by European institutions in response to the European public debt crisis (Piron, 2013b).

The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (also known as the "Fiscal Compact"), which was transposed in Belgian law by a cooperation agreement of December 2013,[12] transformed the Section into an independent fiscal council. In addition to its tasks related to fiscal coordination, the Section is now also in charge of overseeing compliance by the federal and the federated entities with the fiscal path they agreed upon and transmitted to European institutions. In the event of "significant observed deviations" from either the medium-term objective or adjustment path towards it, a correction mechanism is automatically triggered to eradicate it within eighteen months. In such cases, the Section assesses whether this gap stems from exceptional

[11] More specifically, this procedure is stipulated in Art.49 of the 'Special Financing Law' as follows:

"The conditions and issuance calendar of each public loan shall be submitted to the Minister of Finance for approval. If such approval is refused by the Minister of Finance, the government concerned may request that the matter be submitted to the Council of Ministers for decision." ...

"After having received the opinion of this department, the King may, on the proposal of the Minister of Finance and by a decree deliberated in the Council of Ministers, limit for a period not exceeding two years the borrowing capacity of a Community or Region for a maximum period of two years. This decision is taken after consultation with the Executive concerned."

[12] Art 4(1) Cooperation agreement of 13 December 2013 between the federal government, the Communities, the Regions and the Community Commissions concerning the execution of article 3(1) of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (O.G. 18 December 2013). See also the Royal Decree of 23 May 2018 on the High Council of Finance (O.G. 31 May 2018).

circumstances, determines the extent of the corrective action to be undertaken, and overlooks its effective implementation (High Council of Finance, 2014: 21-25).

With respect to the revenue side of the budget, Article 1ter(1) SFL currently imposes five restrictions upon regional tax autonomy: (1) compliance with the general framework of the economic and monetary union; (2) the principle of federal loyalty; (3) the prohibition of unfair tax competition; (4) the free movement of persons, goods, services and capital; and (5) the prohibition of double taxation.[13] The Constitutional Court enforces respect for these principles. The latter is another non-majoritarian institution closely linked to Belgium's transformation into a federal state: it was created in the wake of the second State to resolve potential disputes between the federal, regional and community legislatures on the allocation of powers. This "arbitrator" role is explicitly displayed in its initial name, namely "Court of Arbitration". It was only afterwards that its jurisdiction extended to the protection of individual rights and freedoms (set out in Part II of the Belgian Constitution).

Peeters and Mosselmans (2017, 91) stressed the crucial role played by the Constitutional Court in enforcing the principles governing the relationships between the federal government, the communities and the regions. According to them, the Court "supports a broad interpretation of the community and regional powers", as it has tended to take the autonomy of the federated entities "as its starting point". Yet, this general approach has not prevented it from imposing a major limitation on the constitutional power of the regions to impose tax, namely the economic and monetary union. The requirement to respect this general framework emerged as early as 1986 in the case law of the Belgian Court of Arbitration, before being systematised in landmark decision rendered two years later. Reviewing a case related to a Walloon tax levied on water export to the other two Regions, the Court ruled that it ensues from the 1970 and 1980 State reforms that "the new structure of the Belgian state is vested in an economic and monetary union, by which is meant that the institutional framework of an economy is built on constituent units and is characterised by an integrated market (the so-called economic union) and a single currency (the so-called monetary union)" . Concerning economic matters, Belgium's constituent units are required to guarantee the free movement of goods and factors of production between them. Any rule likely to hinder this freedom of movement – such as internal customs duty – is therefore deemed incompatible with the economic union and, consequently, contrary to Belgium's federal structure (Delgrange, 1993).

This seminal decision provides a typical example of the "Europe-friendly stance" displayed by the Belgian Constitutional Court (Popelier & Lemmens, 2015, 213). Directly inspired from the Court of Justice of the European Union case law, it indeed transposed the requirements applying to interstate relations within the European Union to intrastate relations within the Belgian federation. The audacity of this – now broadly accepted – position should be appreciated: at the time, institutional legislation did not contain such principle, which nevertheless drastically limited the exercise, by the federated entities, of their economic and tax competences (Bourgeois, 2014). During the 1988-1989 constitutional reform, the principle of economic and monetary union was officially enacted in Article

[13] The last principle, which is directly aimed at protecting taxpayers, differs from the first four principles, which regulate relations between the various component units of the Belgian federation.

6(1) Special law on institutional reform and in the SFL. Since the sixth State reform, this principle explicitly applies to all regional tax powers.

Legal scholarship regularly likens the general framework of the (internal) economic and monetary union to a specific application, in economic and tax areas, of another guiding principle of Belgian (fiscal) federalism: the principle of federal loyalty. The Constitutional Court has regularly claimed jurisdiction over this principle – enshrined since 1993 in Article 143(1) of the Constitution. It does so "in conjunction with the principles of reasonableness and proportionality (Peeters & Mosselmans, 2017, 99). According to the Court, federal loyalty implies "the obligation not to alter the balance of the whole federal construction when exercising one's own competences". The Court's judicial overview of this polysemic term does not restrain to the "sole exercise of competences", but extends to the "spirit" in which the latter ought to be implemented: when exercising its exclusive competences, each legislature should avoid rendering "the exercise of their competences by other legislatures impossible or extremely difficult". This case law was confirmed on the occasion of the sixth State reform, which expressly extended the jurisdiction of the Constitutional Court to the federal loyalty principle. Moreover, this principle was also inserted into Article 1ter SFL, which circumscribes regional tax autonomy. Just like the federal government, the Regions are thus required to comply with this principle when exercising their powers. However, the concrete impact of this legal requirement has so far remained unpredictable.

When it comes to taxing powers, compliance with the principle of federal loyalty seems redundant with another restriction on regional tax autonomy, namely the prohibition of unfair tax competition. This provision was inserted in the SFL during the fifth State reform (2001) in order to restrict the use of regional surcharges and relieves on the PIT. On the occasion of the sixth State reform, it was even extended to all regional tax prerogatives. However, the concept of "unfair tax competition" is neither defined in the SFL nor in preparatory works. The legislator therefore implicitly delegated this task to the Constitutional Court.

To summarise, the Constitutional Court nowadays has large room for manoeuvre to interpret the legal safeguards of Belgium fiscal federalism. This is partly due to its judicial activism, as it creatively interpreted some of the main principles circumscribing regional tax autonomy. For instance, the principles of (internal) economic and monetary union and federal loyalty were first laid down in the Court's case law, before being enacted in the SFL. When not acting on its own initiative, the Constitutional Court might also be called upon to fill in vacuums in (special) legislation, as illustrated by the example of unfair tax competition. The Court's power of interpretation is further bolstered by the vagueness of many key concepts – which are sometimes not even mentioned in the Constitution nor in special laws. Through its case law, the Constitutional Court has therefore put itself in a position to define the extent to which Regions can effectively engage in tax competition. However, no firm conclusion can yet be drawn regarding its stance on competition. The stakes are nevertheless far from being low, as its case law could starkly impact how federal and regional government exercise their taxing powers.

5. THE ROLE OF SOLIDARITY

As explained above, and until 1989, the federal grants were distributed on the basis of a criterium that was the average of population (to the advantage of Flanders), fiscal capacity (at that time still to the advantage of Brussels) and surface area (to the advantage of Wallonia). When the SFL was introduced in 1989, it was decided, at the request of Flanders, to abandon this "1/3rd, 1/3rd, 1/3rd key" and to give a more prominent place to the PIT criterium, or to fiscal capacity. Crucially, this was partly compensated by introducing a solidarity mechanism. This provides an additional grant to regions with a fiscal capacity that is lower than the federal average.

In this sense, this mechanism again expresses the horizontal principle of equality within a federation. According to this principle, citizens in the same circumstances can count on the same public service, regardless of inter-regional differences in fiscal capacity. This is why the name of the mechanism is rather unfortunate. It has nothing to do with vertical redistribution between rich and poor citizens (as in the progressive personal income tax or social security), but with horizontal equality between individual citizens of the same federation.

The formula below determines the solidarity contribution a region can count on under the new SFL when its fiscal capacity is below the national average:

$$SOL_{region} = 0{,}8 \times \left(POP_{region} - PB_{region}\right) \times B, \quad (1)$$

where POP_{region} represents that region's population share of the total, national population, and PIT_{region} represents the region's share of federal PB revenues (the new PIT criterium). Thus, 80% of the difference between a region's population share and its PB share in the federal total is compensated.

The reasoning is as follows. When more people live in a region in percentage terms than contribute to the federal PIT revenues, the fiscal capacity of that region (measured as PIT revenues per capita) is lower than the national average. We show below the shares in population and PIT revenue for the three regions.

Share in	Flemish Region	Walloon Region	Brussels Region
Population	57,5%	32,2%	10,3%
PIT revenues	63,5%	28,2%	8,3%
difference	-6%	4%	2%

Table 3: Share in population and PIT revenues for the three regions

For Wallonia and Brussels, POP_{region} is larger than PIT_{region}, so the difference in the above formula becomes positive. Only in this case, a solidarity amount is provided.

Finally, the extent of solidarity is also partly determined by the basic amount to which the percentage is applied. This is the *B* in the formula above. In the new SFL that amount is set at €20.09 billion. It is the sum of the newly granted fiscal autonomy (10.74 billion), the new regional allocation (5.25 billion), and half of the PIT community grant (4.1 billion). Multiplied by 80% of the difference from the last row of Table 3, this results in an additional allocation for Wallonia and Brussels of €676 million and €264 million respectively in 2015. Compared to the solidarity mechanism from the old SFL, this represents a decrease of €180 million for the Walloon region and €72 million for the Brussels region. An important difference with the old solidarity mechanism is that, under the new system, the basic amount is not only indexed to inflation but also to economic growth. In time, this can cause the initial difference in solidarity contributions between the old and new SFL to be closed, or even reversed.

6. MERITS AND DEFICIENCIES OF BELGIAN FISCAL FEDERALISM

If we compare the Belgian distribution of competences with what, according to the economic theory of federalism, would be an ideal blueprint, the end result of six state reforms is reasonably positive. Certainly, certain competences, such as care for the elderly, could be organised in a more homogenous way. Other powers, especially in the area of regulation, belong more at the federal level. Fiscal autonomy could be even higher, but only on the condition that the regionalised personal income tax does not have too many unwanted effects in the future. This remains to be seen and requires empirical research. In other words, there is room for well-considered improvement, but certainly not for a 7th state reform in which the federal level is all but eliminated. In an economy as highly integrated as the Belgian one, which only covers a small area, the disadvantages of a further split are simply too great. Missed economies of scale, competitive and spill-over effects of all kinds resulting from such a 'confederal' model would undermine prosperity. The Achilles' heel of Belgian federalism does therefore not lie in the vertical division of powers and its financing, but rather in two other weaknesses.

First, the system suffers from its 'sui generis' character, with the interwoven communities and regions as its most important feature. Thus, both the Flemish and French-speaking communities decide on policies conducted within the boundaries of the Brussels Capital Region, which inevitably means that the regions and communities end up in each other's wake. The advantages of decentralisation, partly resulting from the increased visibility of regionalised policy, are thus lost in a difficult to untangle knot of decision-making. Secondly, and related to this, the position of the Brussels region in a complex stratification of 'spill-overs' is becoming increasingly untenable. How do we integrate the Brussels economy and labour market with its hinterland in Flanders and Wallonia? How do we give the hundreds of thousands of low-skilled young people in Brussels the opportunity to find work in the rest of the country? How do we ensure that mobility to and from Brussels improves?

If we limit ourselves to the economic argumentation, the solutions are obvious. As soon as we expand the Brussels region, so that its borders coincide with, for example, the province of Brabant of old, many of the 'spill-overs' and coordination problems disappear. If we also turn the Brussels area into a full-fledged region - i.e. with its own education policy, its own health care system, and its own cultural policy - we reinforce this process, and improve the visibility of the streamlined policy.

Of course, there are many more motives at play than just economic ones. Politically, therefore, such an ideal image does not stand a chance, certainly in the short term. But that does not mean that we cannot take elements from it to arrive at a workable solution. Such as the observation that a classic territorial federalism, with fully-fledged, equivalent, and territorially defined regions, would already be a step forward. It would create clarity for the voter and provide the necessary transparency for politicians to work together as partners. Prosperity in the future will depend to a large extent on cooperation agreements and voluntary coordination mechanisms. But cooperation is only possible if everyone's motives are clear and everyone's levers and bargaining powers are more or less the same. And if cooperation does not work, for whatever reason, at least voters know who is to blame and why.

7. DO'S AND DON'TS: WHAT THE EU CAN LEARN FROM FISCAL FEDERALISM IN BELGIUM

To follow

7.1 DEFICIENCIES – NEGATIVE EXAMPLES

7.2 ACHIEVEMENTS – POSITIVE EXAMPLES

8. CONCLUSION

To follow

9. BIBLIOGRAPHY

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To follow

APPENDIX A: TO FOLLOW