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# The finances of the communities and regions

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## Introduction

Since 1970 the Belgian administrative system has evolved into a federal structure with three communities and three regions. The Flemish, Walloon and Brussels Capital Regions are territorially defined entities with powers in such spheres as town and country planning, housing, the environment, public works, supervision over lower level authorities and certain aspects of the policy on agriculture, energy, transport, employment and the economy. The Flemish, French and German-speaking Communities, comprising the population of the Dutch, French and German language areas respectively, mainly have powers relating to subjects concerning people, such as education, culture, welfare and certain aspects of health policy(1). In Flanders, the community and regional institutions have been merged.

The Belgian administrative reform took place in five phases, in 1970, 1980, 1988/89, 1993 and 2001 respectively, with powers increasingly being devolved from federal level to the federated entities. At the same time, the funds were provided to finance those powers. The administrative reform therefore had a major impact on Belgian public finances.

This article is in five sections. Section 1 outlines the position of the communities and regions in general government as a whole. Section 2 analyses the revenues of the communities and regions. Section 3 discusses their expenditure. Section 4 contains an analysis of the changes in the financing balance and the debt level. Finally, section 5 explains the results of the projections concerning the movement in community and regional finances.

## 1. Position of the communities and regions in general government

At present, both the revenues and the expenditure of the communities and regions account for around a quarter of general government revenue and expenditure. Education accounts for roughly half of the expenditure of the communities and regions.

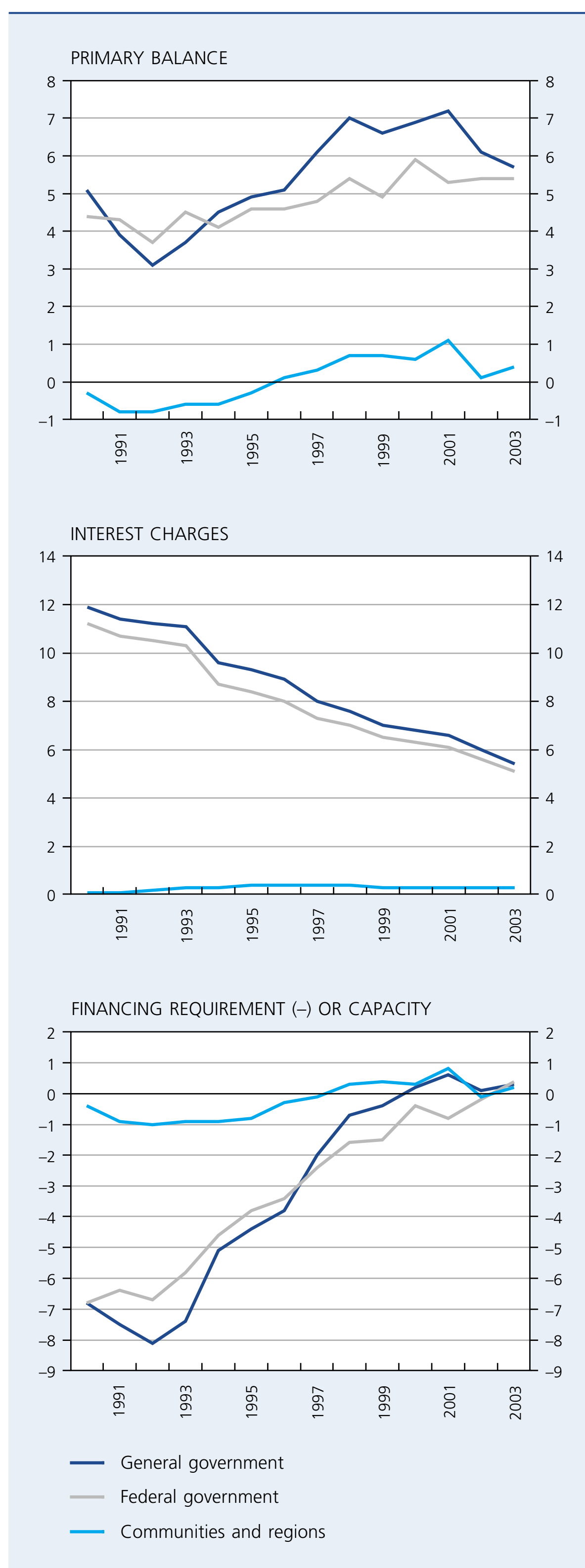
During the past decade, the financing balance of general government has gradually been improving. The deficit, which still stood at 6.8 p.c. of GDP in 1990, was converted to a surplus of 0.3 p.c. in 2003, almost all of which was attributable to the movement in the balance of the federal government. The improvement in that balance was attributable partly to the increase in the primary surplus, but was due mainly to the interest charges, which fell by 6.1 p.c. of GDP between 1990 and 2003.

The balance of the communities and regions has also improved. At the beginning of the 1990s, they were still recording deficits of around 1 p.c. of GDP, but in recent years the communities and regions have tended to balance their budgets or even achieve a surplus. In view of the relatively low interest charges of the communities and

(1) In the bilingual Brussels Capital Region, the community powers are exercised by the French Community Commission, the Flemish Community Commission and the Joint Community Commission.

**CHART 1** PRIMARY BALANCE, INTEREST CHARGES AND FINANCING BALANCE OF GENERAL GOVERNMENT

(Percentages of GDP)




Source : NAI

**TABLE 1** GOVERNMENT EXPENDITURE AND REVENUE [1]

(Annual average percentage change at constant prices, 1991-2003) [2]

| | Primary expenditure | Revenue |
|---|---|---|
| General government | 2.5 | 2.3 |
| Federal government | 0.9 | 1.0 |
| Communities and regions | 2.5 | 3.1 |
| Local authorities | 3.0 | 2.5 |
| Social security | 2.5 | 2.1 |
| *p.m. GDP growth* | *1.8* | |

Sources : NAI, NBB.
(1) Adjusted for the main non-recurring factors.
(2) Deflated by the national consumer price index.

regions, the main factor in that improvement is the change in the primary balance. The primary deficits of the communities and regions, which were still as high as 0.8 p.c. of GDP in the first half of the 1990s, have given way to primary surpluses in the last few years.

The explanation for this improving trend in the balance of the communities and regions lies in the fact that the real rate of growth in their primary expenditure, which matched that of general government, was 0.6 of a percentage point lower, on average, than the growth of their revenues between 1990 and 2003. Revenues in fact increased sharply : with growth of 3.1 p.c. per annum in real terms, the communities and regions saw their revenues increase considerably faster than those of general government, which increased by 2.3 p.c. [1]

In 2003, the general government debt came to 100 p.c. of GDP. The federal government accounted for over 90 p.c. of the consolidated gross debt – in other words, the liabilities minus the government securities held by the State itself. Only a small percentage of the debt is attributable to the communities and regions. Since they recorded deficits for a major part of the 1990s, their debt ratio increased from 3.2 p.c. of GDP in 1990 to a peak of 7.4 p.c. of GDP in 1996. Improved financing balances made it possible to reduce the debt level after that to 5.2 p.c. of GDP by the end of 2003.

(1) In this article, the national accounts data have been adjusted to avoid breaks in the series and to align them more closely with budgetary reality. To take account of the fact that the public broadcasting companies were reclassified in the government sector in 2002, the revenue and expenditure figures were adjusted. No account was taken of the imputed pensions or the imputed social security contributions. The data concerning the Brussels Capital Region before 1995 have been adjusted to take account of the effect of the Region's assumption of the powers of the Brussels Conurbation from 1995 onwards. Although these adjustments affect the pattern of revenues and expenditure, their impact on the balances is neutral.

## 2. Revenues

### 2.1 General

The revenues of the communities and regions can be divided into three categories:

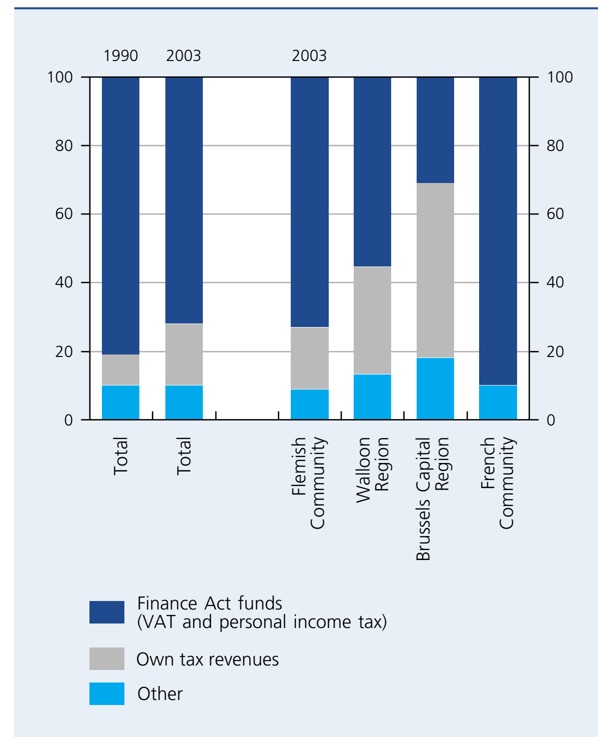
– their resources consist mainly – in 2003 the figure was 72 p.c. – of a portion of the proceeds from personal income tax and VAT made over to them by the federal government in accordance with the parameters laid down in the Finance Act 1989 (1), supplemented by the Saint Michel Agreement of 1993 and the Lambermont agreement of 2001. These revenues will be referred to here as "Finance Act funds";
– their own tax revenues, such as registration fees, inheritance taxes, motor vehicle duty, water charges and environmental levies, currently represent around 18 p.c. of their revenues;
– the remaining 10 p.c. consists of other transfers from the federal government, the proceeds from the sale of goods and services and other miscellaneous revenues.

The revenue structure tends to vary from one individual entity to another. In practice, the communities have hardly any tax revenues of their own because of the lack of any territorial basis (2). The Finance Act funds therefore represent a much larger proportion of total revenue in the French Community than elsewhere. The two "genuine" regions, the Walloon Region and the Brussels Capital Region, raise a relatively large proportion of tax revenue themselves. In the Brussels Capital Region the figure actually comes to half of the total revenues. The Flemish Community's own tax revenues fall mid-way between those of the other federated entities, which is to be expected for an entity which is both a community and a region.

Under the Lambermont Agreement which granted greater fiscal autonomy to the regions, the communities and regions saw a sharp increase in their own tax revenues from 2002. The impact of this on the budget was neutralised by reducing the amount of personal income tax made over pursuant to the Finance Act via the "negative term". This shift in resources has no influence on the revenues of the federated entities as a whole, but it does distort the rate of growth of the individual revenue items. In this article, those growth rates are adjusted for the influence of this shift.

CHART 2 STRUCTURE OF THE REVENUES OF THE COMMUNITIES AND REGIONS

(Percentage shares)




Sources: NAI, NBB.

Since 1990, the total revenues of the federated entities have increased in real terms by 3.1 p.c. per annum. The three different revenue categories each grew by around 3 p.c. Later on in this section there will be a more detailed explanation of the reasons for this.

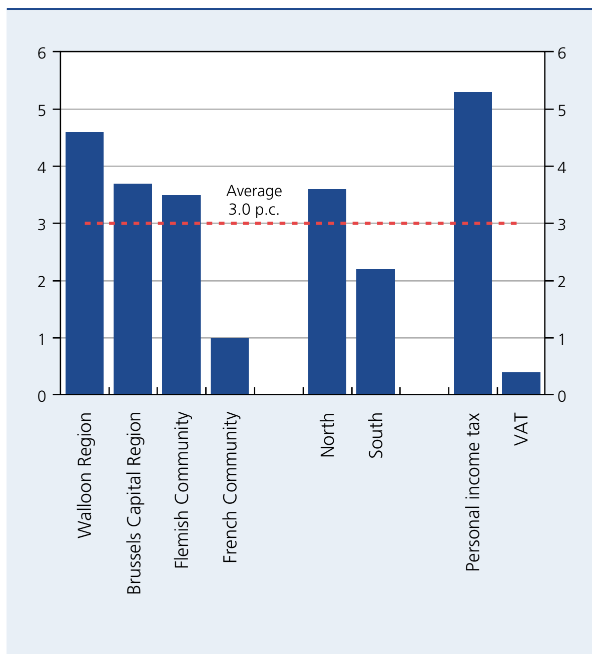
### 2.2 Finance Act funds

The revenues of the communities and regions consist mainly of the part of the proceeds from personal income tax and VAT to which they are entitled under the Finance Act rules. These funds increased in volume by an average of 3 p.c. between 1990 and 2003, far outpacing real GDP growth (1.8 p.c.) and the rise in general government revenues (2.3 p.c.) (3).

(1) Special law of 16 January 1989 on the financing of the communities and regions.
(2) The French community receives a small amount in the form of levies on RTBF, RTL-TVI and private radios.
(3) Under the Saint Michel Agreement (1993) and the Lambermont Agreement (2001), the regions were given more powers. They therefore also received supplementary budgets. However, the effect of this measure on the average revenue growth for the period between 1990 and 2003 is marginal (around 0.04 p.c. per annum).

CHART 3 FINANCE ACT FUNDS

(Annual average percentage change at constant prices, 1991-2003) (1)




Sources: FPS Finance, NAI, NBB.
(1) Deflated by the national consumer price index.

The average growth rate of the Finance Act funds varied greatly according to the individual entity: 4.6 p.c. for the Walloon Region, around 3.5 p.c. for the Brussels Capital Region and the Flemish Community, and just 1 p.c. for the French Community.

These variations are not surprising since the figures relate to different types of entity – communities, regions and the Flemish entity which is both a community and a region – and the rates of increase in the revenues stipulated by the Finance Act vary greatly according to whether the revenues are used to finance education – by far the most important community power from the point of view of the budget – or other powers of the communities and regions [1]. Since 1990, funding for education – i.e. the VAT revenues allocated – has grown in real terms by only 0.4 p.c. per annum, whereas the personal income tax allocated has risen by 5.3 p.c.

One way of eliminating the influence of institutional differences and comparing more uniform entities is to calculate the revenues of the north and south of the country. Here, the north is defined as the Flemish Community and 20 p.c. of the Brussels Capital Region; the south comprises the French Community, the Walloon Region, the German-speaking Community and 80 p.c. of the Brussels Capital Region. The calculations reveal that, between 1990 and 2003, the Finance Act funds increased in real terms by 3.6 p.c. per annum in the north, compared to just 2.2 p.c. in the south.

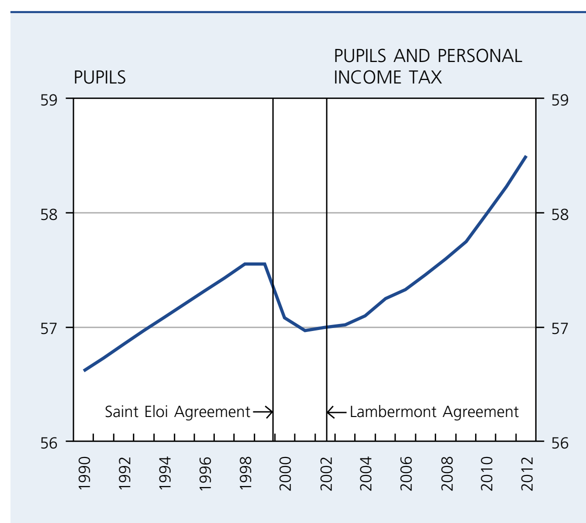
Later on, this article will explain the difference in the growth rate on the basis of the principal mechanisms underlying the increase in the resources handed over to the regions and communities in the form of both VAT and personal income tax revenues.

### 2.2.1 Increase in VAT resources

As already stated, the VAT resources allocated to the two communities to finance their expenditure on education increased by an average of 0.4 p.c. per annum in real terms between 1990 and 2003. This very weak growth is due to the mechanism built into the Finance Act 1989, whereby these resources are only adjusted in line with the movement in consumer prices and 80 p.c. of the rise in the number of persons under the age of 18 in the community where the number of young people shows the largest increase or the smallest decline [2]. In the

CHART 4 SHARE OF THE FLEMISH COMMUNITY IN THE VAT RESOURCES ALLOCATED TO THE COMMUNITIES

(Percentages)




Sources: State revenue and resources budget, NBB.

(1) When the Finance Act 1989 was first introduced, the VAT resources corresponded to the former education grants. Since then, there has no longer been any explicit link between the two, since the communities have autonomy over the whole of their revenues.

(2) Here it was assumed that 20 p.c. of the education spending consists of fixed costs which are unaffected by the number of pupils. The French Community accounts for 80 p.c. of the number of young people under the age of 18 in the Brussels Capital Region, while the Flemish Community accounts for 20 p.c.

event, that proved to be the French Community, where the number of young people showed a very small increase (averaging 0.1 p.c. per annum). This mechanism demonstrates that there is no connection at all between the increase in the resources allocated, despite their name, and the increase in VAT revenues. Under the Lambermont Agreement, additional lump sum resources were allocated to the communities from 2002, namely 198 million euro in 2002 and another 149 million euro in 2003.

Between 1990 and 2003, the VAT resources allocated to the Flemish Community increased by 0.5 p.c. per annum, slightly outpacing the rise for the French Community (0.3 p.c.). These growth differences are due to the allocation formulas used.

The Finance Act 1989 provided for a gradual shift away from the education grant allocation existing in 1988, namely 56.5 p.c. for the Flemish Community and 43.5 p.c. for the French Community, towards an allocation based on the number of pupils registered in 1987, namely 57.55 p.c. in the Flemish Community and 42.45 p.c. in the French Community. As a result, the allocation formula was gradually adjusted in favour of the Flemish Community.

Under the Saint Eloi Agreement, the grants were allocated from 2000 onwards on the basis of an annual census of the number of pupils. This caused the share of the Flemish Community to decline from 57.55 p.c. to around 57 p.c. from 2000 onwards, so that its resources grew rather more slowly than those of the French Community during that period.

As a result of the Lambermont Agreement, the number of pupils ceased to be the sole basis for the allocation of the VAT resources; gradually, more importance was attached to the amount generated by personal income tax in each community. In practice, this means that, in 2002, 65 p.c. of the supplementary funding granted under the Lambermont Agreement – i.e. not the initial budget specified in the Finance Act 1989 – was allocated on the basis of pupil numbers and 35 p.c. on the basis of personal income tax revenues. This last percentage will gradually increase to 100 p.c. in 2012.

The share of the Flemish Community in personal income tax came to 64 p.c. in 2003, far more than the figure based on pupil numbers (57 p.c.). Assuming that these figures remain unchanged, the allocation of VAT resources will be altered in the years ahead in favour of the Flemish Community – according to the simulations, its share will increase from 57 p.c. to almost 58.5 p.c. in 2012 – and to the detriment of the French Community.

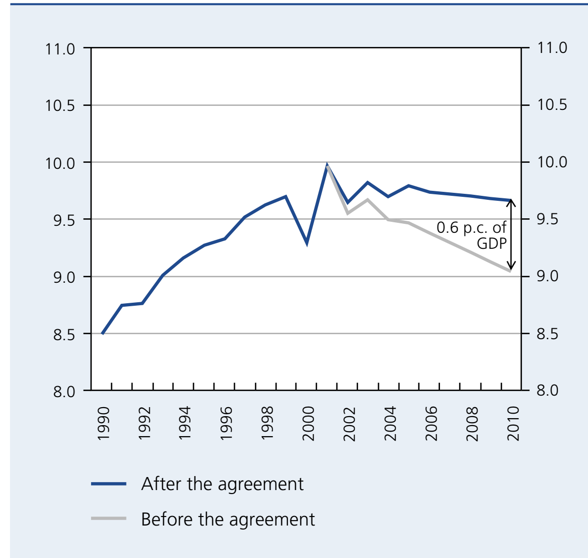
## Impact of the Lambermont Agreement on the revenues of the communities and regions

The special law of 13 July 2001 on the refinancing of the communities and the extension of the fiscal powers of the regions, implementing the Lambermont Agreement, brought a fundamental change in the calculation of the budget resources allocated to the communities and regions.

The main provision of the Lambermont Agreement concerned substantial supplementary funding for the communities. During the Finance Act's transitional period, up to 1999, the VAT resources transferred to the communities were only adjusted to allow for inflation and 80 p.c of the change in the number of young people under the age of 18. Under the Lambermont Agreement, these VAT resources were increased sharply by the allocation of flat-rate amounts of 198 million euro in 2002, 149 million euro in 2003 and 2004, 372 million euro in 2005, 124 million euro in 2006 and 25 million euro in the period from 2007 to 2011. In addition, from 2007 onwards the total VAT resources will be 91 p.c. linked to the real growth in gross national income.

CHART 5 IMPACT OF THE LAMBERMONT AGREEMENT ON THE RESOURCES ALLOCATED [(1)]

(Percentages of GDP)




Sources : State revenue and resources budget, NAI, NBB.

(1) Personal income tax (disregarding the effect of the transfer of new regional taxes from 2002) and VAT.

Under the Finance Act, the personal income tax and VAT resources allocated to the communities and regions during the transitional period from 1989 to 1999 tended to increase in relation to GDP. Without the Lambermont Agreement, the opposite would have happened from 2000 onwards. As a result of the agreement, the share of the communities and regions in government revenues will have increased by 0.6 p.c. of GDP by 2010. As a result, the funds transferred to the communities and regions will be closely aligned with GDP growth, though without exceeding it.

### 2.2.2 Growth of resources in the form of personal income tax

First, this section explains the reason for the large increase in the proportion of personal income tax revenues allocated to the communities and regions. Next follows a detailed examination of the variations in growth rates between the different entities.

#### 2.2.2.1 The communities and regions as a whole

Part of the personal income tax revenues collected in Belgium is transferred to the regions and, to a lesser extent, to the communities to finance their powers other than education. [(1)] The amount allocated to the communities and regions in the form of personal income tax came to roughly 30 p.c. more than the VAT resources transferred in 2003.

During 1990-2003, these funds increased in real terms by an average of 5.3 p.c. per annum. For the proportion of the personal income tax revenues allocated, the Finance Act 1989 distinguishes between the transitional period – from 1989 to 1999 – and the final period commencing in 2000. The average real growth of 5.3 p.c. during 1991-2003 is the outcome of an extremely strong 6.8 p.c. rise in the transitional period and a far more modest growth rate of 2 p.c. from 2000 onwards.

(1) Since 2002, as a result of the Lambermont Agreement, the Community Commissions and municipalities in the Brussels Capital Region have also received a small part of the personal income tax (around 50 million euro per annum).

During the transitional period, it was primarily two mechanisms, the "annual instalments" and "bonuses", that accounted for the strong rise in the transfers in the form of personal income tax. [1]

The communities and regions did not receive immediately each year the full amount that the federal authority had to transfer to them for the new powers. However, the largest part of this amount still owing was paid later in the form of annual instalments calculated for a period of 9 to 10 years. The entities therefore received in year t+1 a first annual instalment which related to year t; in year t+2 they received the second annual instalment for year t and the first for year t+1, etc. Thus, the gradual accumulation of the various annual instalments in the 1990s resulted in a rapid growth rate.

Under the Finance Act 1989, the allocation of the resources between the various entities was changed: there was a gradual switch away from the formula existing up to 1988, which was replaced by the relative contributions of the entities to personal income tax revenues. [2] During the transitional period, two techniques were applied here.

1. For some of the powers, at the end of the transitional period the budget resources granted to each region in proportion to the personal income tax collected in their own territory must be equal to the average for the regions as a whole. To attenuate the effect of that criterion – because the relatively poor entities thus lose resources, while the richer ones gain – the Finance Act provides for a solidarity allowance in favour of the regions where the personal income tax paid per capita is below the average. During the transitional period, this technique only changes the allocation of the resources among the three regions; it has no impact on the overall resources transferred to the entities by the federal authority, and therefore does not affect their growth rate.

2. In contrast, for some of the other powers the resources allocated to each entity in proportion to the personal income tax collected on its territory are gradually linked to the highest percentage calculated for the various entities. This technique prevents any reduction in the resources for the poorer entities, and only increases the allocation to the richer entities. This gradual allocation of "bonuses" during the transitional period implied additional funding from the federal government and therefore represents the main reason why the resources transferred in the 1990s increased so rapidly.

Since the start of the final period in 2000, the calculation of the personal income tax allocated to the communities and regions has been simpler. For the entities as a whole, the real growth rate is determined mainly by the rise in real gross national income [3] and by the changes (at constant prices) in the total amount of the solidarity allowance. [4] These changes occur if there are variations in the trend in personal income tax paid per capita in the respective regions. [5]

From 2000 to 2003 the amount of personal income tax transferred increased in real terms by an average of 2 p.c. per annum. This was due to the fact that gross national income grew by 1.4 p.c. and there was also an increase in the solidarity allowances in favour of the Walloon Region and the Brussels Capital Region. This second factor will be examined in more detail at the end of the next section.

#### 2.2.2.2 Individual entities

For the individual entities, the differences in the growth rate are much larger for the allocated part of the personal income tax revenues than for the VAT resources. Where the regions are concerned, the resources in the form of personal income tax increased between 1990 and 2003 by 6.5 p.c. for the Flemish Region (for regional powers only), against 4.6 p.c. for the Walloon Region and just 3.7 p.c. for the Brussels Capital Region. As regards the communities, the funds increased by 6 p.c. for the Flemish Community (community powers only), exactly double the figure of 3 p.c. for the French Community. To sum up, this means an increase in personal income tax of 6.3 p.c. for the north as opposed to 4 p.c. for the south.

These striking variations are due to the Finance Act 1989 which stipulates that the allocation between the different entities of the allocated part of the personal income tax revenues must take account of the personal income tax

(1) During the initial years of the transitional period, the growth rate was also speeded up by the fact that the revenues intended for the regions were only released progressively as the regions actually took over the powers assigned to them (capital spending). However, this factor is of minor importance since the period considered by this article does not begin until 1990.

(2) The allocation formula applicable up to 1988 was based on the population, the land area and the personal income tax in each entity.

(3) Since the Lambermont Agreement, the calculation has become somewhat more complicated. First, the funding is linked to the real growth in gross national income and to the national consumer price index, but after that it is reduced by what is called the "negative term". However, the latter increases by only 91 p.c. of the real growth in gross national income, so that – on balance – the growth rate of the personal income tax transferred slightly outpaces that of gross national income.

(4) Each year the increase in the funding allocated is also influenced by adjustments relating to the amounts due in the previous year, because the final parameters may differ from the provisional figures.

(5) During the transitional period, the solidarity allowance had no influence on the funds allocated as a whole. In contrast, during the final period every change affects the amount of the total funds allocated.

collected in each territory,[1] but with the proviso that this principle of a "fair return" is moderated by the granting of a solidarity allowance to the regions with a weaker economy.

The technique whereby this principle is reflected in the figures is rather complicated. However, the mechanism explaining the differences in growth between the entities can be illustrated on the basis of two findings.

First, in 1989 – the first year in which the new funding system applied – there were large differences between the various entities in the funds allocated on the basis of the former federal credits, expressed as a percentage of the personal income tax collected in each entity. As already stated, under the Finance Act it was decided that these percentages would be progressively aligned – at least in respect of part of the funds allocated – with the highest percentage calculated for the various entities[2]. For the relevant part of the resources intended for the regional powers, the 1989 figures were 15.8 p.c. for the Brussels Capital Region, 19.1 p.c. for the Flemish Region and 28.5 p.c. for the Walloon Region. As regards the funds allocated for community powers other than education, the figures were 12.4 p.c. for the Flemish Community and 15.4 p.c. for the French Community.

In practice, this meant that, in 1989, for powers other than education, an amount based on the former federal credits was allocated to the French Community; expressed in relation to the personal income tax collected in that entity, this came to 15.4 p.c. The corresponding figure for the Flemish Community was only 12.4 p.c. At the end of the transitional period, all other things being equal, it was necessary to increase this figure to 15.4 p.c. in all entities so that supplementary resources – "bonuses" – were granted to the Flemish Community during the 1990s. The mechanism was the same for the regional powers concerned. Therefore, the fact that, in 1989, for some of the powers, the funds granted were relatively modest in the Flemish Community and the Brussels Capital Region in relation to the personal income tax collected, led to the progressive allocation of supplementary funds to these entities; this was one reason for the relatively steep rise in their revenues.

Second, the principle of linking most of the budget resources allocated to the proceeds of personal income tax gave rise to different growth rates in each entity, not only because of the "bonuses" mentioned above and relating to the 1989 allocation, but also because personal income tax revenues have grown at different rates in the three regions. During the period considered, between 1990 and 2003, the real annual growth in the proceeds of personal income tax came to 3.6 p.c. in the Flemish Region, compared to 2.7 p.c. in the Walloon Region and barely 1 p.c. in the Brussels Capital Region[3]. This divergence in economic development over this period is another reason for the relatively strong rise in the share of the proceeds from personal income tax allocated to the Flemish Community.

For the Brussels Capital Region, the reason for the increase in the resources allocated is more complex. On the one hand, the funds allocated to this region in 1989 were relatively meagre in relation to the proceeds from personal income tax, and the Brussels Capital Region – like the Flemish Community – therefore qualified for the gradual allocation of "bonuses". However, their favourable effect was more than offset by the very weak growth in personal income tax per capita in this region during the 1990s.

As already stated, the impact of the proceeds of personal income tax on the resources allocated is attenuated by the granting of a solidarity allowance, where appropriate. The Finance Act provides for such an allowance to be granted once there is a negative difference, for a particular region, between personal income tax per capita and that same variable for the country as a whole. The amount of this allowance is fixed according to the size of that difference.[4]

In the case of the Walloon Region, this applied each year: the negative deviation of 9.4 p.c. recorded in 1990 for personal income tax increased to 11.5 p.c. in 1993, a level which was more or less maintained until the end of the 1990s, before increasing to 13.9 p.c. in 2003[5]. In the Brussels Capital Region, the relative decline in personal income tax collected per capita was substantial. While the level of personal income tax per capita was still 12 p.c. above the national average in 1990 (compared to only 3 p.c. in Flanders), this positive difference declined steadily, and was converted to a negative difference from 1997, reaching 6.4 p.c. in 2003. Since 1997 the Brussels Capital Region has therefore qualified for an increasing solidarity allowance.

(1) For the purpose of determining the formula for allocation between the communities, 80 p.c. of the personal income tax collected in the Brussels Capital Region is attributed to the French Community and 20 p.c. to the Flemish Community.

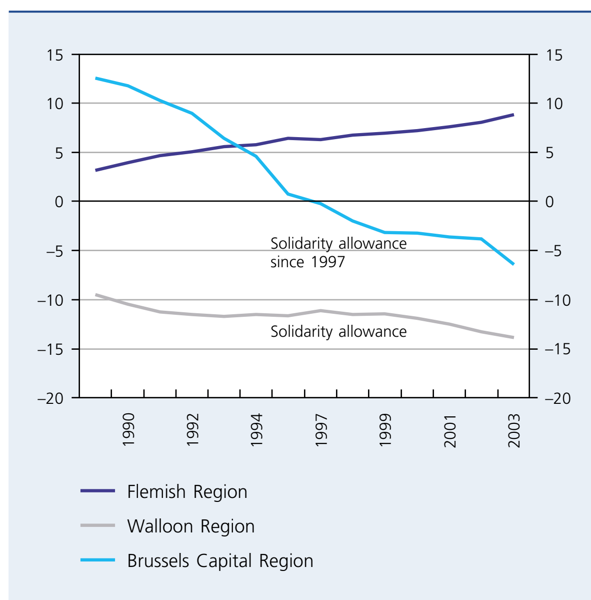
(2) For the regional powers, this concerned the second and third parts of the funding, relating to the former credits for the Municipal and Provincial Fund and the former allowances. For the community powers, it concerned the powers other than education.

(3) These differences in growth rates have little connection with demographic trends – in the Brussels Capital Region the rise of 0.1 p.c. on average is nonetheless slightly below the figure of 0.3 p.c. seen in the rest of the country – but they do to a large extent reflect the divergences in personal income tax per capita.

(4) The basic amount of the solidarity allowance, expressed in 1988 francs, comes to 468 francs (11.60 euro) per head and per percentage point of difference between the region and the country as regards the proceeds of personal income tax per capita. This amount is adjusted each year in line with the national consumer price index.

(5) The figures stated are the percentages used to calculate the funding in any particular year, but they relate to the latest available statistics, namely those for the preceding tax year.

CHART 6 PERSONAL INCOME TAX PROCEEDS PER CAPITA
(Percentage deviation from the national average)




Sources: State revenue and resources budget, NBB.

## 2.3 Own tax revenues

### 2.3.1 General overview and volume of own tax revenues

The regions exercise their fiscal powers in three ways. First, the Finance Act contains a list of taxes which used to be federal revenues and which are transferred to the regions. Next, the regions can charge additional cents or grant rebates on personal income tax. [1] Finally, the regions have their own tax-raising powers in respect of items not already taxed by another authority.

The taxes transferred to the regions form by far the largest category of own tax revenues, representing 89 p.c. in 2003. In practice, these consist of registration fees, inheritance taxes, motor vehicle duty, road fund tax, withholding tax on income from immovable assets, the "eurovignette" (road haulage toll), gift tax and three minor taxes, namely the tax on amusement machines, the tax on gambling and betting and the tax on the opening of licensed premises. The radio and television licence fee is also part of the taxes transferred. Before 2002, the proceeds from this tax went to the communities; since the Lambermont Agreement, this tax has constituted revenue for the three regions. This change had no impact on the budget because the amount of personal income tax transferred was increased or reduced respectively by the same amount for the communities and regions. The Lambermont Agreement also granted the regions full autonomy over this tax. The three regions have made use of that power: in Flanders and the Brussels Capital Region, the radio and television licence fee has been abolished, and the rates have been lowered in the Walloon Region.

Under the Lambermont Agreement, the volume of these taxes transferred to the regions increased significantly from 2002 onwards. Existing taxes which had not previously been handed over to the regions (motor vehicle taxes) or only in part (41.408 p.c. of the registration fees on transfers of title in return for payment) were from then on handed over in full to the regions. In addition, supplementary regional taxes were transferred to the regions: the road fund tax, the mortgage registration fees and the fees on the division of immovable property, the "eurovignette" and gift tax. Altogether this came to around 2.7 billion euro in supplementary regional taxes; as already stated, their impact on the budget was neutralised by a reduction in the personal income tax transferred via what is called the "negative term". A number of federal restrictions on regional taxes were also lifted and the regions now have total autonomy over the basis of assessment, the tax rates and the exemptions. [2]

Apart from the taxes transferred, all the regions have also introduced water charges and environmental levies. Finally, they have introduced – for a small amount – other taxes on items not taxed by any other authority. In practice, the main ones are the flat-rate tax payable by heads of households, businesses and self-employed persons and the tax on non-residential buildings in the Brussels Capital Region.

The budgetary importance of the entities' own tax revenues expressed in relation to the Finance Act funds is highly variable. For the Flemish Community, this category of revenues is less important because this entity is both a community and a region. [3] The Walloon Region's own tax revenues represent just over half of the Finance Act funds. In contrast, in the Brussels Capital Region these resources are very important: here, the region's own tax revenues are actually 60 p.c. greater than the allocated portion

(1) The regions have been able to charge additional cents or grant rebates – up to a maximum of 3.25 p.c. from 1 January 2001 and 6.75 p.c. from 1 January 2004 – on the personal income tax proceeds for the region. However, these reductions or increases in tax must not give rise to any reduction in the progressive character of personal income tax, while all forms of unfair tax competition are also excluded.

(2) Although the regions have power to determine the basis of assessment for the withholding tax on incomes from immovable property, they cannot modify federal assessed property incomes. As regards the motor vehicle tax, the road fund tax and the "eurovignette", the exercise of this power is governed by a cooperation agreement to be concluded in advance by the three regions.

(3) The Flemish Community's own tax revenues amount to 75 p.c. of the Finance Act funds made available for regional powers only.

**TABLE 2** OWN TAX REVENUES AS A PERCENTAGE OF THE FINANCE ACT FUNDS

(2003)

| | Flemish Community | Walloon Region | Brussels Capital Region | p.m. Total (millions of euro) |
|---|---|---|---|---|
| **1. Taxes transferred to the regions** | **21.5** | **52.7** | **135.3** | **5,279** |
| Registration fees | 8.3 | 19.1 | 67.7 | 2,088 |
| Inheritance taxes | 5.0 | 11.9 | 36.4 | 1,239 |
| Motor vehicle tax | 5.2 | 11.1 | 18.5 | 1,151 |
| Road fund tax | 1.1 | 2.0 | 6.0 | 248 |
| Withholding tax on income from immovable property | 0.9 | 0.9 | 2.7 | 164 |
| Radio and television licence fees | 0.0 | 5.4 | 0.0 | 153 |
| Eurovignette (road haulage toll) | 0.4 | 0.6 | 0.8 | 82 |
| Gift tax | 0.3 | 0.5 | 1.0 | 63 |
| Other | 0.3 | 1.2 | 2.3 | 91 |
| **2. Water charges and environmental levies** | **2.5** | **3.2** | **3.8** | **463** |
| **3. Other levies** | **0.3** | **0.8** | **22.7** | **201** |
| **Total** | **24.3** | **56.7** | **161.8** | **5,944** |

Sources : NAI, NBB.

of personal income tax. These high figures are due to the relatively substantial proceeds from registration fees, inheritance tax, motor vehicle tax and other levies such as the flat-rate regional tax and the tax on non-residential buildings.

### 2.3.2 Pattern of own tax revenues per region [1]

Taking all the federated entities together, own tax revenues increased by 3.2 p.c. per annum in real terms between 1990 and 2003. However, this increase was not uniform : while the annual average rise was only 2.1 p.c. in Flanders, it came to 3.8 p.c. in Brussels and actually reached 4.5 p.c. in Wallonia. This corresponds to a rise of 2.2 p.c. in the north and 4.3 p.c. in the south. The picture here is therefore the opposite of that presented by the rate of growth of the Finance Act funds.

These variations in the growth pattern of own tax revenues are due to the movement in the various revenue categories. In the Walloon Region, the real growth of the main sub-item, namely taxes transferred to the regions, was much higher – at 3.5 p.c. per annum – than in the other two regions where the increase was around 1.5 p.c. However, in the Brussels Capital Region this weak growth was largely offset by a considerably bigger increase in the other taxes, namely the introduction and raising of the flat-rate regional tax payable by heads of households, enterprises and self-employed persons, and a tax on non-residential buildings. Conversely, water charges and environmental levies made a smaller contribution to the growth of the budget in this region.

The movement in taxes transferred to the regions is examined in more detail below. In this connection, a distinction should be made between the period preceding 2002 and that which followed. Before 2002, the rates of certain minor taxes, such as the tax on gambling and betting, the tax on amusement machines and the withholding tax on incomes from immovable property were modified, but the effect on regional taxes in general was limited. That means that the substantial increase in those taxes as a whole over the period between 1990 and 2001 – when real growth averaged 3.6 p.c. [2] – was largely spontaneous and was due to the expansion of the tax bases in question. Nonetheless, it is clear that this growth varied greatly between the regions : in 2001, the index which stood at 100 in 1990 came to 174 in Flanders, against 149 in the Walloon Region and barely 117 in the Brussels Capital Region.

(1) To determine the movement in own tax revenues per region, the radio and television licence fee charged before 2002 is imputed to the various regions, even though at that time it actually constituted community revenue.

(2) Following adjustment for the effect of the Saint Michel Agreement, namely the decision to allocate the entire proceeds of the radio and television licence fee to the communities from 1993 onwards.

However, from 2002 onwards the regions made significant use of the greater fiscal autonomy granted to them under the Lambermont Agreement. In the Walloon Region, the impact of the tax cuts was relatively small, and in the Brussels Capital Region the effect of the reduction in the rates was entirely offset by the increase in other taxes. In the Flemish Community, on the other hand, the structural reduction came to 0.8 billion euro – or around 40 p.c. of the own tax revenues in 2001 – and 1 billion euro taking account of the non-recurring cut introduced in 2002.

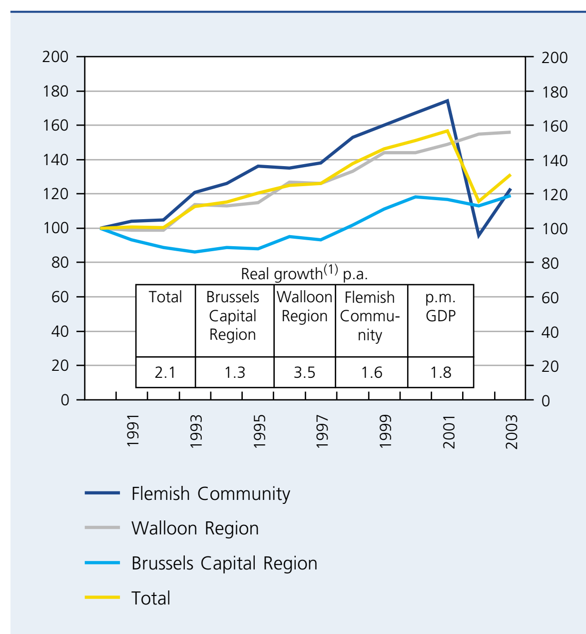
In the Flemish Community, the main measure was the introduction of a zero rate for the radio and television licence fee in 2002, and the reduction in registration fees implemented in the same year[1]. Apart from these structural measures, a non-recurring cut of 62 euro per person was also granted in respect of personal income tax payable on incomes in 2000. In practice, this reduction was implemented via the tax assessments, and its main impact on the budget was felt in 2002 (223 million euro). The budgetary impact was clearly apparent in the figures for the Flemish Community: in 2002, own tax revenues were down by 45 p.c. [2], but in 2003 they increased by 14 p.c., largely because of the absence of the non-recurring flat-rate reduction in personal income tax.

The Brussels Capital Region also introduced a zero rate for the radio and television licence fee in 2002. However, this tax cut was offset by an increase in the flat-rate tax on heads of households, enterprises and self-employed persons and an increase in the tax on non-residential buildings. In 2003, some of the inheritance tax rates were reduced and a preferential rate was introduced for housing. However, this measure was more than offset by a rise in inheritance taxes on bequests to relatives in the collateral line or to unrelated persons. In addition, the registration fees payable were reduced by 5,625 euro – or 7,500 euro in certain districts of the city – but this was partly offset by the abolition of the reduced rates for "modest" housing.

In the Walloon Region, the rates of the radio and television licence fee were reduced from 200 euro to 140 euro in 2003 for television sets and from 29.4 euro to 25 euro for car radios. The flat-rate charge for household waste was also abolished in 2003. An inheritance tax reform was introduced which had no impact on the budget: the first, tax-exempt tranche was increased to 25,000 euro for inheritances worth up to 125,000 euro per person and an adjustment was made for combined households, these measures being offset by an increase in the rate applicable to bequests in the collateral line or to unrelated persons.

**CHART 7** TAXES TRANSFERRED TO THE REGIONS

(Indices at constant prices [1], 1990 = 100)




Sources: FOD Financiën, INR, NBB.
(1) Deflated by the national consumer price index.

**TABLE 3** OWN TAX REVENUES

(Annual average percentage change at constant prices, 1991-2003) [1]

| | Walloon Region | Brussels Capital Region | Flemish Community |
|---|---|---|---|
| Total | 4.5 | 3.8 | 2.1 |
| Regional taxes transferred | 3.5 | 1.3 | 1.6 |
| Contribution made by [2]: | | | |
| Water charges and environmental levies | 0.8 | 0.3 | 0.7 |
| Other | 0.2 | 1.7 | 0.1 |

Sources: FPS Finance, NAI, NBB.
(1) Deflated by the national consumer price index.
(2) In the case of the water charges and environmental levies and other taxes, the figures are stated in terms of contributions (and not growth rates) since, in 1990, the proceeds came to zero in the majority of cases.

(1) First, the existing rates were cut by around 20 p.c. Next, the registration fees already paid can be taken into account up to a maximum of 12,500 euro, subject to certain conditions, on the purchase of a new home. Finally, for first-time buyers, the first 12,500 euro of the purchase price of a home was granted exemption.
(2) Excluding the supplementary funding made available by the Lambermont Agreement.

**TABLE 4** PRINCIPAL RECENT TAX MEASURES

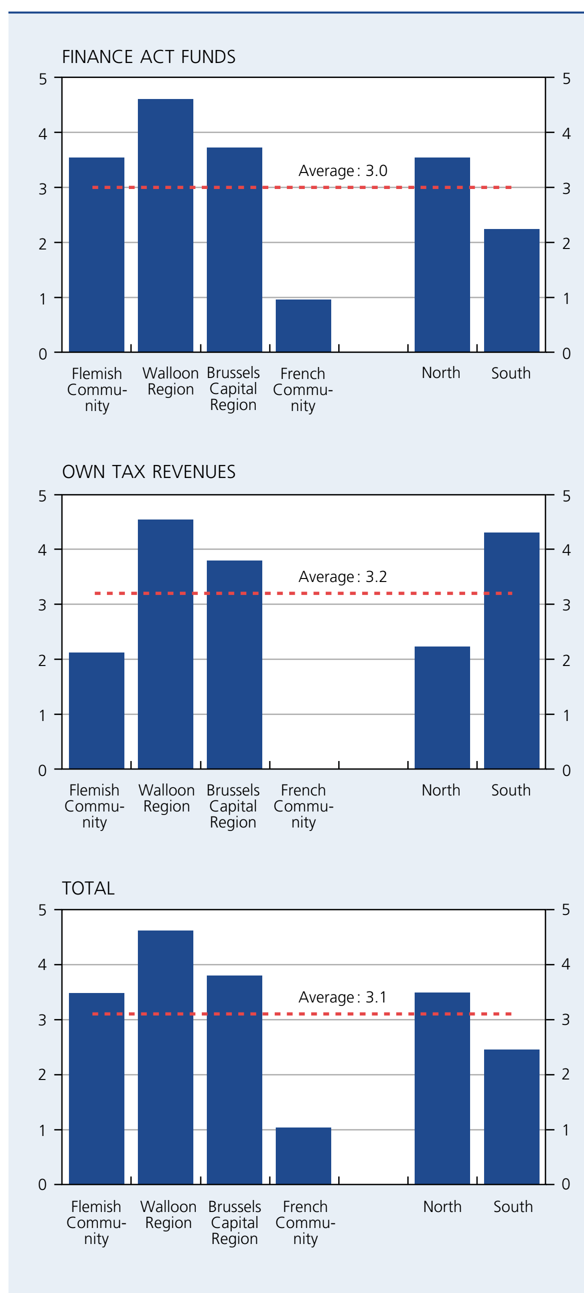
(Millions of euro)

| | Flemish Community (2002) | Brussels Capital Region (2002-2003) | Walloon Region (2003) |
|---|---|---|---|
| **A. Structural** | | | |
| Radio and TV licence fee | –455 | –63 | –19 |
| Registration fees | –367 | –11 | – |
| Inheritance tax | – | 12 | 0 |
| Other | – | 63 | –20 |
| **Total** | **–822** | **0** | **–39** |
| **B. Non-recurring cut in personal income tax** | –223 | – | – |
| **Total** | **–1,045** | **0** | **–39** |

Sources: Budgets of the communities and regions, NAI.

**CHART 8** FINANCE ACT FUNDS AND OWN TAX REVENUES

(Annual average percentage change at constant prices [1] 1991-2003)




Sources: FPS Finance, NAI, NBB.
(1) Deflated by the national consumer price index.

## 2.4 Overall view of the Finance Act funds and own tax revenues

As already demonstrated, the pattern of Finance Act funds and own tax revenues varied between 1990 and 2003 in the different federated entities. The Finance Act mechanism, consisting essentially in a switch to the allocation of resources according to the personal income tax collected, had the effect of generating much stronger growth in these resources in the north of the country, namely 3.6 p.c. in real terms, than in the south (2.2 p.c.). In recent years, this has created scope for a large reduction in own tax revenues in the north of the country while in the south the reforms had to be implemented within a neutral budget framework. The growth of own tax revenues was therefore far more modest in the north of the country (2.2 p.c. in real terms) than in the south (4.3 p.c.). However, even after the tax cuts, the Finance Act funds and own tax revenues together continued to increase, on average, by around one percentage point per annum faster in the north of the country.

## 2.5 Other revenues

Apart from the Finance Act funds and own tax revenues, the communities and regions also have various other sources of revenue. A significant part comes from transfers from other authorities, excluding the portions allocated to the federated entities out of the proceeds of VAT and the personal income tax allocated.

Transfers from the federal government came to 1,137 million euro in 2003 [1]. This mainly concerned resources granted to the regions to finance the programmes for getting the unemployed back to work. There is also a subsidy for foreign students in university education. Under the Saint

(1) Some of the grants were specified in the Finance Act, others are made pursuant to an ordinary law or annual budget laws.

Eloi Agreement of 1999, the amount of these two types of resources was substantially increased. Mention must also be made of the grant to the German-speaking Community, where financing is governed by a separate law(1). Every year, part of the profits from the National Lottery is shared between the communities. The Brussels Capital Region receives a grant to finance initiatives aimed at developing and promoting the international role and function of Brussels. The Joint Community Commission also receives a federal grant. Finally, there is the so-called "dead hand" compensation, which constitutes partial compensation payable to the Brussels Capital Region for the fact that buildings belonging to public institutions are exempt from withholding tax on income from immovable property.

Transfers from local authorities totalled 137 million euro in 2003. This mainly concerned the transfer of powers from the Brussels Conurbation to the Brussels Capital Region. The revenues of the Brussels Conurbation, consisting mainly of taxes, were in fact transferred to the revenue budget of the Brussels Capital Region which takes responsibility for all the expenditure of the conurbation.

A major part of the other revenues consists of the proceeds from the sale of goods and services, such as university enrolment fees.

## 3. Expenditure

The primary expenditure of the communities and regions increased on average by 1.8 p.c. per annum in real terms between 1994 and 2003(2). In 2003, the Flemish Community accounted for 56 p.c. of this expenditure, the French Community 21 p.c., the Walloon Region 16 p.c. and the Brussels Capital Region 6 p.c.

However, the increase in expenditure was not uniform in the various communities and regions. While the rise was very modest – just 0.3 p.c. in real terms – in the French Community between 1994 and 2003, the growth rate fluctuated between 2.1 and 2.6 in the other federated entities. This was undoubtedly related to the far weaker increase in revenues in the French Community. To sum up, since 1994 expenditure has clearly increased faster in the north, with a growth rate of 2.1 p.c. per annum, than in the south where the rise was only 1.4 p.c.

The volatility of expenditure growth measured by the standard deviation is greatest in the Walloon Region and in the Brussels Capital Region, which can be regarded as genuine regions. This is probably due to the specific character of their expenditure, a substantial part of which consists of investments, subsidies, capital transfers, etc. The French Community has the lowest volatility, the reason being that much of its expenditure consists of education spending, comprising mainly wage costs. The Flemish community, which exercises both community and regional powers, comes very close behind it.

**TABLE 5** PRIMARY EXPENDITURE OF THE COMMUNITIES AND REGIONS

(1995-2003, annual average percentage change at constant prices, unless otherwise stated)(1)

| | Percentage share(2) | Expenditure growth(3) | p.m. Standard deviation |
|---|---|---|---|
| **Communities and regions** | – | **1.8** | **1.9** |
| of which : | | | |
| Flemish Community | 56 | 2.1 | 2.2 |
| French Community | 21 | 0.3 | 1.6 |
| Walloon Region | 16 | 2.3 | 5.2 |
| Brussels Capital Region | 6 | 2.6 | 6.0 |
| **North** | **57** | **2.1** | **2.2** |
| **South** | **43** | **1.4** | **2.3** |

Sources : NAI, NBB.
(1) Deflated by the national consumer price index.
(2) In 2003.
(3) Adjusted for the main non-recurring factors.

## 4. Movement in balances and debt

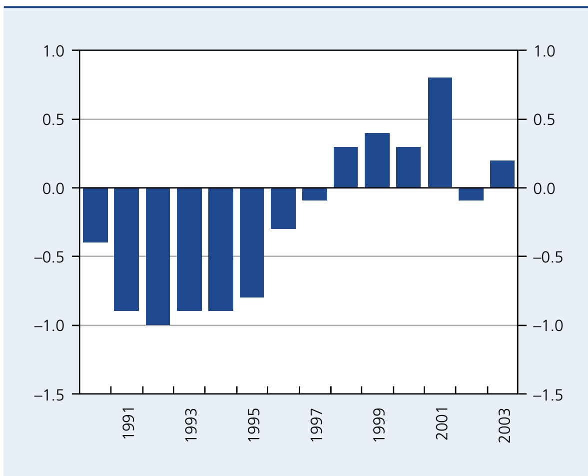
### 4.1 Movement in the balances of the communities and regions

The balance for the communities and regions as a whole increased from a deficit of between 0.4 and 1 p.c. of GDP in the early 1990s to a surplus of 0.2 p.c. of GDP in 2003.

There were two phases here. At the end of the transitional phase of the Finance Act, in 1999, the surplus stood at 0.4 p.c. of GDP. The improvement in the balance was due to the strong growth of revenues, which increased by an average of 4.3 p.c. per annum in real terms between 1990 and 1999, whereas expenditure increased by 3.1 p.c. In contrast, after 2000, in the final phase of the Finance

(1) Law of 31 December 1984 reforming the institutions of the German-speaking Community.
(2) Since 1989 the National Accounts Institute has published the accounts for the communities and regions as a whole. Accurate figures for the individual communities and regions have only been available since 1994.

CHART 9 FINANCING REQUIREMENT (–) OR CAPACITY OF THE COMMUNITIES AND REGIONS
(Percentages of GDP)

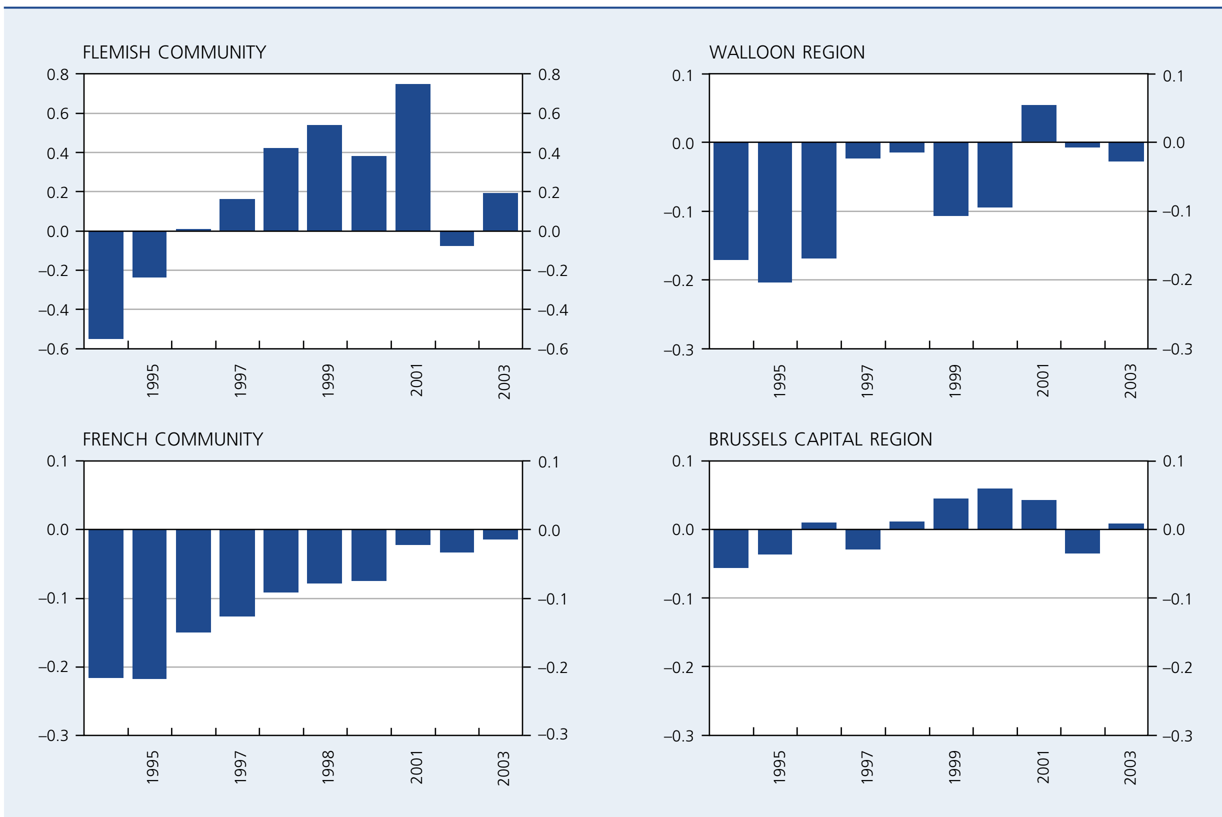



Source : NAI.

Act, the average annual growth of revenues in real terms dropped to 1.4 p.c., owing to the smaller rise in funds transferred under the Finance Act and to tax cuts applied by certain regions. Since the real expenditure growth during this period, although declining, was still 2.3 p.c., the surplus was reduced to 0.2 p.c. of GDP in 2003.

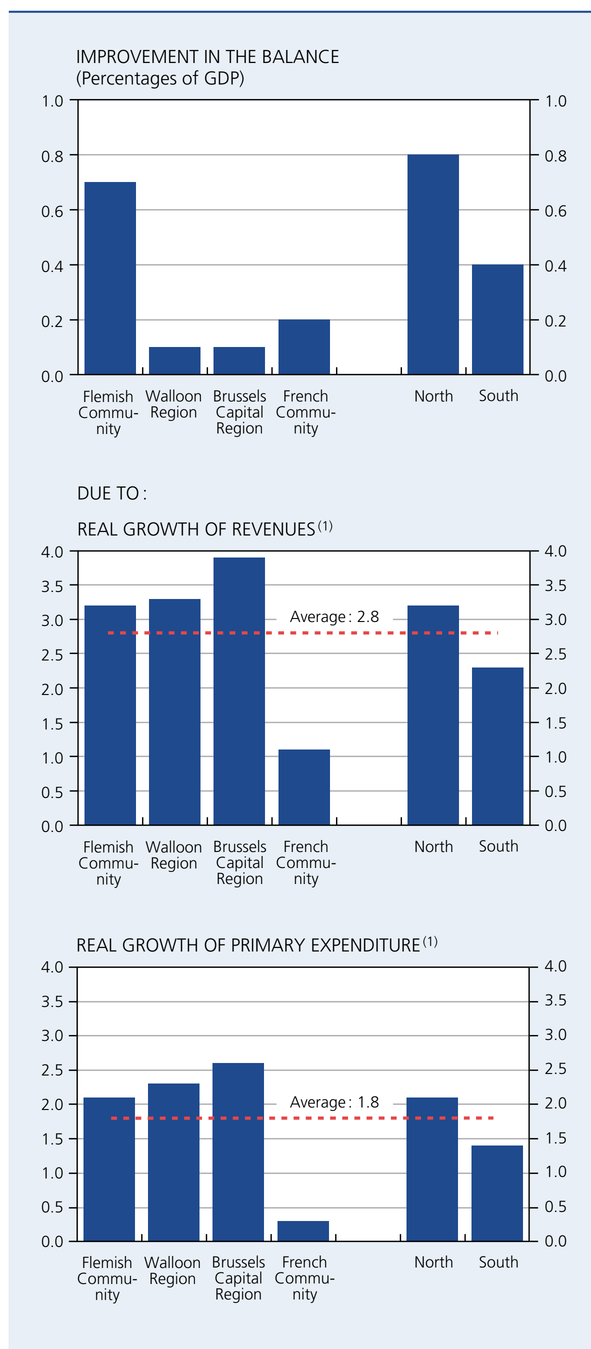
All the communities and regions succeeded in achieving a gradual improvement in their balance. The Flemish Community, which was still showing a deficit of 0.6 p.c. of GDP in 1994, recorded a budget surplus from 1996 onwards which actually came to 0.7 p.c. of GDP in 2001. Subsequently, the surplus declined to 0.2 p.c. of GDP in 2003. The French Community managed to eliminate almost the whole of its deficit, which came to just over 0.2 p.c. of GDP in 1994, so that in 2003 it recorded only a very small deficit. Much the same happened in the Walloon Region : the deficit of just under 0.2 p.c. of GDP in 1994 was subsequently cut significantly. By 2003 the Walloon Region was showing only a small deficit. Finally,

CHART 10 FINANCING REQUIREMENT (–) OR CAPACITY OF THE COMMUNITIES AND REGIONS
(Percentages of GDP)




Source : NAI.

**CHART 11** MOVEMENT IN THE BALANCES, 1994-2003




Sources : NAI, NBB.
(1) Deflated by the national consumer price index.

the Brussels Capital Region succeeded in converting its deficit into a surplus, which reached a peak in 2000. A small surplus was recorded in 2003.

The gradual improvement in the balances is due to the fact that revenues grew faster than expenditure. For the communities and regions as a whole, revenues increased by an average of 2.8 p.c. per annum between 1994 and 2003, whereas primary expenditure grew by 1.8 p.c.

In the Flemish community, the Walloon Region and the Brussels Capital Region, the real growth of revenue and primary expenditure was higher than average. In contrast, during this period, the French Community saw only a slow increase in its revenues, and the real growth of primary expenditure averaged only 0.3 p.c.

In the north, the real increase in revenues came to 3.2 p.c. between 1994 and 2003, despite the tax cuts introduced at the end of this period. This relatively favourable trend in resources during that period provided scope for relatively rapid real growth of primary expenditure, at 2.1 p.c., and also led to a relatively substantial improvement in the balance, amounting to 0.8 p.c. of GDP. In the south, where real revenues grew by 2.3 p.c., the improvement in the balance of 0.4 p.c. of GDP was only possible because the real growth of primary expenditure came to just 1.4 p.c.

## 4.2 Budget coordination between the federal government and the communities and regions

In a federal state, it is logical that each entity contributes towards the attainment of the budget targets applicable to general government. In view of this need for budget coordination, the "Government Financing Requirements" unit was created by the Finance Act within the High Council of Finance. Every year, this unit issues an opinion formulating recommendations both for general government and for each of the communities and regions.

On the basis of these opinions, budget targets were fixed until 2005 under the cooperation agreement of 15 December 2000 [1]. The basic philosophy behind these targets is that all the entities must at least achieve a balanced budget by 2010 at the latest. [2] For the Flemish Community, that entails a gradual reduction in its surplus. The other entities which were still recording deficits must eliminate them.

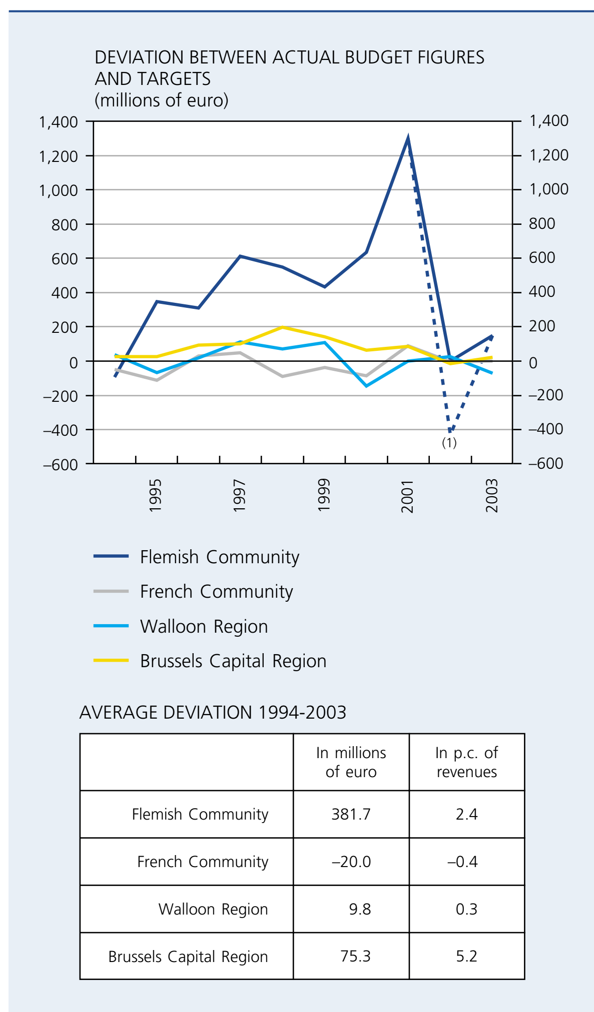
To check whether the communities and regions have met the targets set in the successive cooperation agreements, the targets are compared with the budget balances determined subsequently, as calculated by the High Council of Finance. [3]

(1) The cooperation agreement of 15 December 2000 was subsequently amended by the decisions of the Consultation Committees of the federal government and the governments of the communities and regions dated 21 March 2002, 22 September 2003 and 16 December 2003. These adjustments were mainly of a technical nature.

(2) For the regions, a small surplus is recommended, equivalent to the amount spent on loans and participating interests.

(3) The definitions used for this purpose by the High Council of Finance up to 2001 are different from the ESA balances as calculated by the National Accounts Institute and used in the other tables.

**CHART 12** ATTAINMENT OF THE AGREED BUDGET TARGETS




AVERAGE DEVIATION 1994-2003

| | In millions of euro | In p.c. of revenues |
|---|---|---|
| Flemish Community | 381.7 | 2.4 |
| French Community | –20.0 | –0.4 |
| Walloon Region | 9.8 | 0.3 |
| Brussels Capital Region | 75.3 | 5.2 |

Sources : HCF, NBB.
(1) Taking account of the balances of all the institutions which, according to the ESA, should be consolidated with general government.

Between 1994 and 2001 the Flemish community systematically beat the target – sometimes by a substantial margin. However, the picture is less clear-cut for 2002. Under the agreement of 21 March 2002 between the federal government and the communities and regions, it had been decided that the examination of the actual budgets would in future be based on the ESA methodology. For 2002, a transitional system taking account of the balances of certain institutions which, under the ESA, are consolidated with general government was applied. The balance thus calculated for the Flemish Community conformed to the agreed target. However, the agreement also stipulated that the communities and regions should not take decisions causing a deterioration in the balances of the other institutions which are consolidated with general government. Owing partly to the negative balances of those institutions, the negative deviation between the balance of the Flemish Community, according to the ESA, and the target came to 428 million euro in 2002. However, the budget outcome in 2003 was once again better than agreed.

Up to the year 2000, the French Community repeatedly failed to achieve the targets. In contrast, in 2001 it outperformed the budget target, while in 2002 and 2003 the targets were more or less exactly met. Although the Walloon Region succeeded in meeting its targets most of the time, a negative deviation in relation to the target was recorded in 2000, for instance, and in 2003. The results for the Brussels Capital Region have been systematically better than the target. The average positive deviation actually totalled 5.2 p.c. of the region's revenues between 1994 and 2003. At the end of this period, i.e. in 2002 and 2003, the balances achieved were very close to the targets.

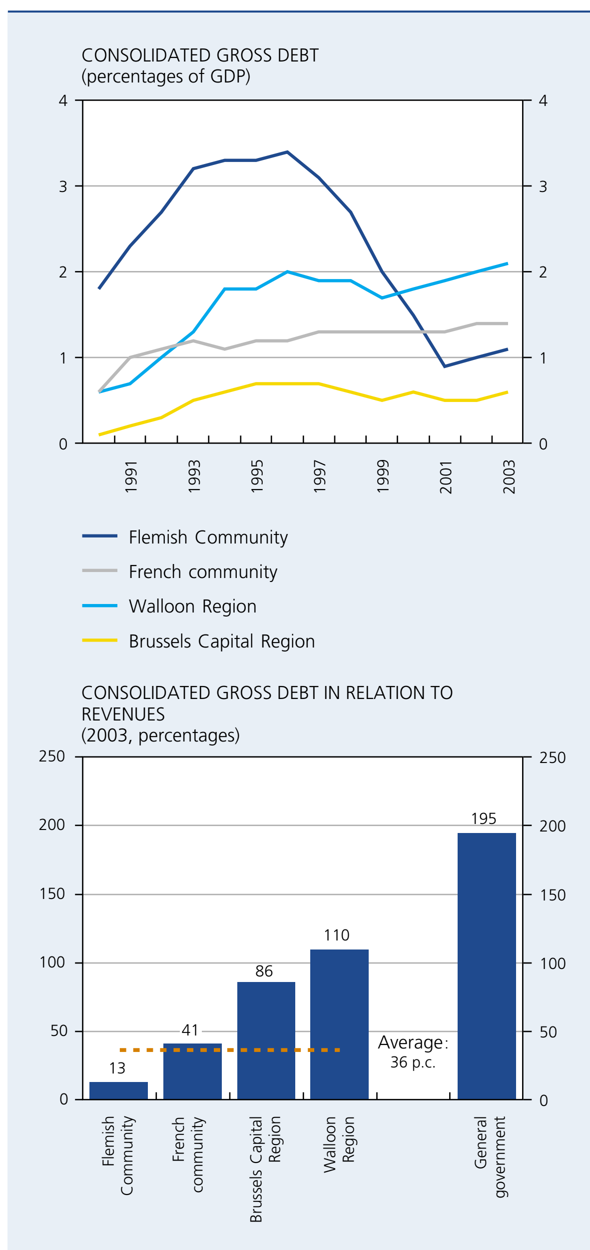
## 4.3 The debt of the communities and regions

As already stated, the debt of the communities and regions represents only a small part of the general government debt. Having risen from 3.2 p.c. of GDP in 1990 to 7.4 p.c. of GDP in 1996, this debt has since pursued a favourable trend. In 2003 the debt of the communities and regions totalled 5.2 p.c. of GDP.

This downward trend in relation to GDP is attributable to the Flemish Community, which succeeded in reducing its debt, mainly as a result of the surpluses achieved between 1996 and 2001. Its debt therefore declined from 3.4 p.c. of GDP in 1996 to 1.1 p.c. of GDP in 2003. Thus, the debt of the Flemish Community fell below the levels recorded by the French Community (1.4 p.c. of GDP) and the Walloon Region (2.1 p.c. of GDP). The debt of the Brussels Capital Region came to 0.6 p.c. of GDP in 2003.

One way of expressing the relative size of the debt is to consider it in relation to revenues. This reveals large variations in the relative size of the debt between the entities. For the Flemish Community, the debt is very small since this ratio was only 13 p.c. in 2003. For the French Community, too, the ratio is relatively low (41 p.c.). In the Brussels Capital Region the debt is relatively greater : in 2003 the ratio came to 86 p.c. Finally, in the Walloon Region the debt represented 1.1 times the annual revenues in that year. However, all these debt ratios are far lower than the level of 195 p.c. confronting general government – i.e. mainly the federal government.

**CHART 13** CONSOLIDATED GROSS DEBT OF THE COMMUNITIES AND REGIONS




Sources : NAI, NBB.

## 5. Projections

This section contains projections regarding the movement in the revenues of the communities and regions up to 2010. Assuming that all the entities at least achieve a balanced budget in 2010 – in accordance with the targets set by the High Council of Finance[1] – the permissible increase in primary expenditure can be deduced.

### 5.1 Revenue projections

Such an exercise is only possible on the basis of a whole range of assumptions regarding future developments. The main one concerns the real growth of gross national income averaging 2 p.c. between 2004 and 2010.[2] It is also assumed that the movement in personal income tax will be the same in the three regions. Finally, the calculations are based on the assumption that the rise in own tax revenues and other revenues will correspond to GDP growth[3]. The share of these revenues is particularly substantial in the Brussels Capital Region. However, the possibility of developments deviating from this assumption cannot be ruled out, especially as the regions have greater fiscal autonomy under the Lambermont Agreement. If the movement in the parameters differs from the assumptions, the results will of course also be different. The projections presented here are therefore intended purely as an illustration.

On the basis of these assumptions, the Finance Act funds will increase by an average of 1.8 p.c. per annum during this period. However, the increase varies for the individual entities. For the Flemish Community (1.9 p.c.) and the Brussels Capital Region (2.2 p.c.) this revenue growth will be greater, while it will be less for the French Community (1.5 p.c.) and the Walloon Region (1.6 p.c.).

These divergences are due to various factors. As already stated, the formula for allocating the resources transferred to the communities in respect of VAT will gradually change, all other things being equal, in favour of the Flemish Community and to the detriment of the French Community. For the allocation of the supplementary funding granted under the Lambermont Agreement, there will in fact be a gradual switch to the proceeds of personal income tax.

There is also the effect of the "negative term". This refers to the reduction in the personal income tax transferred to the regions to offset the new tax transfers to the regions since 2002. The change in this negative term is linked to

(1) For the regions, a small surplus is recommended equal to the amount of expenditure in the form of loans and participating interests. For the French Community, allowance is made for the achievement of a surplus of 100 million euro by 2010, as specified in its debt reduction plan (decree of 19 December 2002).

(2) These calculations are also based on the assumption of an average annual increase of 1.75 p.c. in the national consumer price index, and on the population forecasts of the National Statistical Institute and the Federal Planning Bureau. For the number of pupils per community, the ratios were taken as those applicable in 2004. On the basis of the change in the number of pupils over the past decade and the expected demographic trend, however, there is a possibility that the trend in the number of pupils will be slightly more favourable in the French Community than in the Flemish Community.

(3) With the exception of the allowances for getting the unemployed back to work – for which nominal amounts apply – and the allowances for foreign students, which are only adjusted in line with inflation.

**TABLE 6** PROJECTIONS FOR PRIMARY EXPENDITURE GROWTH, 2004-2010 : COMMUNITIES AND REGIONS

| | Flemish Community | French Community | Walloon Region | Brussels Capital Region | North | South | Total |
|---|---|---|---|---|---|---|---|
| Change in the balance (percentages of GDP) (1) | –0,2 | 0,1 | 0,1 | 0,0 | –0,2 | 0,1 | 0,0 |
| Real growth of revenue (2) | 1,9 | 1,5 | 1,6 | 2,0 | 1,9 | 1,6 | 1,8 |
| of which : | | | | | | | |
| Finance Act funds | 1,9 | 1,5 | 1,6 | 2,2 | 1,9 | 1,5 | 1,8 |
| **Real growth of primary expenditure (2)** | **2,3** | **1,4** | **1,3** | **2,1** | **2,3** | **1,4** | **2,0** |

Sources : HCF, NAI, State revenue and resources budget, NBB.
(1) Change necessary to achieve HCF targets for 2010.
(2) Deflated by the national consumer price index (assumption : 1.75 p.c.).

91 p.c. of GNI growth ; the compensation for the radio and television licence fee is only linked to inflation. Since the initial amount of the personal income tax transferred is linked to the real growth of GNI and the inflation rate, and the negative term arrived at by deducting this initial amount increases more slowly, the amount ultimately granted to the federated entities will increase faster than GNI. This effect is particularly favourable to the Brussels Capital Region ; the reason is that the negative term is relatively large there, since the supplementary taxes transferred to the regions in 2002 were greater there, in relative terms, than in the other regions.

Finally, there is the effect of the solidarity allowance. The Finance Act stipulated that, in real terms, the amount of this allowance depends on the difference in level between the personal income tax paid per capita in each region. Since this projection assumes that the movement in personal income tax will be the same in the three regions, that implies that there will be no increase in the real amount of the solidarity allowance. That is in contrast to the rest of the part of personal income tax allocated, which will increase by slightly more than GNI in real terms. Since, for the Walloon Region, this solidarity allowance represents over a quarter of the revenues provided under the Finance Act,[1] that will substantially reduce the real increase in those revenues.

As a result of all these factors, the Finance Act funds will increase by an average of 1.9 p.c. per annum in the north between 2004 and 2010, while in the south the increase will be only 1.5 p.c..

## 5.2 Projected growth of primary expenditure

On the basis of the approach adopted, it is possible to deduce that the real growth of primary expenditure for all the communities and regions can average 2 p.c. per annum between 2004 and 2010. That figure corresponds exactly to the assumption made for the growth of GDP at constant prices and the real GNI growth over the same period. In other growth scenarios, too, the increase in expenditure would continue to correspond to the expansion of economic activity.

For the Flemish Community, primary expenditure can grow by 2.3 p.c. in real terms. Since revenue growth will be very slightly less than GDP growth, this relatively strong rise is attributable to the scope available to the Flemish Community for reducing its surplus. For the Brussels Capital Region, primary expenditure can grow by 2.1 p.c. per annum in real terms, corresponding to the expected increase in Finance Act funds. In contrast, for the French Community and the Walloon Region, primary expenditure can grow by only 1.3 and 1.4 p.c. in real terms. This is due to the relatively weak revenue growth of these entities combined with the need for a further reduction in their deficits. To sum up, for the period 2004-2010, real growth of primary expenditure totalling 2.3 p.c. per annum is possible in the north, while in the south the increase will be only 1.4 p.c.

(1) In 2003 the solidarity allowance came to 27 p.c. of the personal income tax transferred to the Walloon Region (after deduction of the negative term). For the Brussels Capital Region, the figure was 17 p.c.

## Conclusion

The past decade has seen a systematic improvement in the financing balance of the communities and regions, mainly as a result of the strong revenue growth. During the transitional period which ended in 1999, the special mechanisms provided under the Finance Act contributed towards a very steep increase in the funds allocated in respect of personal income tax. For the communities and regions as a whole, the rise in expenditure equalled that recorded by general government.

As regards the part of personal income tax allocated to the communities and regions, the gradual switch to an allocation formula based on the proceeds of the personal income tax collected in each entity caused the Finance Act funding to rise faster in the north than in the south of the country. This enabled the north to implement substantial tax cuts recently, while the tax reforms introduced in the south of the country had a much smaller impact. Since revenues have grown faster than expenditure over the past ten years in each entity – with expenditure rising by more in the north than in the south of the country – all the communities and regions succeeded in achieving an improvement in their financing balance.

In order to achieve the target of a balanced budget in 2010, set by the High Council of Finance, the increase in expenditure for the communities and regions as a whole must not outpace GDP growth. The permissible expenditure growth will probably not be the same for each individual entity. In the north, expenditure can increase by slightly more than in the south, partly because the north has scope for gradually reducing its surplus, while in the south the deficits – albeit small – need to be eliminated.