Re-Bel Noon Exchange

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Reforming the Special Finance Act:

How they tried,
Why they failed

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Summary

1. Warming up: overview of SFA
2. Review of the main events
3. Perceived problems and disagreements (discussion)

1. Warming up: overview of SFA

Regions	Communities
regional taxes	no community taxes
part of PIT revenue	part of PIT revenue
	part of VAT revenue
(other) grants	(other) grants
borrowing	borrowing

1. Warming up: overview of SFA

	Brussels	Wallonia	French Community	Flanders Region +Com
Millions of € 2010				
Regional taxes	1195	2218		4099
Part PIT to Regions	858	3358		5519
Part PIT to Communities			1943	3694
Part VAT to Communities			5498	7452
Other grants and revenues	219	800	587	1844
Total	2272	6376	8028	22609
in % of total revenues				
Regional taxes	53	35		18
Part PIT to Regions	38	53		24
Part PIT to Communities			24	16
Part VAT to Communities			68	33
Other grants and revenues	10	13	7	8
Total	100	100	100	100

1. overview of SFA – Fiscal autonomy

- how large is the fiscal autonomy today?
  - regions or communities?
  - numerator:
    - actual revenues
    - or potential revenues?
- recent estimation by CERPE:
  - Wallonia 49%
  - Flanders 62%
  - Brussels 63%
- see discussion Q1: fiscal autonomy

1. overview of SFA – grants

Federal revenues (billion €)

PIT: 32,2

VAT: 25

Exc: 7

Corp: 12

Soc Sec: 45

12,4
(38,4%)

Basic PIT grant

1,1

+ solidarity

- 4,1

- Neg Term

5,6
(17,4%)

PIT Grant

(BXL: +90 million for COCOM; 24 million COCOF & 6 million VGC)

VAT: 11,5

VAT Grant

1,2

Lambermont

9,3

Without solidarity:
25,8% of PIT

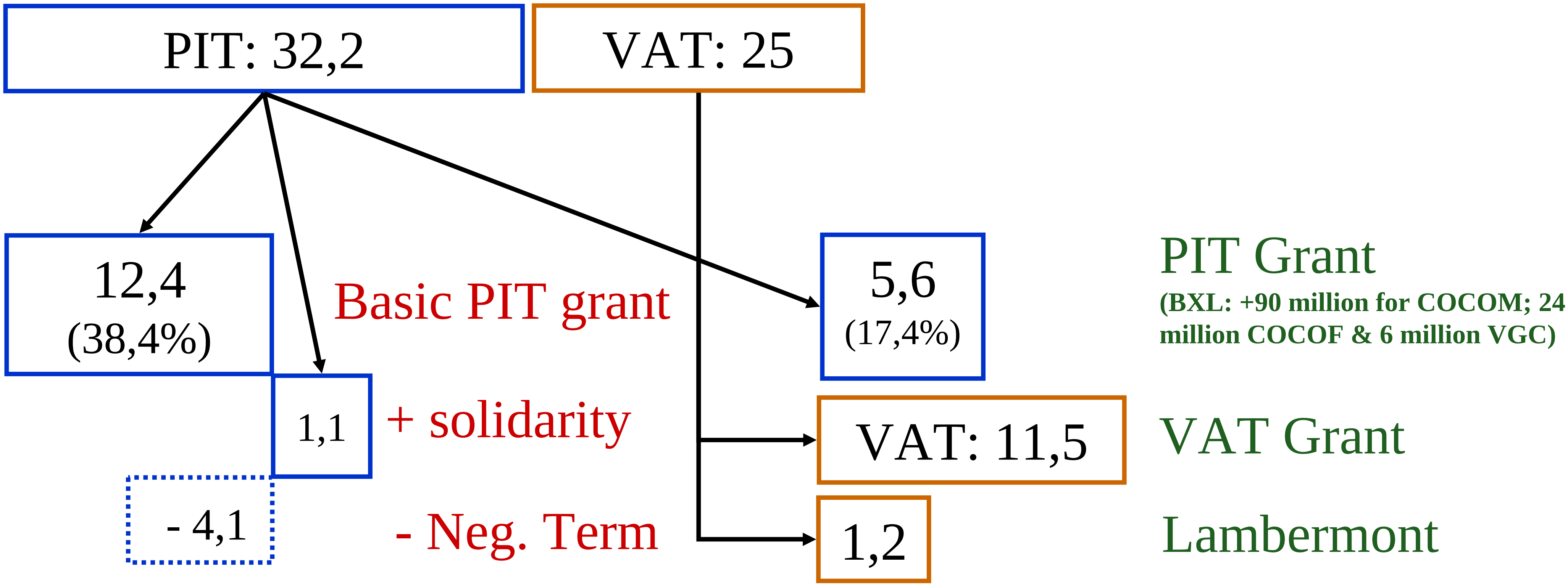
18,3

3 regions

2 communities

1. overview of SFA – grants

Federal revenues (billion €)



Two questions:

1. How do the (joint) grants evolve over time? (vertical)
2. How are the joint grants allocated to regions and communities (horizontal allocation)

1. overview of SFA – grants

- grants have been fixed historically
- indexed with CPI and federal growth
  - see Q4: elasticity >1 stays at federal level
- global
  - makes the regional revenues interdependent
- horizontal allocation with two rules:
  - regional contrib. to PIT rev. (“Juste Retour”)
  - needs criterion (for VAT grant)

1. overview of SFA – horizontal allocation

	FLA	WAL	BXL
Population (% 31/12/78)	56,9	32,7	10,3
Size (% 1978)	44,3	55,2	0,53
PIT Revenues (% AJ 77)	55,2	30,1	14,6

- 1970: average of the 3 percentages

1978:	52,1	39,4	8,5

- 1989: transition towards PIT for PIT-grant
  - gradual: 1989-1999

1. overview of SFA – horizontal allocation

- horizontal allocation 2009

	FLA	WAL	BXL
p.m.: 1978	*52,1*	*39,4*	*8,5*
		2009	
Population (%)	57,8	32,5	9,7
PIT Revenues (%)	63,3	28,3	8,4

- Q2: reponsability: more Juste Retour?

1. overview of SFA – solidarity

- horizontal allocation 2009

	FLA	WAL	BXL
p.m.: 1978	*52,1*	*39,4*	*8,5*
		2009	
Population (%)	57,8	32,5	9,7
PIT Revenues (%)	63,3	28,3	8,4
PIT revenues/capita (€)	3335	2657	2628
PIT revenues/cap. (Belgium=100)	109,5	87,2	86,3

1. overview of SFA – solidarity

	FLA	WAL	BXL
deviation (in %-points)	+9,5	-12,8	-13,7

- amount: 18,3 € per person

	WAL	BXL
x	12,8	13,7
=	234 €	251 €
x	Population	
	803 million	259 million

- 18,3: indexed with CPI, but not with real income growth

1. overview of SFA – solidarity

Year	BEL	FLA		WAL		BXL	
	PIT/cap	PIT/cap	Dev (%)	PIT/cap	Dev (%)	PIT/cap	Dev (%)
1989	1576	1614	**2,4**	1443	**-8,5**	1793	**13,8**
1990	1606	1657	**3,2**	1454	**-9,4**	1807	**12,5**
1995	2061	2180	**5,8**	1824	**-11,5**	2157	**4,6**
1996	2099	2234	**6,4**	1856	**-11,6**	2116	**0,8**
2000	2523	2705	**7,2**	2223	**-11,9**	2442	**-3,2**
2001	2639	2840	**7,6**	2309	**-12,5**	2543	**-3,6**
2002	2795	3023	**8,2**	2420	**-13,4**	2686	**-3,9**
2003	2947	3208	**8,9**	2539	**-13,9**	2757	**-6,4**
2004	2972	3242	**9,1**	2563	**-13,7**	2726	**-8,3**
2005	2935	3203	**9,1**	2546	**-13,3**	2640	**-10,1**
2006	2764	3038	**9,9**	2351	**-14,9**	2505	**-9,4**
2007	3046	3335	**9,5**	2657	**-12,8**	2628	**-13,7**
2008	3211	3527	**9,8**	2792	**-13,1**	2737	**-14,7**

1. overview of SFA – solidarity

		WAL		BXL	
	Basic Amount (€)	Deviation (%)	Amount (mio €)	Deviation (%)	Amount (mio €)
1990	12,4	-9,4	**377,8**	12,5	**-**
1995	14,0	-11,5	**531,8**	4,6	**-**
1997	14,5	-11,1	**528,3**	-0,2	**3,0**
1998	14,6	-11,5	**559,0**	-2,0	**27,1**
2000	15,2	-11,9	**601,6**	-3,2	**46,6**
2003	16,0	-13,9	**747,2**	-6,4	**101,1**
2004	16,4	-13,7	**758,0**	-8,3	**134,2**
2005	16,8	-13,3	**754,2**	-10,1	**169,2**
2006	17,2	-14,9	**869,1**	-9,4	**161,6**
2007	17,5	-13,0	**885,6**	-12,9	**164,7**
2008	18,3	-12,8	**802,7**	-13,7	**258,7**

- Q3: solidarity too large?

1. overview of SFA – negative term

12,4	Basic Grant
1,1	+ solidarity
- 4,1	- Negative Term

- Compensation for fiscal competences transferred in 2001
- Big amount
  - Indexed with CPI and 0,91 of real growth
- Especially important for BXL:

1. overview of SFA – 'perverse' effect

million €	FLA	WAL	BXL
Basic Grant	7843	3509	1042
Negative Term	-2564	-1083	-495
Solidarity	-	803	259
Total	5279	3228	805
Per capita (€)			
Basic Grant	1282	1021	1010
Negative Term	-419	-315	-480
Solidarity	-	234	251
Total	863	940	781

1. overview of SFA – Communities

Basic Grant PIT	PIT: 5,6		
Basic Grant VAT		VAT: 11,5	
Lambermont			1,2

- Basic Grant PIT:
  - Indexed with CPI and growth
  - horizontal allocation:
    - PIT revenue (Juste Retour)
    - PIT BXL: 20% Fl. Com. Fl. – 80% Fr. Com.
  - No solidarity mechanism

1. overview of SFA – Communities

Basic Grant PIT	PIT: 5,6		
Basic Grant VAT		VAT: 11,5	
Lambermont			1,2

- Basic grant VAT:
  - Indexed CPI and "needs criterion"
  - 0,80 of population growth < 18 (highest growth rate of the two communities)
  - 2007: indexed with 0,91% of real growth
  - horizontal allocation: number of pupils (6-17)
- Lambermont: juste retour

1. Warming up: overview of SFA

1. Grants versus fiscal autonomy
2. horizontal allocation
   - Juste Retour for PIT (15 bn)
   - needs criterion for VAT
3. Important solidarity mechanism
   - ≠ interpersonal solidarity
4. Negative Term (important for BXL)

Summary

1. Warming up: overview of SFA
2. Review of the main events
3. Perceived problems and disagreements (discussion)

2. Review main events

1. High Level Group
2. Note De Wever
3. Calculations National Bank
4. Note Vande Lanotte
5. ...

2. Review – 12 Principles High Level Group

1. Financiële bevoegdheden van de entiteiten significant verhogen
2. Deloyale fiscale concurrentie vermijden
3. Behoud regels progressiviteit belastingsschalen
4. Geen structurele verarming van één van de deelstaten
5. Verzekeren leefbaarheid federale staat en behoud van zijn fiscale prerogatieven
6. Versterken responsabilisering met link naar bevoegdheden en handelen, rekening houdend met verschillende startpositie en diverse parameters
7. Rekening houden specifieke situatie Brussel en sociologische realiteit
8. Gemeenschappen: rekening houden met bevolking- en leerlingenaantallen
9. Behoud solidariteit tussen entiteiten; wegwerken perverse elementen
10. Financiële stabiliteit van de entiteiten garanderen
11. Evenwicht globale overheidsfinanciën bewaren
12. Verifiëren van de pertinentie van de simulaties

2. Review – Note De Wever

- replaces PIT-grant (R & C.) by Regional PIT
  - by means of genuine ‘split rate’ (as opposed to tax credit)
  - taxable income: jointly determined
  - Comm. partly financed from Regions
- not explicit about level of rate
  - confusion about estimated revenues
- progressivity mentioned, but unclear
- solidarity mechanism
  - in terms of taxable income/capita
  - closing gap between 60% and 80%
    - leads to WAL: 52€/capita and BRU: 194€/capita

2. Review – Note Vande Lanotte

A. Financing of the Regions

- Existing grants based on PIT (EUR 13 bn)

  \+ to be transferred tax expenditures (EUR 2 bn)

  = replaced by Regional tax on PIT basis

- Tax basis : federal level

  Tax brackets : Regions

  Tax rates : Regions

- (with unchanged policies)

  = 26.7% of total notional PIT receipts

  = 40% of total effective PIT receipts

  (after tax reductions & credits)

2. Review – Note Vande Lanotte

A. Financing of the Regions

- is *not* a split rate
  - federal rates unchanged
  - federal tax credit to compensate for regional PIT
  - autonomous regional PIT

federal	26,22% used for tax credit	regional
25	6,56	6,56
30	7,87	7,87
40	10,49	10,49
45	11,80	11,80
50	13,11	13,11

2. Review – Note Vande Lanotte

A. Financing of the Regions

- Constraints :
  - Progressivity cannot be reduced
  - “Tax snake” of 25% w. r. t. what a taxpayer would have paid
  - Responsibility for impact of tax expenditures on CO_2 emissions
  - Transition over 20 years
    - *Equalization transfer in year T+1 such as no loss*
    - *Constant current amount until T+10*
    - *Gradual cut over T+11 / T+20*

A. Financing of the Regions

- Comments

"Micro-tax adjustment" system:

- if Federal cuts professional outlays, higher tax basis leading (with unchanged Regional rates) to higher Regional receipts, to be paid back to the Federal
- Sharing of elasticity gains
  - *effect PIT=f(Taxable Income) => stays at federal level*
  - *effect Taxable Income=f(GDP) => compensated by correcting individuals i Taxable Income (GBI) as follows:*

$$GBI_i^* = GBI_i \times \frac{growth\ GDP}{growth\ GBI}$$

2. Review – Note Vande Lanotte

A. Financing of the Regions

- Comments
  - use of macro and historical parameters renders individual tax liability hard to predict and complex
  - Corporate taxation remains federal (but 3% tax credit)
  - Progressivity = major brake on tax competition on higher incomes
  - PIT may not reflect the effective tax contribution of a given Region
  - Criterion = Residence vs. work
  - Expected favorable composition effects accruing to debt reduction

    (tax basis increased more rapidly than GDP)

2. Review – Note Vande Lanotte

A. Financing of the Regions

- New competences
  - Through grants
  - To be converted into additional Regional PIT
  - Up to 50% of effective PIT receipts
  - Legitimacy for tax basis as Federal under pressure

2. Review – Note Vande Lanotte

A. Financing of the Regions

- New solidarity mechanism
  - 80% of tax basis gap
  - To be paid by Federal, not by richer Region

  - Comments :
    - *less than 80% of tax receipts gap due to progressivity*
    - *less generous than current system at time T_0 but indexation*

2. Review – Note Vande Lanotte

B. Financing of the Communities

- VAT part
  - Both basic amount & Lambermont indexed to inflation, birth rate, and 91% of real growth
  - With from 2016 onwards average birth rate at 100% instead of most favorable birth rate at 80%

- PIT part
  - Sharing based on effective PIT revenue for the Federal
  - i.e. no impact of use by a Region of its autonomy on the financing of “its” Community

2. Review – Note Vande Lanotte

B. Financing of the Communities

- New competences – child allowances (EUR 5.6 bn)
  - *Current average amount per Community indexed and adjusted for children between 0 and 18*

Comments :

- *Responsibility w.r.t. unemployment*
- *Responsibility w.r.t. education after 18*
- *No link with real growth*

2. Review – Note Vande Lanotte

B. Financing of the Communities

- New competences – elderly care (EUR 2.8 bn)
  - *Each Community receives current amount with indexation on nominal GDP and number of 65+*

Comments :

- *“needs” criterion*
- *65+ vs. 80+ : impact on total outlays*
- *65+ vs. 80+ : not identical for both Communities*

2. Review – Note Vande Lanotte

B. Financing of the Communities

- New competencies – health care (EUR 0.5 bn)
  - *Indexation on nominal GDP*
  - *Shared on the basis of tax contribution*

Comments :

- *“juste retour” criterion*
- *impact on total outlays (real growth below current health care norm)*

2. Review – Note Vande Lanotte

B. Financing of the Communities

- New competencies – justice (EUR 0.6 bn)

  p.m.

- Transition over 20 years

  Cf. Regions

2. Review – Note Vande Lanotte

C. Financing of Brussels

- Adjustment for commuters
  - *computation of net inflow of commuters (NI)*
  - *computation of average regional tax paid in Brussels (AT)*
  - *Compensation for 15% of AT * NI*

- Comments
  - *No split of what is paid by a given taxpayer between residence and work*
  - *Brussels only*
  - *15%*
  - *Use of average tax, while commuters may have higher income*
  - *Paid by Federal, home Region receives 100%*
  - *Indirect impact on computation of "juste retour"*

2. Review – Note Vande Lanotte

C. Financing of Brussels

- Adjustment for international civil servants
- Bonus for bilingual civil servants

2. Review – Note Vande Lanotte

D. Contribution to sustainability

- Partial take-over of the pension bill of R & C civil servants
- Idea of a 10% linear cut in means to be transferred

E. Miscellaneous

- Federal bonus for Regions with higher than expected increase in employment rate
- Deductibility of Regional tax on trucks & company cars
- ...

Summary

1. Warming up: overview of SFA
2. Review of the main events
3. Perceived problems and disagreements (discussion)

3. Discussion

1. Fiscal autonomy
2. More responsibility
3. Perverse effects and degree of solidarity
4. Brussels
5. Financial sustainability

3. Discussion 1) Fiscal autonomy

- Can we agree to leave out Communities from fiscal autonomy due to Brussels?

- why ask for more fiscal autonomy?

  - as current room for maneuver far from fully utilized
  - presumed behavioral reaction of policy makers?
  - accountability?
  - other?

3. Discussion 1) Fiscal autonomy

- Propositions:
  - ‘Split rate’
    - advantages:
      - *Visibility*
      - *Accountability*
    - problems:
      - *Complexity*
      - *Federal loses elasticity bonus (partially)*
      - *Risk of no agreement on tax reform*
      - *Loss of room for urgency tax revenue increase*
      - *Economic theory: vertical externalities*
  - Increase margin for proportional surcharges (“centimes additionels” or “soutractionels”/ op- en afcentiemen)
  - Others ?

3. Discussion 2) Responsibility

- Difference between ‘juste retour’ and ‘responsibility’

  Ill.: oil discovery in one Region

- Already significant through ‘Juste Retour’?

- Why does one want further increase?
  - based on evidence of behaviour?
  - what is Region responsible for? how to measure?
  - agree that development trap is exaggerated ?
    - High economic growth rate correlation across Regions ?
    - Policies driven by common good ?

3. Discussion 2) Responsibility

- if further increase necessary
  - => also 'Juste Retour' in grant for Communities?
  - or more evident reforms to reach objective:
    - pension contribution Regions and Communities?
    - tax expenditures (mortgage, environment, ...)?
    - labour market performance?
    - grant as % of revenues? which revenues?

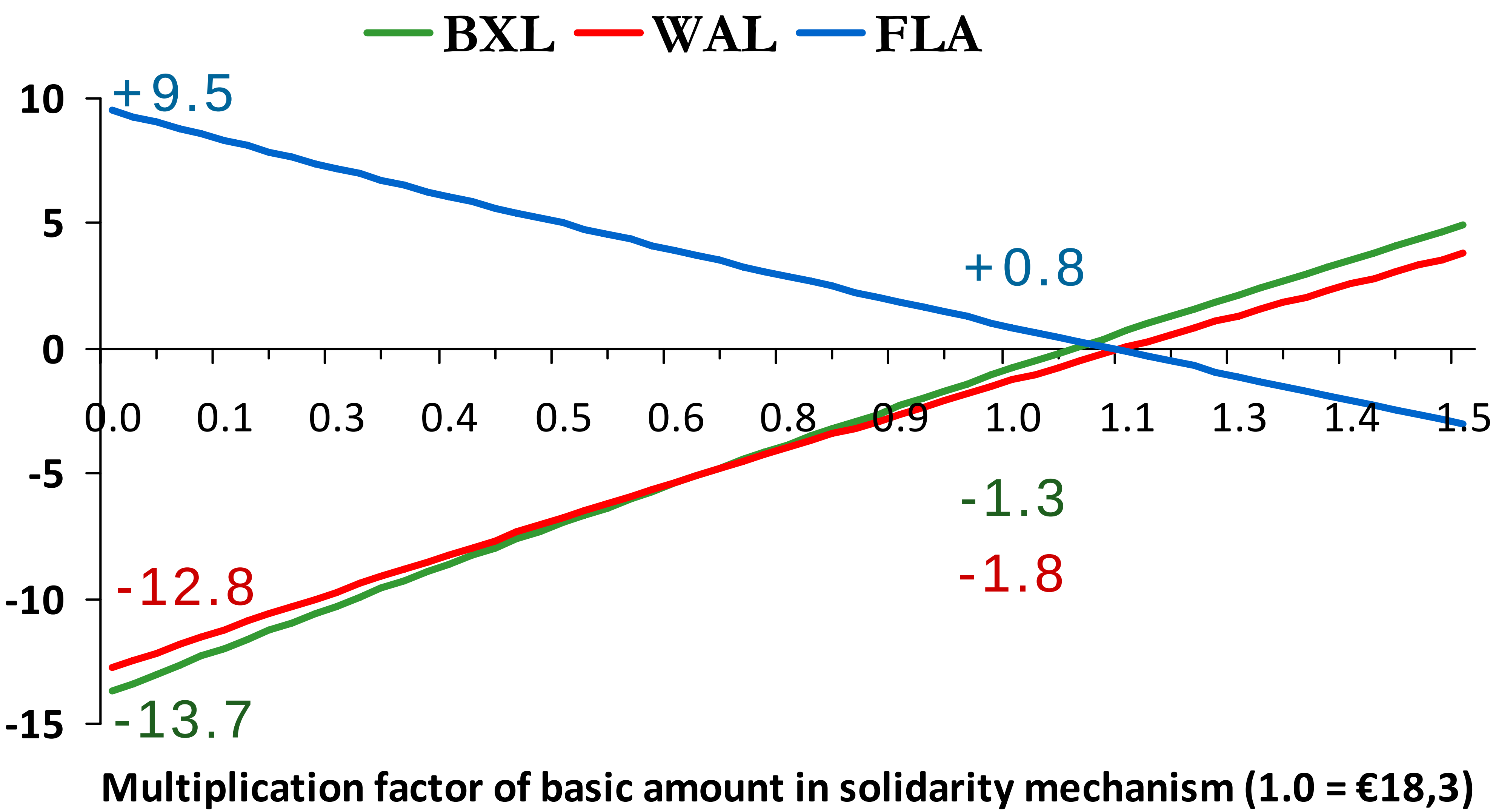
      problems: elasticity bonus? is not fiscal autonomy

3. Discussion 3) pervers effect; solidarity

- Any reason why one would not be prepared to remove negative term?
- Can we agree on general principle that no (or as few as possible) historical elements should be built in a new SFA?
- Should the “compensation for PIT as biased indicator of juste retour” be removed from the solidarity mechanism ?
- Should it be paid directly by the richer Region ?
- Is the solidarity excessive? see following graphs:

3. Discussion 3) pervers effect; solidarity

Deviation in %-points of regional revenues per capita compared to federal average, for varying degrees of solidarity, **before negative term**



3. Discussion 3) pervers effect; solidarity

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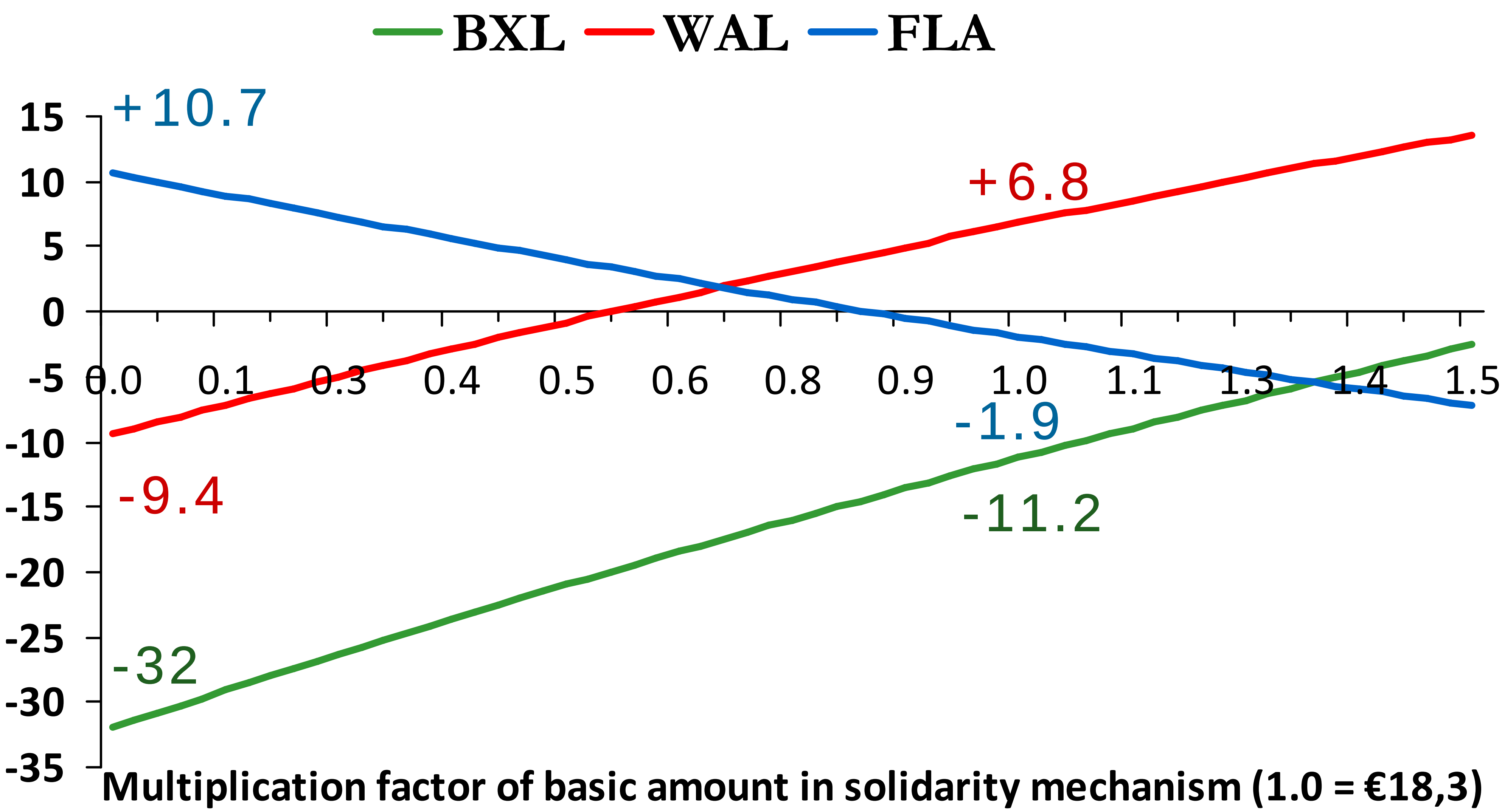


3. Discussion 4) Brussels

- Should commuting be taken into account ?
- If yes, any reason not to split taxes paid by each commuting taxpayer ?
- Why not to look abroad about the percentage for sharing commuters' taxes ?
- Should other factors ("main morte", ...) be taken into account and, if yes, how ?
- Should the leakage between PIT and corporate taxes, deemed more acute in Brussels, be taken into account ? (cf. W. Moesen)
- Should the 80/20 rule be revisited ?

3. Discussion 5) financial sustainability

- Grants indexed with federal growth

  => elasticity >1 goes to federal level

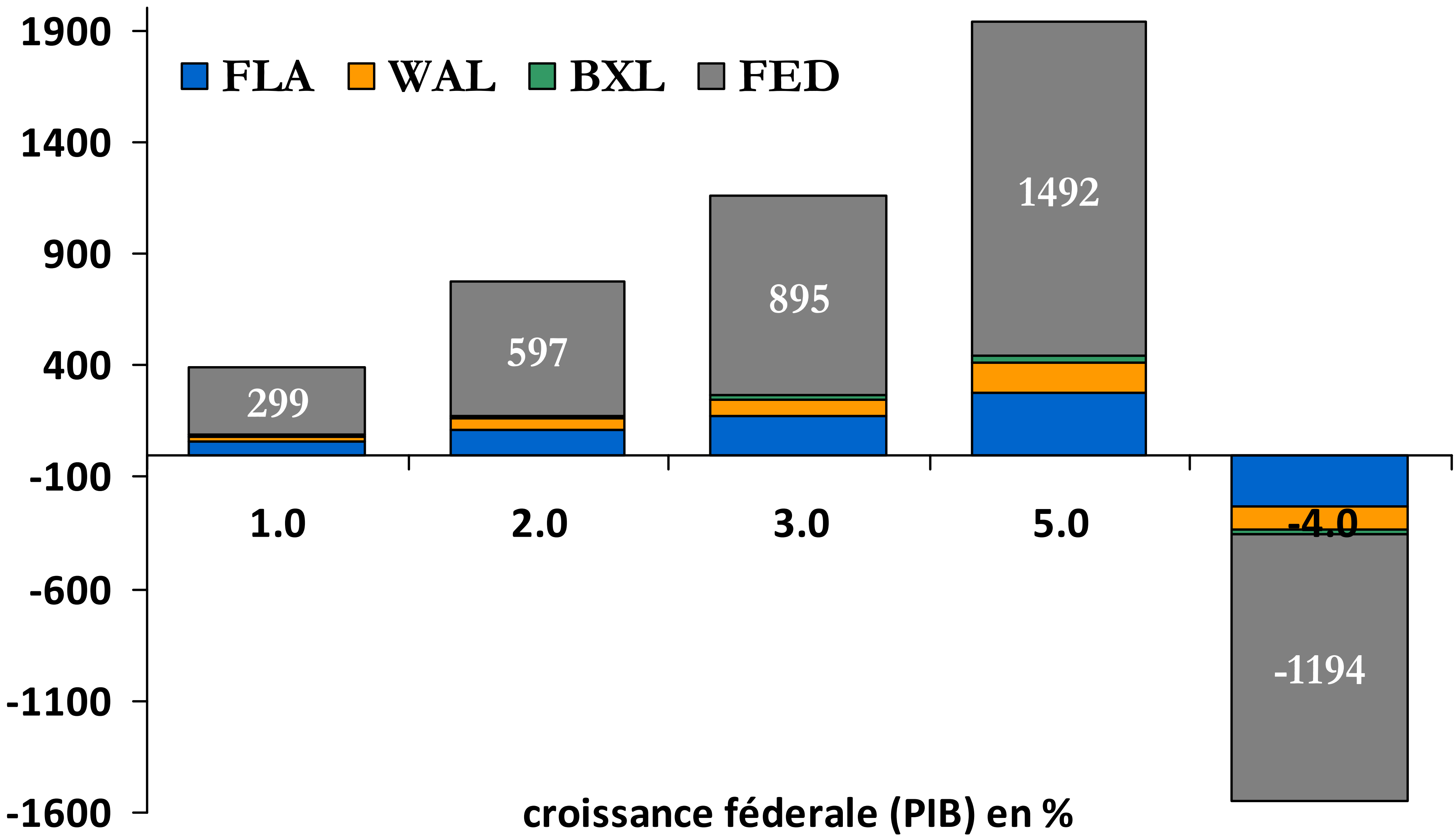
- Empirical size of this elasticity? For how long ?
- Who should enjoy the elasticity ?
- If more money accrues to Brussels, who should pay for it ?
- Should transfers of new competences be fully financed ?
- Regarding current arrangements, should R & C contribute more to fiscal sustainability ?

3. Discussion 5) financial sustainability

- complexity if one wants to compensate
  - new negative term in proposal Frank VDB
  - partial transfer of budget with new competences
  - complex adjustment in proposal VDL: has complexity to be avoided as such?
  - other ways to make Regions contributing in federal financial sustainability? pension contribution?

3. Discussion 5) financial sustainability

Croissance recettes fiscales (mio €) aux taux différents, élasticité 1,2



Conclusion

- Reformed SFA must be possible
  - political choice on size of solidarity
  - remove perverse effect (negative term)
  - guarantee federal finances

- Isn’t the major problem a political one:
  - how important is “federal”?
  - who represents ‘federal’ in negotiations?