

Promoting fiscal discipline in a federal country: the mixed track record of Belgium's High Council of Finance

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Structure of the presentation

- 1. High Council of Finance: an introduction**
- 2. Belgian public finances**
- 3. Impact of the Council's recommendations**
- 4. Proposals to strengthen the Council's effectiveness**
- 5. Concluding remarks**



Belgium's High Council of Finance: an introduction



The High Council of Finance

- ▶ Belgium has two fiscal councils in the sense of Debrun et al (2009)
 - **National Accounts Institute:** independent macroeconomic projections for the budget (in practice prepared by Federal Planning Bureau)
 - **High Council of Finance:** independent assessments of and recommendations for budgetary policy

- ▶ High Council of Finance: long history, established in 1937
 - broad mandate but at first compromised by political interference
 - reformed several times over the years (1967, 1981)
 - 1989 reform: against the background of transition to a federal state
 - creation of section 'Public Sector Borrowing Requirements'
 - specific competences for fiscal coordination between federal government and regions and communities ('federated entities')(Special Law of 16 January 1989 on the financing of regions and communities)
 - 2006 reform (after short hiatus): current structure and mandate (Royal Decree of 3 April 2006 on the High Council of Finance)



The High Council of Finance (2)

- ▶ chaired by Minister of Finance, two Deputy-Chairmen (among which the Governor of the National Bank of Belgium)
- ▶ 24 members, five-year renewable terms
 - 12 proposed by federal Ministries and other 'federal' institutions (National Bank of Belgium, Federal Planning Bureau)
 - 12 proposed by governments of regions and communities
- ▶ Bureau: prepares and organises the work but in practice large degree of autonomy for sub-entities
- ▶ current structure: two permanent sections + one Study Committee
 - Study Committee on Ageing (created in 2001) : annual updates of long-run macroeconomic and budgetary impact of ageing
 - section 'Taxation and Social Security Contributions': tax policy
 - section 'Public Sector Borrowing Requirements': budgetary policy
- ▶ Secretariat: officials of the federal Ministry of Finance
- ▶ Council responds to government requests but can also act on its own initiative



The section Public Sector Borrowing Requirements

- ▶ 12 members (6 'federal', 6 'sub-national')

- ▶ typically two types of reports each year:
 - assessment of past and present budgetary policy (in Q1), in particular implementation of budget and stability programme
→ can be quite critical (e.g. HCF, 2008)

 - budgetary outlook or medium- and long-term (around end of Q2)
 - specific recommendations for budget balances of general government, its sub-sectors and individual federated entities
 - Council can, in theory, recommend to the federal MoF to limit borrowing of a certain federated entity (the 'nuclear bomb': art. 49 of Special Law)

- ▶ in most recent period: distinction between both reports a bit blurred + modifications to publication calendar (partly due to changes in timing of stability programme updates)

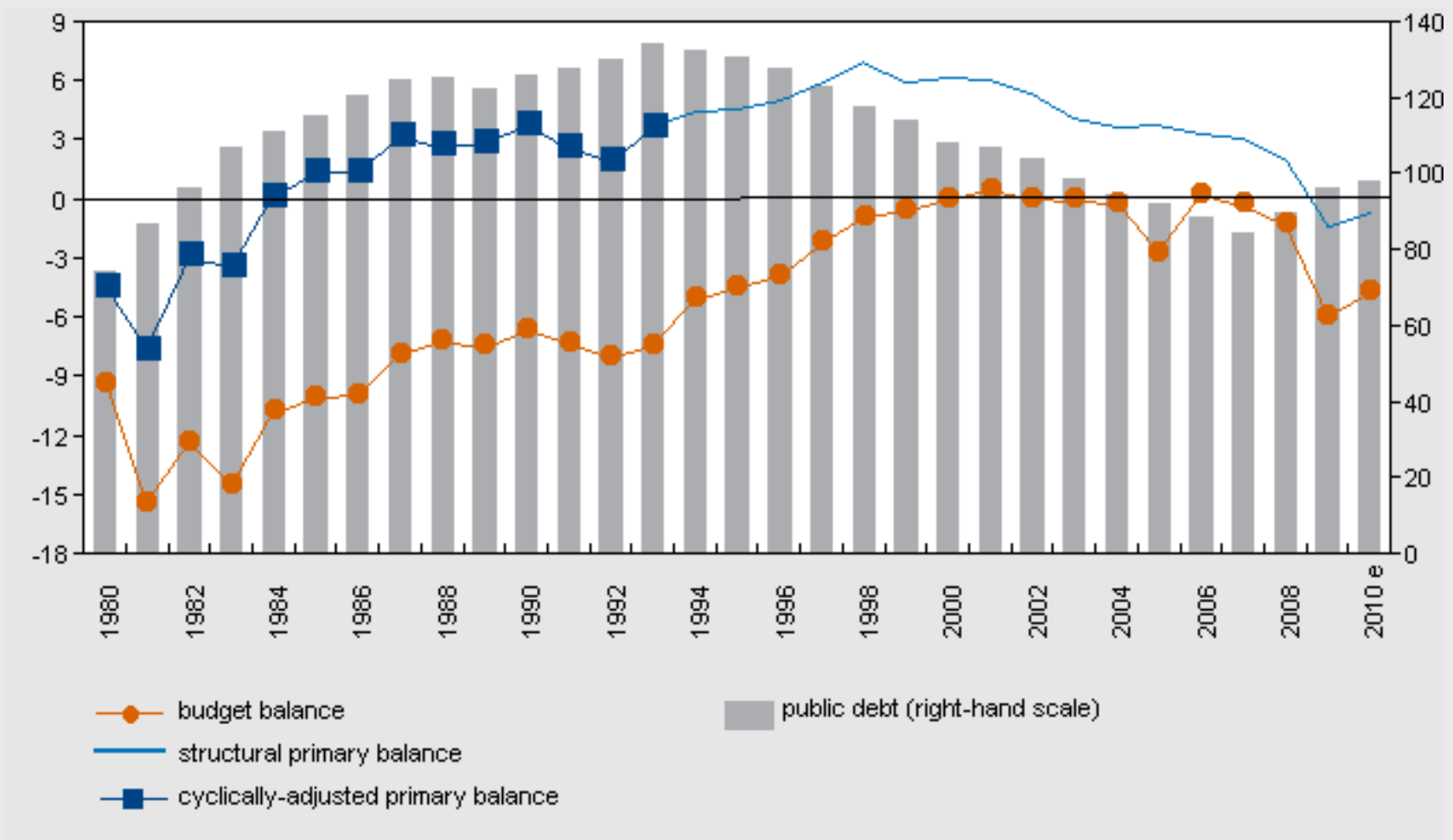


Belgian public finances: past, present and future



Budget balances and debt of general government

(percentages of GDP)

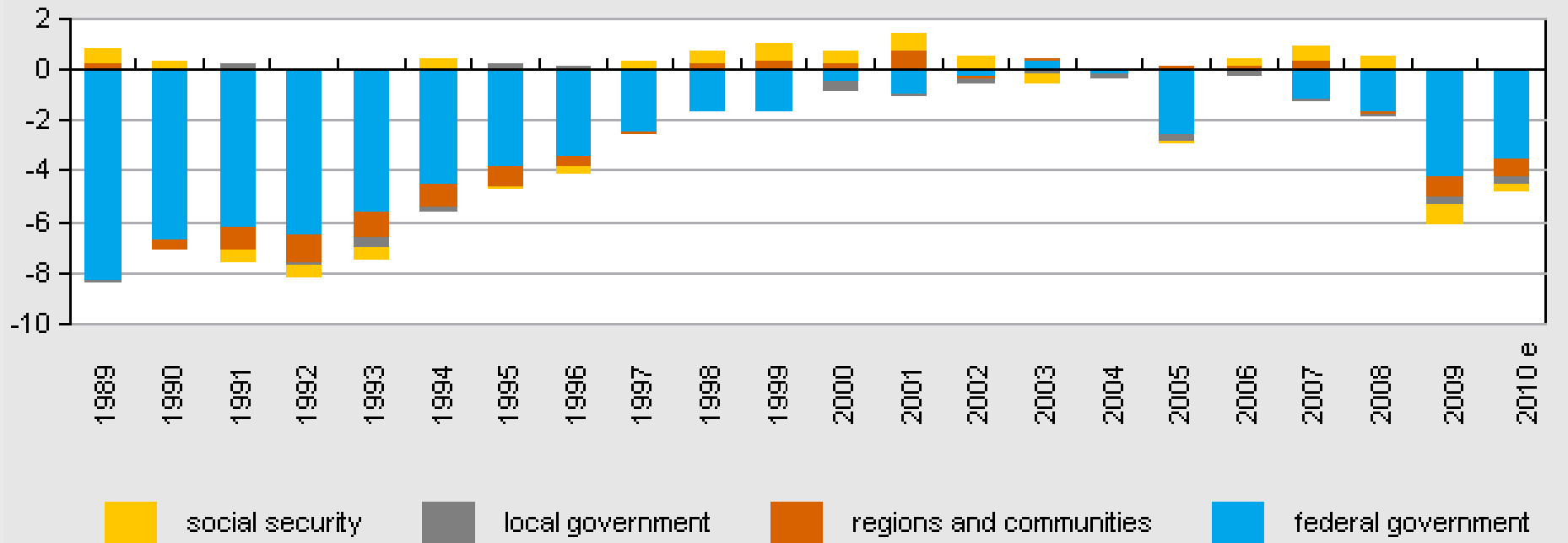


- 1981-1987: first wave of fiscal consolidation (after devaluation)
- 1993-1998: second wave of fiscal consolidation (Maastricht)
- after euro adoption: significant fiscal loosening



Budget balances by sub-sector of general government

(percentages of GDP)

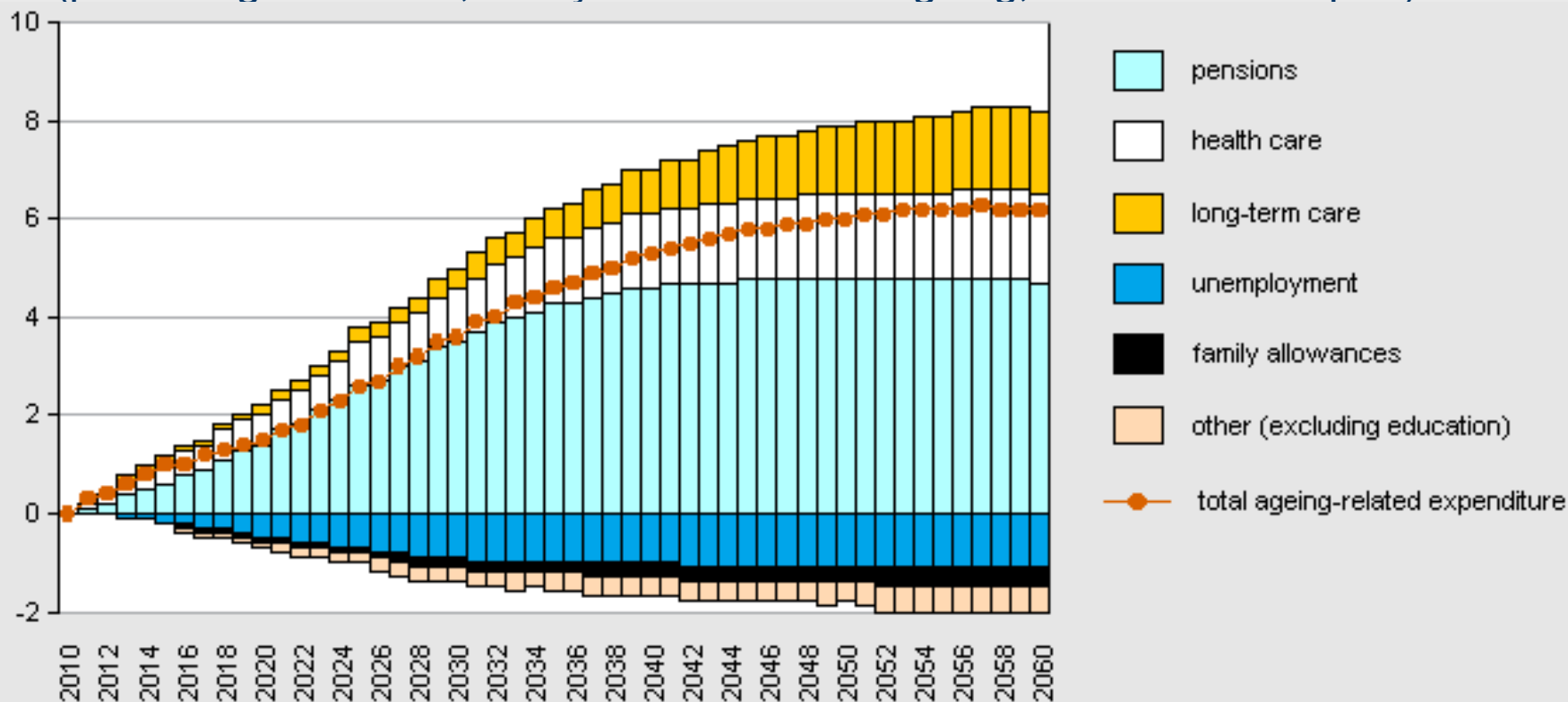


largest swings + largest 2010 deficit for federal government



Projected increase in ageing-related expenditure

(percentages of GDP, Study Committee on Ageing, 2010 annual report)



- SCA: +6.2% of GDP by 2060
- AWG (EPC): +6.5% of GDP by 2060
- Balassone et al (2009): significant upside risks + partial pre-funding more fair
- EC: Belgium among the 'countries facing the largest sustainability challenges'

→ need for **rapid and substantial fiscal consolidation !!!**



Impact of the High Council of Finance's recommendations on public finance developments



Recommendations for general government

- ▶ three different periods:
 1. run-up to euro adoption: reduction of high debt ratio + Maastricht criteria
→ deficit below 3% of GDP by 1996 (later: 1997)
 2. 1999-2008: gradual creation of a structural budget surplus (ageing!)
 3. from 2009 onwards: focus on eradication of excessive deficit and return to balanced budget
- ▶ effectiveness of recommendations for medium and long term measured

by synthetic annual indicator (0;5):
$$E_t = \sum_{i=1}^5 q_i i_t$$

with q1: is there a well-defined recommendation?

q2: is the recommendation consistent with previous vintage?

q3: does the recommendation deviate from government plans?

q4: is the recommendation formally adopted by the government?

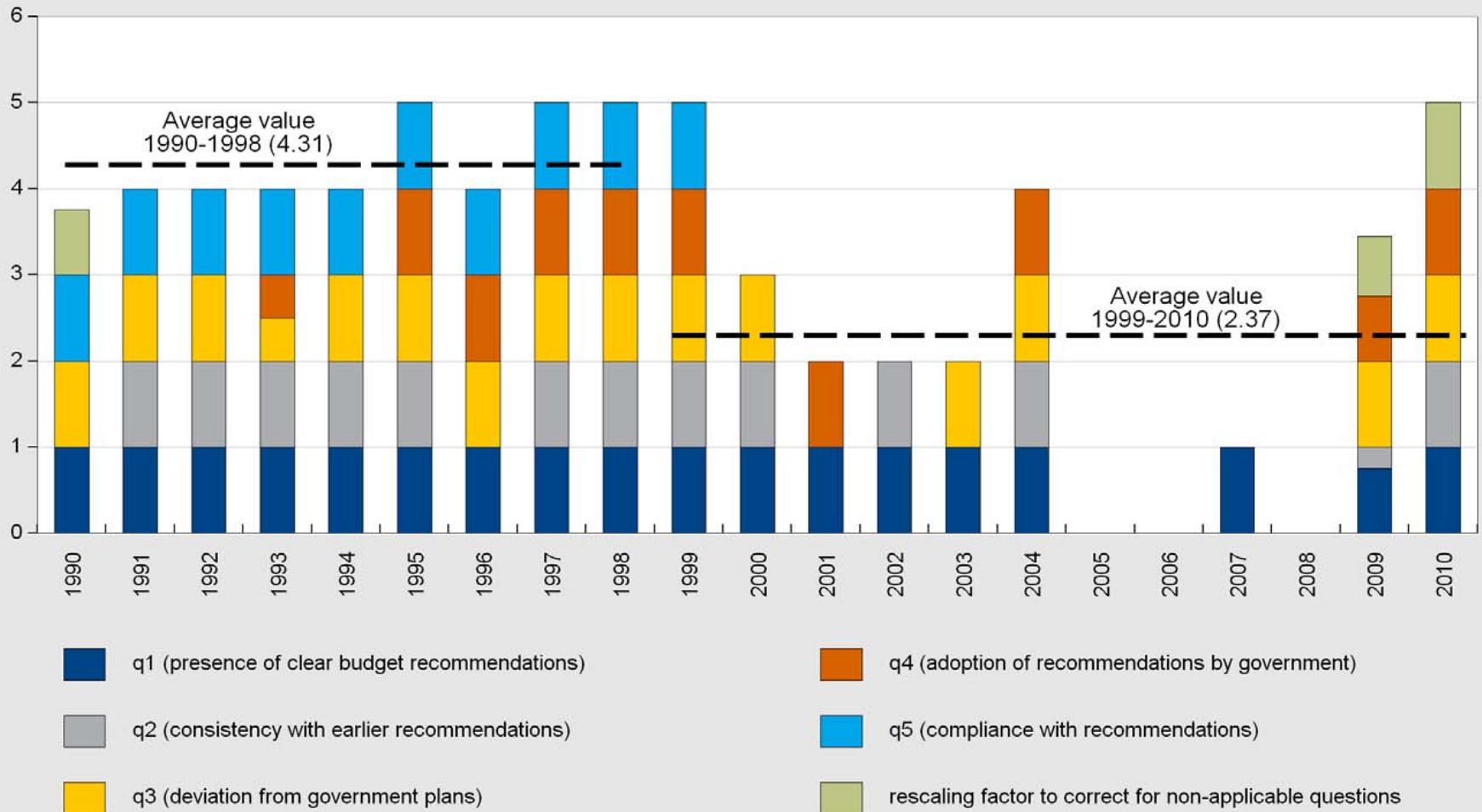
q5: is the recommendation complied with?

caveats: expert judgment required!

not necessarily causal relationship (e.g. q5)



Effectiveness of Council recommendations, general government?



→ clearly: reduced 'impact' after euro adoption!
(in line with intuition by Debrun et al, 2007)

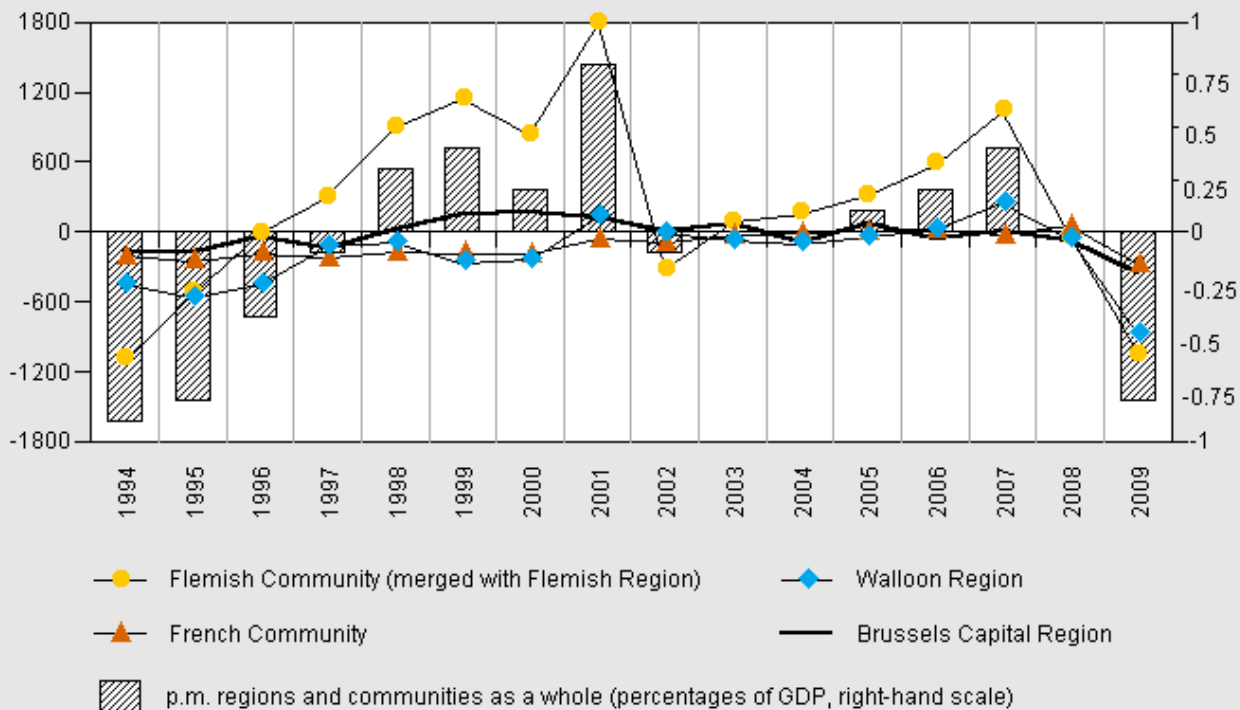


Effectiveness of Council recommendations, federated entities?

first: (differentiated) norms for primary spending growth consistent with stable debt ratio by 2000

later: balanced budgets by 2010 for all federated entities

Budget balances of main federated entities (millions of EUR)



Effectiveness of Council recommendations: main findings

- ▶ in general, impact on fiscal policy seems to have waned after euro adoption; recommendations were less:
 - clear and time-consistent;
 - independent from pre-announced government plans;
 - complied with.

- ▶ however: exogenous factors (change in EU fiscal rules, weakening of Belgian budget institutions and political cohesion)

- ▶ disciplining effect of Council recommendations larger for regions and communities than for federal government (and social security)?

- ▶ budget coordination between federal government and federated entities ('cooperation agreements' anchored to Council recommendations + budget negotiations within the Intergovernmental Consultation Committee)
 - not very formalised or transparent but has worked so far
 - however: facilitated by (certain) federated entities outperforming the targets



Proposals to strenghten the effectiveness of the High Council of Finance



Background

- ▶ important fiscal challenges ahead
- ▶ Council's mixed track record (reduced impact in recent period)
- ▶ 'smooth' fiscal coordination between government levels in the past does not imply any guarantees for the (near) future:
 - bulk of ageing costs = federal expenditure
 - nearly entire debt service = federal responsibility
 - current revenue-sharing mechanisms imply that (transferred) revenue of federated entities will grow more or less in line with GDP
 - increasing financial strains on federal government
 - incentives for regions and communities to contribute to rapid and important fiscal consolidation (in particular, creation of surpluses)?
 - HCF (e.g. 2009): current institutional arrangements make substantial consolidation in the longer term 'impossible'
- ▶ proposals on the basis of past experiences and lessons learnt:
 - budget institutions
 - Council's (section's) internal operation



Proposals: budget institutions

1. streamline and coordinate budget processes

logical order: HCF recommendations → coordinated elaboration of medium-term targets for all government levels (+ EU stability programme) → annual budgets

formal budget coordination via internal stability programmes?

2. increase the political costs of deviating from recommendations

e.g. obligation to publicly justify any deviation (to parliament)

3. define appropriate instruments to increase ownership of budget targets

- numerical national fiscal rule (cf. Germany)
- more realistic - and symmetric - commitment devices: (at least) 'soft' sanctions proposed by HCF, adopted by IGCC



Proposals: internal operation

- 1. always put forward a single, well-defined and time-consistent recommendation**

self-discipline on behalf of the section: choices should be made and deviations from previous recommendations (more) clearly explained

- 2. anchor recommendations more clearly to EU fiscal framework**

refer to preventive (MTO) + corrective (EDP) procedures of the Pact

- 3. create a permanent technical working group (reassess role of secretariat), possibly including external fiscal experts**

- preparation of medium-term recommendations
- beef up analytical work on appropriate policy options

- 4. support the ongoing reflection on a general overhaul of the distribution of competences and revenue-sharing arrangements**



Concluding remarks

- ▶ impact of High Council of Finance on fiscal discipline appears to have waned after euro adoption
- ▶ 'consensual' approach to fiscal coordination may come under strain in the (near) future
- ▶ against this background: concrete proposals to strengthen the Council's role in a more streamlined and coordinated budget process
- ▶ hopefully supported by other developments (political cohesion, more effective EU fiscal framework, return to 'normal' growth conditions, etc.)
- ▶ more generally, advisory fiscal councils of this type have to manoeuvre skillfully between Scylla and Charibdis:
 - fully independent but politically irrelevant
 - simply copying (legitimising?) government plans

Council should steer a steady middle course!

(if proposed increased importance of Council recommendations implies 'stronger winds' towards Charibdis side, explore additional mechanisms to shield Council from partisan interests?)



Thank you for your attention!

