The New EU Governance Framework and Regional Policy Autonomy: The Examples of Belgium and Spain

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On the 31st of May, Bruegel hosted a discussion on the new package for economic governance that the European Council is expected to adopt in June and on the effects it is likely to have on Member States – like Belgium and Spain – in which the regional dimension of decision-making is relevant. The event was chaired by André Sapir (Bruegel and ULB) and brought together Commissioner Joaquín Almunia (Vice-president of the European Commission), Belgian Finance Minister Didier Reynders , Mr Koen Alvoed (Professor of Economics at HU Brussel, affiliated since July 2009 to the cabinet of the Flemish Minister of Finance and Budget), Mr Alain Cuenca (Director General for Financial Coordination with the Regions and Local Entities at the Spanish Ministry of Economy and Finance) and Mr Etienne de Callataÿ (Chief Economist, Bank Degroof).

André Sapir opened the event pointing out that the financial crisis has radically changed the approach to economic governance in Europe. This change substantiated into the proposal of a new package aimed at broadening and strengthening the surveillance and coordination of economic policies in the European Union. The package contains the new procedure for budgetary surveillance and correction of excessive deficits, but also includes new requirements for the budgetary framework of national Member States as well as the new procedure for the prevention and correction of excessive macroeconomic imbalances. After highlighting the importance to understand how these relevant changes can affect decentralised countries like Belgium and Spain, Sapir left the floor to Joaquin Almunia.

Commissioner Almunia presented some elements of the package and linked them with the situation of Spain. A major goal of the package is to achieve a *deeper* surveillance of the economy: policymakers are now aware that it is no longer sufficient to focus on fiscal deficit alone and that also public debt needs to be monitored – as envisioned at the origin of Stability and Growth Pact (SGP). At the same time, the pact is intended to ensure *broader* surveillance and to fill in a gap in the Maastricht framework, which was focusing only on fiscal surveillance while neglecting other macroeconomic imbalances that in the end proved to be dangerous. Ireland and Spain are two examples of countries that have been fiscally virtuous but are now in a difficult situation because of the transmission of the external private indebtedness onto the public sector. Then Commissioner Almunia briefly described the situation of Spain, where the deficit of the 17 regions increased during the crisis to 2.8% of GDP in 2010. In 2011 the level of indebtedness was not very high, but accessing the market to refinance/issue new debt is more difficult for regions than for the central government. On top of that, it is very difficult to cut the regional deficit in Spain, because regional balances tend to be less affected by the cyclical conditions especially on the expenditure side (due to the fact that expenditure at regional level is mainly related to structural provisions such as education and health). The speaker also remarked the importance to introduce a regional fiscal framework with a legally binding expenditure rule for the regional governments and concluded by saying that Spain will need an increased degree of shared responsibility in the future, especially in light of last regional elections after which the political colour of most regions is now different from that of the central government.

Then Minister Reynders took the floor and gave a brief historical overview of the Belgian situation, recalling that in 1993 Belgium had a very high debt ratio (138% of GDP) compared to its closest neighbours Germany and France (both with about 40/45% of GDP), whereas now the country ranks in the European average. This result was achieved after 30 years during which the country strictly focused on debt and deficit reduction. Now –Didier Reynders said – the priority for Belgium is the adoption of structural reforms in the areas of pensions, labour market policies and expenditure management in the healthcare system. In Belgium, the main financial decisions are taken at the national level but there exists also an agreement with the local authorities to plan the evolution of regional deficit. The minister pointed out Belgium will probably go towards an even more decentralised model and will likely see in the next years the transfer of more and more competences to the regions (even in the fiscal area). In light of this tendency, he expressed a full support for the EU initiative and stressed the importance of setting up a SGP with both an international and an internal dimension (with legally binding constraints on regions).

The intervention of the Belgian Finance Minister was followed by that of Mr Cuenca explaining the situation of Spain, another country that could boast a very good fiscal position before the crisis and is now in a difficult situation. Spain has three level of government: central government, 17 regions (autonomous) and 8116 local authorities. At the regional level, local communities are responsible for the provision of health services, education, social services or regional infrastructures. Like Belgium, Spain is a recently decentralised country: in 1982 regions accounted for only 3.6% of public expenditures against 35.6% in 2009. Regional authorities have become the principal agent of expenditure and the share of central government declined from 53% in 1982 to 21%. Given that revenues at the regional level do not cover entirely the expenses, Spain has a system of transfer between central and regions that ensures each region has sufficient funds and that redistributes resources to some extent. The crisis had a strong impact on public finances in Spain, especially on the central government although it also induced a considerable increase in the deficit of regions. After describing the regional system of financing – based on the coexistence of regional taxes and transfers from the central government – Mr Cuenca pointed out that the Spanish framework formally ensures a certain degree of interregional solidarity although the practical implementation has been to some extent weak in practice.

Next to speak was Mr Algoed, asked by André Sapir to give his opinion about the idea of national SGPs and about how and how far the solidarity of Spanish system could/should be implemented in Belgium. Mr Algoed agreed on the importance to set up national SGP in decentralised countries and shared Mr Reynders' opinion about the need for Belgium to focus on structural reforms (among which also the reform of financing system of regions and communities). Mr Algoed pointed out that even though there is no explicit internal SGP yet, the current Flemish government (that already has a multiannual budgetary procedure) has decided to keep a balance budget from 2011 onwards and is also considering the introduction of an expenditure norm. He added that the reach of a balance budget in 2015 will be a huge challenge for Belgium, but also stressed that the real debate will probably be about how the burden of this adjustment has to be split between the central government and regions/communities. Under the scenario foreseen in the special finance act, regions are projected to have a surplus in 2014 and the use of such a surplus is a sensible issue to be discussed. Mr Algoed suggested that the surplus might be a way to finance the transfer of more competencies to sub-national authorities and would permit haircuts to the transfer of means, which in turn might ease the achievement of more stable public finances at the federal level. Concerning the degree of solidarity and responsibility, Belgian communities finance almost exclusively through grants whereas regions have more fiscal autonomy – as they rely on both grants and taxes. On top of that, there is also a solidarity mechanism in place and there have been proposals to make the region co-shareholders of the tax pay, to induce them to invest more in the development of the tax base.

The last intervention was provided by Mr de Callataÿ, who started by pointing out a twofold risk connected to the delegation of competences to regions: on one hand there is the possibility to have a fiscal slippage if sub-national levels do not comply with budget rules; on the other hand the risk is to create a kind of crowding out effect, with the federal government left with almost no residual competences. De Callataÿ said Europe seems to be facing an “impossible trinity”: the need for a closer monitoring of fiscal policy by the EU is sensible but in practice is difficult because in some countries sub-national authorities are independent from the federal government and at the same time EU institutions do not interact with sub-nationals bodies. It is also unthinkable to give up one of the three priorities: EU monitoring is needed; fiscal autonomy of sub-national authorities is an established fact in many countries and the tendency seems towards deepening it; direct relationship between the EU and local bodies is hardly feasible as many national governments would see it as a challenge to their own authority. Given the difficulty to reach an effective EU control over sub-national policies, the only way to proceed seems to be by fostering coordination at the national level. He pointed out that Belgium already did it in the past with the High Council of Finance (a body made of experts whose duty is to identify possible risk of slippage of public finance at national and sub-national levels), although this experience was more successful in the ‘90s but than in recent years when it was unable to prevent some fiscal slippage.