Economic Aspects of Constitutional Change 
The case of Belgium

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Abstract
Recently a leading Belgian French-speaking weekly magazine headlined that Belgium will not split. In this paper we try to highlight why that journal might be right, thus why Belgium will not experiment the secession of rich Flanders. Therefore we investigate with economists’ eyes the trajectory of Belgian Federalism. Such topic however requires a look at Belgian history; that motivates our first section on Belgium history in a nutshell. Then, in the second section, we turn to a short presentation of the six reforms of the state which occurred between 1970 and 2013, each granting more autonomy to Belgian regions and communities. That succession of reforms makes Belgian federalism an evolutionary and maybe endless repeated game whose players have different strategies: an offensive one for the north and a conservative one for the south. In section 3 we risk a prospective view about 2014 that we call the year of all dangers: every observer of Belgium’s evolutions asks the question of the occurrence of a seventh reform of the state. The moving outcome of that Belgian game might be compared, in our fourth section, with that of a joint application of the theory of fiscal federalism and the subsidiarity principle. Finally, in the last section we try to draw some lessons from Belgian experience, which may be useful for Scotland.

Keywords: Belgium, Federalism, Secession

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1 E-mail address: marcel.gerard@uclouvain.be; the author wants to thanks Vincent Dujardin, Andre Decoster and François Vaillancourt for helpful comments and suggestions.
Today Belgium is a federal country consisting of three regions in charge of matters related to territories and of three communities in charge of matters related to persons. Regions and communities overlap – see the map in Appendix 1. The three regions are Flanders, Brussels and Wallonia; the three communities are the Flemish Community, the German-speaking Community and the French-speaking Community. However executives and administrations of Flanders and the Flemish Community have merged some decades ago and decided to locate in Brussels; the French-speaking Community and Wallonia have a common Minister-President since 2009, and de facto a common government though the capital city of Wallonia is Namur and that of the Community, renamed Wallonia-Brussels Federation, is Brussels, which of course remains the federal capital. The competencies of those six entities have grown progressively since 1970 at the occasion of six reforms of the state; simultaneously the competencies left at the centre have been reduced.

Is that country threatened by secession? If the answer is yes, the secessionist should be the richest entity, Flanders. Recently however a leading Belgian French-speaking weekly magazine titled that Belgium will not split. In this paper we try to highlight why that journal might be right and why that statement should be qualified.

Therefore we read with economist’s eyes the trajectory of Belgian Federalism. We cannot examine such topic however without a look at Belgian history; that motivates our first section. Then, in the second section, we turn to a short presentation of the six reforms of the state which occurred between 1970 and 2013, each granting more autonomy to Belgian regions and communities than the previous one. That succession of reforms is a key characteristic of Belgian federalism which makes it a progressive or evolutionary, and maybe endlessly, repeated game whose players have different strategies: an offensive one for the north, asking for more and more autonomy for Flanders, and a conservative one for the south, basically interested by keeping solidarity between individuals, regions and communities as well as interregional transfers which it benefits of. The equilibrium which emerges after each step of the game is tentative, unstable and looks as an institutional handiwork. The outcome of that game might be usefully compared, in our fourth section, with that of a joint application of fiscal federalism theory and the subsidiarity principle; such an elegant approach is however rather unlikely in Belgian context, but it provides us with a useful benchmark and is actually in line with what happens for the devolution of competencies in matters of Personal Income Tax (PIT). Before conducting that exercise of economic analysis we will risk however a prospective exercise about the year 2014 that most observers of Belgium view as “the year of all dangers” for that country – see section 3. Finally in section 5 we set forth some lessons of the Belgian experiment which could be useful for Scotland.

1. Belgian history in a nutshell

Today Belgian debate cannot be coped with without a look at Belgian history. In some sense modern Belgian is the outcome of King of Spain Philippe II decision to stop the catholic Reconquista of Low Countries north of Antwerp and to turn his army against England, on board of the famous (for its fiasco) “Invincible Armada” (Perin, 1988). That decision delineated the separation between the

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2 Let us add that Belgium counts 11 million inhabitants over a 30,500 km² territory. Within that country, Flemish (or Dutch) is spoken as primary language by around 60% of the population, against French by 40% and German by less than 1%.

3 Le Vif, 31 (27), July 5-11, 2013.
catholic southern part of the Low Countries under the Kingdom of Spain, and later under Austria and France; and a mainly protestant northern part of the Low Countries gathered within the United Provinces. That was in the sixteenth century.

As explained in Gérard (2002), Belgium is a hodgepodge resulting from the assembly, through marriage, conquest and treaty, of a series of geographic entities, vassals of the king of France or of the German emperor, dotted with cities jealous of their privileges. In the 15th century, the same person was the prince of a series of earldoms and duchies that included, broadly speaking, in addition to other territories that are now part of France, such as Franche-Comté and Burgundy, the current kingdoms of Belgium and the Netherlands, excluding the episcopal principality of Liège, whose territory at the time covered a large part of Wallonia and the Flemish province of Limburg. It is the descendant of this mighty duke of Burgundy, Charles V, who also became king of Spain, emperor of Germany and sovereign of part of Sicily and the Americas, who proclaimed in 1519 the indivisibility of the Low Countries, comprising 17 provinces. The success of Protestantism in these territories, more so in the northern than the southern portion, threatened the unity of the 17 provinces and encouraged Charles’ son Philip II to engage in internal reconquista, which stopped just north of Antwerp, for the reasons stated above. The seven northern provinces made up the United Provinces, which became independent in 1579 and are the ancestor of the now Kingdom of The Netherlands. The ten southern provinces remained Spanish, and then became Austrian in 1713 before becoming independent in 1790, very briefly as the “États Belgiqes Unis,” or United Belgian States, i.e. several states, not just one state, in which central power was quasi absent.

In 1792 the French invaded the southern part of the Low Countries and the episcopal principality of Liège, a member of the German Empire; and they organized those territories as a series of departments like in the rest of France. The French also developed schools where classes were taught in French. Then although peasants and workers were speaking Flemish dialects in Flanders, and mostly Walloon patois, languages of the French family, in the south, a ruling class developed across the country whose cement was French.

As a consequence the Belgian Revolution of 1830 produced a French-speaking state ruled by a bourgeoisie and a nobility speaking French – in Table 1 till 1894 most voters are probably French-speaking -, a language not spoken by non-elite people in both the north and south. Simultaneously people aggregating to the elite turned to become French-speaking and a city like Brussels moved from a Flemish town to a French-speaking capital.

Some Flemish graduates however, and among them many clerics, undertook a revival of the Flemish language and attempted to mobilize the Flemish people around their cultural heritage. With the progressive extension of the voting right, that mobilization became successful and Flemish gained over French in the northern part of the country.

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4 See Comprendre la Belgique Fédérale, De Boeck and Larcier / La Ligue des Familles, Bruxelles, 1997; see also Perin (1988).
5 Charters recognized the cities' privileges, especially their right to autonomous internal management. Upon his accession, the prince was asked to come and confirm the charter. At that time, he made his joyful entrance into the city.
However the Flemish movement cannot be reduced to a social one, being more multidimensional. It certainly includes components like conflicts of catholic vs. liberal and socialist, or industrial vs. rural region; but the need for at least some nation-building in the 1830’s-1850’s, and the way King Leopold 1 responded to this, together with the more general Romantic Movement, is also an important element in the beginning of the Flemish movement. As an example King Leopold 1 paid Flemish writer Henri Conscience to write the story of the “Golden Spurs”, a battle where Flemish peasants defeated French chivalry on July 11, 1302; that day is now the National Day of Flanders.

![Table 1 – Votes in Flanders* and the progressive generalisation of the voting right](image)

<table>
<thead>
<tr>
<th>Year</th>
<th>Electoral rule</th>
<th>Votes in Flanders</th>
<th>Votes Kingdom</th>
<th>Flanders % Kingdom</th>
</tr>
</thead>
<tbody>
<tr>
<td>1848</td>
<td>Tax voting*</td>
<td>22,365</td>
<td>44,311</td>
<td>50.4728</td>
</tr>
<tr>
<td>1870</td>
<td></td>
<td>36,040</td>
<td>72,873</td>
<td>49.4559</td>
</tr>
<tr>
<td>1892</td>
<td></td>
<td>46,015</td>
<td>104,728</td>
<td>43.9376</td>
</tr>
<tr>
<td>1894</td>
<td>Plural voting**</td>
<td>777,670</td>
<td>1,802,980</td>
<td>43.1325</td>
</tr>
<tr>
<td>1912</td>
<td>One male one vote</td>
<td>1,114,508</td>
<td>2,621,771</td>
<td>42.5097</td>
</tr>
<tr>
<td>1919</td>
<td></td>
<td>785,872</td>
<td>1,761,141</td>
<td>44.6229</td>
</tr>
<tr>
<td>1946</td>
<td></td>
<td>1,154,750</td>
<td>2,365,638</td>
<td>48.8135</td>
</tr>
<tr>
<td>1949</td>
<td>One person one vote</td>
<td>2,465,572</td>
<td>5,030,883</td>
<td>49.0087</td>
</tr>
<tr>
<td>1971</td>
<td></td>
<td>2,746,884</td>
<td>5,281,631</td>
<td>52.0083</td>
</tr>
<tr>
<td>1991</td>
<td></td>
<td>3,476,296</td>
<td>6,162,160</td>
<td>56.4136</td>
</tr>
<tr>
<td>2010</td>
<td></td>
<td>3,687,813</td>
<td>6,527,367</td>
<td>56.4977</td>
</tr>
</tbody>
</table>

* Flemish provinces only (i.e. doesn’t include the Flemish municipalities of the Brussels constituency, thus figures underestimate Votes in Flanders).

**Only male citizens paying tax are entitled to vote

**Every male citizen has the right to vote but those who pay tax or have a degree receive a second or a third vote; that system is named plural.

Source: Renard and Dodeigne (2012), own calculations

The Flemish movement obtained “language legislation,” i.e. the possibility of using Flemish in the justice system in 1873, in the administration in 1878, in education in 1883, in the universities in 1932, and demanded “cultural autonomy.” Otherwise people in Flanders were rather poor and dedicated to agriculture. This is to set forth that the Belgium issue is primarily social and cultural on the Flemish side, and that the Flemish movement to more autonomy is relatively more right-wing oriented.

In the southern or Walloon part, industry developed across the nineteenth century making that area one of the most prosperous in the world next to England; but also one with the hardest social tensions between a working class living in cities like Charleroi and Mons, and a ruling class agglomerated in Brussels. Thus in the southern part the issue was also primarily social, but in a different, more usual, way. As a consequence, the Walloon movement to autonomy is traditionally left-wing oriented. Notice that transfers then operated from richer Wallonia to poorer Flanders; of course their size was smaller than today due to a much less developed social security.

The distribution of GDP per capita between north and south dramatically changed after World War II, especially after 1958 – see Table 2. And transfers inverted. Indeed, in the south, coal mining industry

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closed down and iron and steel industry reduced in size to quasi nothing today, turning that rich area unto one of the poorest in Western Europe. During the 1958-1966 period of time however, GDP per capita in Flanders first surpassed that in Wallonia. In the meantime industry took off and rapidly grew up in the north around the harbours of Antwerp and Ghent and thanks to a dynamic and dense network of SME’s and individual entrepreneurs; all that made Belgium in general and Flanders especially, a champion of GDP growth rate in the sixties and early seventies – see Table 3.

Table 2 – GDP per capita in Belgium, Brussels, Flanders and Wallonia (Thousands of Belgium francs, current prices; 50 BFr = 1 US$)

<table>
<thead>
<tr>
<th>Year</th>
<th>Belgium</th>
<th>Brussels</th>
<th>Flanders</th>
<th>Wallonia</th>
</tr>
</thead>
<tbody>
<tr>
<td>1958</td>
<td>51.7</td>
<td>75.2</td>
<td>45.2</td>
<td>50.8</td>
</tr>
<tr>
<td>1966</td>
<td>83.3</td>
<td>121.2</td>
<td>76.7</td>
<td>75.4</td>
</tr>
</tbody>
</table>

Source: Romus (1968) quoted by Dujardin and Dumoulin (2008); own adaptation.

Table 3 – Belgium, a growth champion of the sixties and early seventies (Growth rate of the GDP, the GDP per capita and the GDP per hour)

<table>
<thead>
<tr>
<th></th>
<th>Belgium</th>
<th>Netherlands</th>
<th>France</th>
<th>Germany</th>
<th>UK</th>
<th>Western Europe</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>1950-1960</td>
<td>3.00</td>
<td>4.61</td>
<td>4.57</td>
<td>8.17</td>
<td>2.67</td>
</tr>
<tr>
<td></td>
<td>1960-1973</td>
<td>4.93</td>
<td>4.83</td>
<td>5.38</td>
<td>4.34</td>
<td>3.18</td>
</tr>
<tr>
<td>GDP/capita</td>
<td>1950-1960</td>
<td>2.40</td>
<td>3.29</td>
<td>3.65</td>
<td>7.05</td>
<td>2.23</td>
</tr>
<tr>
<td></td>
<td>1960-1973</td>
<td>4.43</td>
<td>3.57</td>
<td>4.31</td>
<td>3.45</td>
<td>2.65</td>
</tr>
<tr>
<td>GDP/hour</td>
<td>1950-1960</td>
<td>3.15</td>
<td>4.16</td>
<td>4.58</td>
<td>7.08</td>
<td>2.11</td>
</tr>
<tr>
<td></td>
<td>1960-1973</td>
<td>5.30</td>
<td>5.25</td>
<td>5.25</td>
<td>5.16</td>
<td>3.90</td>
</tr>
</tbody>
</table>

Source: Cassiers et al. (1994) quoted by Dujardin and Dumoulin (2008); own adaptation.

Since that time the Walloon movement started and requested for a larger autonomy in economic matters – what that movement called structural reforms –, convinced that big private holding companies were moving their investment from the southern part of the country to the northern one, and that Walloon public authorities had to offset the failure of the private sector. In the meantime the Flemish movement continued to claim for cultural autonomy but with Flanders being richer and richer started claiming for autonomy in general, and possibly for independence.

Not surprisingly the political relay of the Walloon movement is to be found in the Walloon branch of the “Fédération Générale du Travail de Belgique” (FGTB) the leading trade union in the southern part of Belgium, close to the Socialist Party. Another relay was the Rassemblement Wallon (RW) a true political party but whose electoral success has always been mitigated – see Table A1 in Appendix 2; that party eventually disappeared, its MPs joining the liberals.

The Brussels “Front Démocratique des Bruxellois Francophones” (FDF) was borne in the sixties to oppose the attempts of the Flemish community to threat French culture and language in Brussels;

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8 Don’t forget that at the end of the fifties and in the early sixties, Keynesian ideas were flourishing.
that party end up also merging with the Liberals but left that coalition after the agreement on the sixth reform of the state, in 2011 – see also Table A1.⁹

The Flemish movement has a more popular anchorage in a series of cultural and social associations, and is far more important in terms of votes. A strong Flemish movement with a political relay in the Parliament still existed before World War II but it tentatively disappeared after that war, some of its leaders having chosen the German camp during the war. The political relay of the Flemish movement come back in the fifties with the Volksunie (VU) which collected its first seat in 1958 with less than 2% of the votes; that party peaked up to 22 seats (on an House of 212) in 1974, with more than 10% of the popular votes. Its further participation to and approbation of a reform of the state (see below) put an end to its existence: it eventually broke into various groups which joined traditional parties (e.g. the group Spirit joined the Flemish Socialist Party and those who joined the Christian Democrats were at the root of today’s Flemish leading party Nieuw Vlaamse Alliantie, NV-A). In the nineties Volksunie was surpassed by another nationalist party called Vlaams Blok, later changed into Vlaams Belang (VB), which is much far to the extreme right (so much that the democratic parties have decided not to do any cooperation with VB). At most recent elections, in 2010, VB went down from 17 to 12 seats while NV-A, no longer in coalition with the Christian Democrats, peaked up to 27, becoming the main Flemish party. Summing up the seats of NV-A and of the VB, plus the one of the Lijst De Decker, we have 40 seats occupied by Flemish nationalists out of 150, which represents 27.5% of Belgian votes or more than 45% of Flemish votes. Notice that the outcome arising from summing up those figures deserves a careful interpretation: one cannot amalgamate votes obtained by the NV-A which is a democratic party and votes for the VB which is an extreme right party considered by other parties as outside the democratic circle.

Six successive reforms of the state occurred between 1970 and 2013 which modelled today’s, and tomorrow’s, Belgium; they are detailed in the next section. During that period, and progressively, especially at the occasion of the most recent reform – that of the years 2011-2013 – the game between Flemish and French-speaking people, including Walloons, turned out to be a game where the former player, richer north, claimed for more autonomy though the latter, poorer south, claimed for keeping the institution unchanged.

The conservative position of the south was dictated by its need of transfers from the north, especially through social security and equalization. The offensive position of the north was guided by the general opinion that Walloons are lazy people who cost a lot to the Flemish.

The year 2014 will be that of all dangers for Belgium – see section 3 below – since we will have simultaneously European, federal and regional elections. Depending on the outcome of those elections, the question of a seventh reform of the state might be on the agenda. Clearly going further in the direction of a larger autonomy for Flanders would reduce Belgium to an empty shell – the so called “Con-federalism”¹⁰ which is not an impossible option¹¹ – but also would need to cope with the hard node of Brussels.

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¹¹ Article 35 of the Belgian constitution paves a way in that direction, but that article has never been implemented. That article states that « The federal government has jurisdiction only in matters that are formally attributed to him by the Constitution and laws enacted under the Constitution itself. Communities or regions, each for its part, are responsible for other matters in the terms and conditions established by law. This
Earlier in that section we wrote that Brussels turned from a Flemish city to a French-speaking one, the largest in Belgium. Now around 85% of Brussels inhabitants consider themselves as French-speaking. Thus sharing the same language as Walloon people, Brussels French-speaking inhabitants join them in the defence of French culture and education. Brussels is actually a multi-cultural and multi-lingual city where French is clearly the dominant language. But Brussels is surrounded by the Flemish region, separated from Wallonia by at least – or at most – one Flemish municipality. The Flemish government views Brussels as its capital city, a choice also done by the French-speaking community. Today we cannot imagine Flanders separating from Belgium without taking Brussels along in that journey and we can hardly imagine the French-speaking inhabitants of Brussels accepting to become residents of a city inhabited by a very language minority within independent Flanders.

This is basically the reason why the above mentioned magazine recently headlined that Belgium will not split. In our opinion that statement should be qualified: Brussels French-speaking people may once face a dilemma and the need to conduct a cost-benefit analysis in order to assess the pros and cons of, say, keeping their own language vs. benefiting of free nursing homes when they are old. Then opportunistic behaviour may not be totally excluded.

Let us add that holding Brussels as part of Flanders leads the Flemish player to see the Belgian game as a two-player one, with the two players (Flanders and Wallonia) managing the third one (Brussels), while the French-speaking see the same game as a three-player game (the players being then the three regions: Brussels, Flanders and Wallonia). And some voices claim for a four player game adding the German-speaking community as a true player.

To conclude this section with some figures, let us stress that over the period 1999-2009, the gross wage increased 35.3% and the taxable income per inhabitant increased by 45.6% in Belgium, but for wages – a good proxy for value added given the capital and service mission of Brussels –, figures are larger for Brussels (39.2%) than for Flanders (35.7%) and Wallonia (31.8%) while for taxable income they are smaller for Brussels (31.2%) against Wallonia (48.7%) and Flanders (46.4%). Thus Brussels creates wealth but that wealth to a large extent benefits the other two regions, so that there is a spill over effect (to be discussed later in this paper, but already notice that 234,000 Flemish and 123,000 Walloon work in Brussels against 337,000 Brussels residents; as a consequence a large amount of money generated in Brussels is consumed and pays tax outside the region of the capital city) and a relative decrease in Brussels wealth. One also notes that a recent catch up by Wallonia with income increasing more rapidly in Wallonia than in Flanders.

That variation among figures set forth that transfers occur between regions the quantification of them still being a perilous exercise, see Table 4; on the table a positive sign characterizes a net contributing region and a negative sign a net benefiting region.

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12 That difference is in line with the very roots of the demand for decentralisation which are cultural in the North (hence the importance of the two language communities and the “non-existence” of Brussels) and are economical in the South (and hence closer to classical, territorially defined, federalism).
Table 4 – Estimations of interregional transfers in Belgium
(in % of regional domestic products)

<table>
<thead>
<tr>
<th>Authors</th>
<th>Data for year</th>
<th>Flanders</th>
<th>Brussels</th>
<th>Wallonia</th>
</tr>
</thead>
<tbody>
<tr>
<td>National Bank of Belgium (2008)</td>
<td>2005</td>
<td>3.4</td>
<td>0.4</td>
<td>-8.2</td>
</tr>
<tr>
<td>Meunier, Mignolet and Mulquin (2007)</td>
<td>2005</td>
<td>3.2</td>
<td>1.0</td>
<td>-8.7</td>
</tr>
<tr>
<td>Van Gompel and Van Craeynest (2004)</td>
<td>2003</td>
<td>4.2</td>
<td>-2.3</td>
<td>-8.4</td>
</tr>
<tr>
<td>Cattoir and de Callataï (2001)</td>
<td>2001</td>
<td>2.6</td>
<td>2.6</td>
<td>-8.4</td>
</tr>
</tbody>
</table>

Source: Decoster and Valenduc, eds. (2011).

Inspection of the table shows up that transfers benefit Wallonia and, depending on the assumptions of the studies, Brussels as well. In some sense, the table provides a rationale for the conservative strategy of the French-speaking side. In line with what we have set forth above, the last referred study locates personal income tax revenue and contributions to social security at the place of work; in contrast the other three studies locate them at place of residence.

2. Evolutionary Belgium: six reforms of the state

In this section we review the evolution of Belgian federalism since the first reform of the Belgian state which occurred in 1970 putting an end to the centralised “Belgique à papa” till today quasi completion of the sixth reform.

The interest of this review is in the 40 year evolutionary process behind the successive reforms. Belgian federalism is not the outcome of a single big reform and bang-bang move from a unitary centralised state to a decentralized construction with seven entities. No, it is the outcome of a series of moves in a dynamic game opposing two main players, one in the south fighting to stop its diminishing economic capacity and one in the north initially fighting to defend its culture but progressively realizing it has become richer and richer.

As a consequence the outcome maybe departs from an elegant intellectual construction being closer to institutional handiwork or lumbering (a former Belgian Premier was often compared to a plumber).

Notice that a referendum of the type considered in Scotland or in Quebec is not possible in Belgium.

2.1. The first reform (1970)

The first reform of the state occurred in 1970\(^\text{13}\) and led to the recognition of three cultural communities, each with a cultural council, consisting of Flemish or French-speaking members, respectively, of the Belgian parliament for the Flemish and French councils, and of elected people for the German-speaking council. Communities however had no specific executive but ministers in

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\(^{13}\) On the first four reforms, see also Cattoir (1998). On the whole series of reforms see Decoster and Valenduc (2011), Dejardin et al. (2013).
charge were members of the Belgian government except for the small German community whose council was elected. Matters under responsibility of the cultural councils covered fine arts, libraries, tourism and sport; means consisted of grants from the central authority. Moreover three regions were also created, Brussels, Flanders and Wallonia but not operated due to a lack of consensus on the delimitation and competencies of Brussels. In addition, that first reform enacted measures to protect linguistic minorities, included a process of *alarm bell*\textsuperscript{14} in the parliament, and the parity between Flemish- and French-speaking ministers in the government with a possible exception for the Prime Minister.

### 2.2. The second reform (1980)

The second reform took place ten years later, in 1980. First, the cultural communities were renamed communities, were now run by an executive (government); and received additional competencies related to persons: welfare policy and health.

Second, two regions were actually created, Flanders and Wallonia, but the creation of the Brussels region was postponed; their competencies were related to territory and encompassed such fields like environment, rural renovation, nature preservation, economy, energy, employment, public works and housing. Regions also received executives but like for communities, regional councils were still not elected directly. Flemish communities and Flanders decided to merge setting up a Flemish executive and a Flemish council.

Finally a Court of Arbitrage, now the Constitutional Court, was created.

Regions and communities were permitted by the constitution to levy taxes but the central authority could limit that capacity; and it did in 1989, deciding that communities and regions could only levy taxes on matters not subject to tax by central authorities (*non bis in idem* principle) with the exception of personal income tax which became a joint tax. A new special financial law was passed which organized a new mechanism for financing regions and communities; that mechanism has been applied since 1982. Regions and communities had five sources of income, which are respectively own tax and non-tax revenues, grants from national authorities, transfers from part of the revenue of some taxes and levies, and loans.

Regarding grants from national authorities, the national budget for transferred competencies in 1980 is turned into a grant to communities and a grant to regions, of respectively 966.8 and 1,165.1 million euros. The former is shared between the Flemish and French communities according to a 55-45% key. The latter is shared between Flanders and Wallonia based on a key with three equally weighted components: population, surface and revenue from personal income tax (PIT).

Transfers of part of the revenue include 41% of radio-tv duties, 100% of the withholding tax on the rental income of immovable property, 9% of the tax on the transmission of immovable property and 100% of the inheritance tax revenue. Those revenues are then distributed between the two regions using the derivation principle.

\textsuperscript{14} If a qualified majority of the federal MPs of a given community considers that a law currently debated at the House, is a serious threat for its interest, it may impose a conciliation process.
2.3. The third reform (1988-1989)

In 1988 competencies of the communities and regions were expanded, with a.o. the transfer of education, from nursing school to universities, to the communities. A framework for cooperation agreements between the concerned entities is set up and cooperation is made compulsory in some areas of competencies.

In 1989 the Brussels Capital region was created with the same competencies as the other two regions and within the limits of the 19 municipalities of the Brussels agglomeration. Within Brussels region institutions special community commissions are created to manage person related competencies (the Common, Flemish and French-speaking community commissions).

And a new special financial law is again voted and progressively implemented between 1990 and 2000. Communities receive two new grants. On the one hand the budget of the federal government dedicated to education in 1988 is turned into a claim on VAT revenue, adapted to a price index and to the evolution of the less than 18y population (with a minimum corresponding to that population on June 30, 1988), and then distributed 57.55 – 42.45 between the two main communities – specific rules apply to the financing of the German-speaking community. On the other hand budget for non-education competencies transferred to communities was replaced by a claim on Personal Income Tax revenue indexed on price and GDP growth, and distributed in line with PIT revenue paid by each community, illustrating a so called fair return principle – practically it means by each region with a key for the distribution of PIT paid in Brussels. Similarly the regions also receive a similar claim on PIT revenue.

In addition, an equalisation formula is implemented implying vertical transfers, initially at the expenses of the claim on PIT revenue of the regions but since 2000 charged to the federal level. The region will benefit from an equalisation transfer if its average PIT revenue per inhabitant is smaller than the same average revenue at federal level.

2.4. The fourth reform (1993)

That reform, also called the St Michel agreement, on the basis of the calendar’s saint of the day, has basically two dimensions. The first one has a high symbolic value: article 1 of the Belgian constitution now states that Belgium is a federal country consisting of communities and regions. The second one is an agreement between French-speaking institutions: suffering from a lack of resources, the French-speaking community transfer some of its competencies to the Walloon region and the Brussels French-speaking community commission, but not all the corresponding means. Other changes are also introduced into the Belgian federal design like regional environmental levies.

2.5. The fifth reform (2001)

The 2001 reform is also called the Lambermont reform after the street of the Prime Minister official residence.¹⁵

From a financial point of view, that reform has two dimensions, the refinancing of communities and the enlargement of tax autonomy. Regarding the first dimension, an additional grant is provided to communities and the VAT claim is indexed to 91% of GDP growth. Moreover the VAT claim related to the less than 18y population is now distributed between the two communities in line with the

¹⁵ See also Gérard (2002).
population between 6 and 17y. And in the future (in 2012 and later), extra means, including those coming from the indexation of VAT claim on growth, will be distributed according to the distribution of PIT revenue. Otherwise the other grant available to communities is the PIT claim already mentioned, which is distributed in line with the distribution of PIT revenue, thus based on the fair return principle.

Table 5 – Financial structure of Belgium federalism before the sixth reform (in bion euros)

<table>
<thead>
<tr>
<th>2010</th>
<th>Federal level</th>
<th>Social Security</th>
<th>Communities and Regions</th>
<th>Local entities (provinces, municipalities)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax revenue and contr. to soc. sec.</td>
<td>87.1</td>
<td>50.4</td>
<td>8.1</td>
<td>8.2</td>
</tr>
<tr>
<td>Transfers from the federal level</td>
<td></td>
<td>24.1</td>
<td>34.3</td>
<td>3.3</td>
</tr>
<tr>
<td>Transfers from the comm. and regions</td>
<td></td>
<td></td>
<td></td>
<td>8.2</td>
</tr>
<tr>
<td>Other revenue</td>
<td>7.0</td>
<td>0.1</td>
<td>8.4</td>
<td>5.2</td>
</tr>
<tr>
<td>Net revenue</td>
<td>32.4</td>
<td>75.0</td>
<td>42.3</td>
<td>24.5</td>
</tr>
<tr>
<td>Expenditures</td>
<td>43.7</td>
<td>75.1</td>
<td>44.7</td>
<td>24.6</td>
</tr>
</tbody>
</table>

Source: Dejardin et alii (2013)

Regarding tax autonomy, eco-taxes (environmental levies) have returned to the authority of the federal level but regions have now full power on regional taxes. In exchange a negative term is introduced in the amount of the grant they receive. As already mentioned PIT is a joint tax of the federal and the regions so that regions may levy positive or negative surcharges on the personal income tax within a limit of 6.75% of the PIT they have obtained.

Table 6 – Evolution of the Belgian federalism over the period 1970-2010 (in % of GDP)

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue</th>
<th>Final primary expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>All levels</td>
<td>Federal</td>
</tr>
<tr>
<td>1970</td>
<td>38.1</td>
<td>20.0</td>
</tr>
<tr>
<td>1975</td>
<td>43.4</td>
<td>22.1</td>
</tr>
<tr>
<td>1980</td>
<td>45.5</td>
<td>22.6</td>
</tr>
<tr>
<td>1985</td>
<td>48.3</td>
<td>22.1</td>
</tr>
<tr>
<td>1990</td>
<td>45.5</td>
<td>9.1</td>
</tr>
<tr>
<td>1995</td>
<td>47.6</td>
<td>8.4</td>
</tr>
<tr>
<td>2000</td>
<td>49.0</td>
<td>8.3</td>
</tr>
<tr>
<td>2005</td>
<td>49.3</td>
<td>10.4</td>
</tr>
<tr>
<td>2010</td>
<td>48.8</td>
<td>9.0</td>
</tr>
</tbody>
</table>


In 2010, thus at the eve of the sixth reform, the financial structure of Belgian federalism is found in Table 5. At that moment also, French-speaking leaders firmly oppose any further change in the federal design of the country, especially any partial or total transfer of the social security to regions or communities.
Table 5 is usefully supplemented by Table 6 were the evolution of Belgian federalism is reported; rapid inspection of the Table shows the increase in final primary expenditures at the level of communities and regions, which surpass federal ones in 1995 and onwards. Notice also the growing importance of social security expenditures driven by health care and pensions, and entirely supported by the Federal level till the sixth reform.

2.6. The sixth reform (2011-2013)

At the moment of writing (July-August 2013), the sixth reform is quasi completed, just before new King Philippe took over. It is based on political choices made in 2011. Laws however are still to be voted and implemented.

Basically that reform consists of three elements. The first one is the resolution of an old issue regarding the Brussels area. Despite the French-speaking will to expand the territory of the Brussels region, the limits of that territory have been confirmed and the hope of French-speaking people living in municipalities close to Brussels to become inhabitants of Brussels is definitely over. In exchange Brussels has obtained 61 million euros and the setting of a metropolitan area, whose role is still to be defined (but we can imagine a coordination with neighbouring Flanders on issues of economic interest and on the management of infrastructures).

Second, what was so far a taboo for the French-speaking, i.e. the split of a nation-wide social security, has been partly decentralised: child allowance will leave the set of competencies of the federal level; that represents an around 6 billion euro transfer of competencies. Competencies for 4 billion euros in employment policy and of another 4 billion euros in health policies, including policy with respect to elderly people, mental health and first front medicine, are also transferred to regions and communities respectively, as well as other less important competencies including in the judicial system. All in all transferred competencies will amount to 20 billion euros. A Walloon minister was recently happy to say that public expenditures of the regions will now exceed those of the central government, if one excludes social security. And after the Flemish Minister-President, the Flemish budget will increase of 40% from 27 to 38 billion euros, and “our means for welfare and health will go up from 4 to 10 billion, those dedicated to employment from 1.6 to 4 billion and those for housing policy from 850 million to more than 3 billion”.

Finally the special financial law is again to be changed leading to larger tax autonomy for the regions. According to Federal Premier di Rupo, their own means will go up from 45 to 65 billion euros, an increase of 40% and the tax autonomy will account for 12 billion euros of this amount. A new special law organising the financing of communities and regions is thus expected. Though nothing will presumably been changed to taxes already entirely under regional authority like the tax on immovable properties (a regional tax supplemented with surcharges at provincial and municipal level), regional competencies in terms of Personal Income Tax (PIT) are to be greatly expanded. According to the agreement between the political parties, new PIT means attributed to regions will be of around 11 billion euros corresponding to the financing of the new competencies of the regions and for the existing competencies, replacing the grant computed as a fraction of PIT revenue. That change will enable regions to have a larger authority on their PIT means; practically they will not only

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have the right to add positive or negative surcharges to federal PIT but those surcharges will no longer be limited to 6.75 percent of their PIT revenue as it was the case since 2004.

3. 2014, a year of all dangers?
2014 might be the year of all dangers in Belgium. Indeed in May 2014 an election day will take place when for the first time voters will simultaneously elect Belgian representatives to the European parliament, members of the Belgian federal parliament and those of the regional parliaments (those of Brussels, Flanders and Wallonia)\textsuperscript{18}.

The current federal government has a majority among the French-speaking members of the federal Parliament but not in the Flemish section of the House, where it is only supported by traditional parties which together do not represent the majority of MPs from that linguistic group. Therefore two scenarios at least are possible, depending on the outcome of the Flemish popular votes; either the Flemish traditional parties are rewarded for a successful sixth reform of the state, increasing their share of the votes, and one can then expect that no further step in the decentralisation of Belgium will occur; or the Flemish Nationalist Party N-VA, an acronym for Nieuw Vlaamse Alliantie (New Flemish Alliance), still increases its share of the popular vote, reinforces its leadership in Flanders, and a new reform of the state, the seventh one, is called for; its content however is hard to depict at this moment. Let us try however.

The N-VA is Flemish nationalist, republican and economically liberal. Let us put aside that last element, though for that party it makes it difficult become a partner for the French-speaking Socialist Party, the leading political force in Wallonia. Conjunction of the other two elements makes the independence of the Republic of Flanders the ultimate goal of that party. However the party is realistic enough to understand that both independence and republic are not feasible immediately; therefore it will probably limit its ambition to, let us say, the independence of Flanders within the Kingdom of Belgium, what is called in politically correct Belgian language, con-federalism.\textsuperscript{19}

That political project has two key dimensions. On the one hand, independence is limited to turning the federal level into an empty shell. Going beyond that point is recognised to be of little feasibility due to the existence of Brussels and of the high level of the Belgian public debt too; and probably to the role of trade unions and the wish of Flemish people itself. On the other hand, the republican project could be limited to reducing the powers of the monarchy, changing its role into a purely representative figure. The reason is that most voters of the NVA do not share the republican vision of the leaders of the party.

3.1. Independence within Belgium and the Brussels node
Independence within Belgium means turning the federal level into an empty set. Let us say a set as empty as possible; indeed, even that option is limited, mainly by the Brussels node. Brussels is the capital city of Belgium but also of both the French-speaking Community and of Flanders; and of course of the European Union. Therefore neither the French-speaking nor the Flemish-speaking

\textsuperscript{18} So far the federal legislature lasted for four years and the regional ones for five.
\textsuperscript{19} On the meanings of terms like federalism and con-federalism in the Belgian debate, see Arcq \textit{et al.} (2012), especially pp. 79-80.
people are ready to give up that city to the other community. “It is our Jerusalem”, Philippe van Parijs (2013), an Oxford-Louvain social philosopher, says.  

Indeed a separate Flemish social security, with presumably more generous benefits, will cause a dilemma for Flanders; either it doesn’t cover the Brussels territory and that means Flanders giving up Flemish people living in the Brussels region; or its coverage includes Brussels and is accessible to French-speaking people too, citizens of another state in the extreme secessionist scenario, at least to those who decide to behave opportunistically. Therefore Brussels forces Belgium to keep going. How? That is another issue: Flanders regularly sets forth a co-governance of Brussels by the two linguistic communities, a vision that the far larger in size French-speaking community of Brussels forcefully rejects.

Brussels is not only a French language dominated multicultural city located in Flemish territory. It is also one of the main economic poles of the country. The Brussels area, a much larger entity than the sole political or administrative one, produces around 30 per cent of country’s GDP while covering a much smaller portion of the territory. Brussels strictly defined also produces a much larger fraction of Belgian GDP than its population share. As stated above, numerous commuters contribute to the creation of that wealth but they reside and spend outside Brussels, so that important economic transfers occur with income flowing out from the capital city and its area. Therefore both communities need Brussels as their economic centre.

In its role of keeping Belgium on track, Brussels has an ally, the Belgian public debt. That debt amounts to approximately 100 per cent of Belgian GDP. In case of independence of Flanders, that debt should be distributed between the successors of Belgium and it is likely that Wallonia will not be in capacity to support its part of the burden. That sole expectation will downgrade the Belgian papers pushing up interest rates and the cost of the debt, including for Flanders.

Other allies are the trade union leaders, who north and south seem to be attached to interpersonal solidarity and a large portion of the Flemish people as well, including many artists, not ready to embark in the uncertain vessel of separation.

3.2. Republic within a Kingdom

Although N-VA leaders are clearly republican and a fraction of the Flemish community set forth that the King’s family is currently too much a French-speaking body – with the exception of the new heir princess who is educated primarily in a Flemish-speaking school –, the majority of the Flemish voters, including those of the N-VA party do not seem ready to exchange the King for a President. By the way the question would immediately arise of the linguistic community of the president and the prime minister respectively.

Different however is the issue of the evolution of the role of the King. In current Belgium he plays an active role in the formation of the federal government but not in those of the communities and regions. In the former case, he listens to party leaders after the federal elections took place, appoints an “informateur” and then a “formateur”, or possibly a series of “pre-formateurs”, and thus plays an active political role in the period between federal elections and the formation of the government. In that capacity he may be influential given the fragmentation of the political parties in Belgium – the

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20 See his interview in Belgian weekly magazine Le Vif, 31 (27), July 5-11, 2013.
21 See above: per capita GDP is larger than per capita taxable income in Brussels.
22 According to Le Vif, 2013, op. cit., only around 15% of the Flemish population is in favour of independence.
largest two party fractions account for 27 and 26 members out of 150 and the current government is a coalition of six parties.

However the King has no similar role at sub-federal level, with only the community and region Minister-President swearing allegiance. Therefore it will not be a surprise if the role of the King evolves towards less implication in the political process of designation of the Prime minister – he may be replaced in that process by the speaker of the House or of the Senate, or the Prime minister might be directly elected by the parliament like the Federal Chancellor in Germany – on the one hand, thus becoming a more representative figure as in other modern kingdoms, and at least no longer being a member of the executive. On the other hand, less concerned by the functioning of the federal government, he could be more in phase with the communities and regions, becoming a “federal king” to be understood as a “federative king”. This is called for namely by the Flemish side; and, going in that direction, on the first day of his reign, new King Philippe received all the members of the governments of communities and regions together.

4. Economic analysis vs. handiwork

With that penultimate section we move from a description of facts to a tentative economic analysis. In the first (sub-)section we try to show how the theory of fiscal federalism, jointly with the subsidiarity principle, may provide foundations for an efficient institutional design. In the second one we raise the issue of solidarity between regions and individuals as a pre-condition for a country to exist.

4.1. Institutional lumbering vs. theoretically founded design

A quick reading of the paper immediately reveals that the outcome of the Belgian decentralisation process doesn’t obey a common vision of the political actors to build up a federal state with an optimal, theoretically founded, devolution of competencies.

Instead we are facing a dynamic game where one actor, the North, or the Flemish community, pursues an objective of larger autonomy, motivated by two key drivers, the protection of its culture on the one hand, the mastering of its own wealth on the other hand. Within that actor another game develops: traditional parties are pushed to demand more and more autonomy by a sub-group of politicians and opinion makers, eventually motivated by the creation of an independent Flemish republic. That sub-group permanently threatens traditional Flemish political parties which step by step mimic their radical positions: being at least as nationalist as your competitor is a paying strategy in an ideological vacuum.23 This explains that after each reform, demand for another one occurs. We say that the North has an offensive dynamic strategy.

In front, the South, i.e. the French-speaking people from Wallonia and Brussels, has adopted a defensive strategy (except on the equality of treatment between Brussels and the other regions) since the early seventies and the creation of the Walloon Region. The rationality of their behaviour is to protect implicit and explicit transfers from the North that they need to keep their welfare level surviving.

23 Interestingly the only party which seems to escape that movement is the Green Party whose voters are deemed to know why they are voting for. Conversely the N-VA (Flemish Nationalist Party) has adopted the liberal ideology, the sole clearly set forth among the traditional parties.
Each of the successive tentative equilibriums of the game corresponds to, say, an amount of competencies and financial means transferred from the federal level to communities and regions.

Additionally the decentralisation process at work since the early seventies and even before increases the heterogeneity between players which know less and less about each other; and that movement towards co-existence of separate communities is reinforced by the absence of federal parties.

Could another approach be feasible? Why not ... provided that French-speaking’s give up their defensive strategy and the Flemish credibly commit to respect the outcome of the new one-shot game. This is probably demanding too much but, anyway, that may give a benchmark for thinking about the future of Belgium. Such a benchmark – or more precisely the tool behind the production of such a benchmark – has been developed a.o. by Gérard (2009) and Gérard and Granelli (2010) – the text of this section is adapted from that latter contribution after deletion of the equations – based on Pelkmans (2005) and further developments. Those authors examine to what extent the subsidiarity principle at the root of the construction of the European Union may help redefining the distribution of competencies between the different levels of power in Belgium.

For that purposes, all the competencies are supposed initially attributed to regions and then reasons are discussed which may lead to transferring some of them to the federal level. Such a situation is in line with article 35 of the Belgian constitution, an article however not implemented (see Section 1 above). In the present paper the functional subsidiarity test is qualitatively applied to a single competency, chosen in the field of public revenues, direct taxation. However other applications are straightforward and some will be mentioned.

Imagine a federal country, Belgium, made up of two member regions respectively the North and the South. Social preferences between these regions are heterogeneous: regional median voters are not the clone of each other. That point is important since the interest of people and media of one community for what happens in the other one is declining in Belgium, making heterogeneity going up. All the competencies are initially exerted by regional governments tentatively supposed to be benevolent, by which is meant motivated by the achievement of the highest level of welfare for the median regional voter; for the rest, the economy obeys the rules of perfect competition, an environment in line with Musgrave (1959) and Oates (1972). The hypothesis of non-benevolent governments and the arguments developed by the new political economy will be introduced at the end of this section.

The functional subsidiarity test relates lessons of fiscal federalism and the economic concept of subsidiarity, according to which no competency can be transferred to a higher level of power – to a level of power operated on a larger geographical zone thus here from regions to federal – if it has not been proven that the higher level of power can exert it in a more efficient way. The test develops in three stages. The first one aims at determining which competencies should be transferred from the

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24 Notice that several groups think about that future in a non-partisan and multi-cultural framework, let us mention “Re-bel” coordinated by Paul De Grauwe and Philippe van Parijs, see “Re-bel” website http://www.rethinkingbelgium.eu/about-rebel-initiative.


26 The question of distributions of competencies among levels of power in a federation is not unknown to economists; it has been already approached by R. Boadway in his 1979 book.

27 There are not many federations with only two components in the real world. Let us mention Tanzania, whose components are Tanganyika – on the African mainland – and the island of Zanzibar; though it can be analysed as a two component federation, Belgium is actually a sui generis six component federation.
regional to the federal level, or in other words, exerted in common. If some competencies are actually to be transferred to the federal level, the second question then arises: should they be exerted through intergovernmental arrangements between the two regions, e.g. a conference of the Minister-Presidents; or by a federal agency, like eventually a federal government? And, finally, if a federal agency is called upon, how will that agency act: by issuing rules applicable to all actors across the federation, or by spending a budget received from the lower level of authority, or eventually by also being habilitated to levy its own financial resources? In the context of tax revenue you may translate by the federal determining the sole composition of the tax base, or also the tax rate, getting fees from member regions – as in Spain –, or still collecting revenue and then redistributing it, partially to totally, to regions.

**Acting together**

The two partner regions will decide to act together if acting in common increases the welfare of at least one of them whilst not decreasing that of the other. Two arguments typically induce to act in common, another brakes this process. The first argument is the internalisation of externalities.

In our application, direct taxation, two taxes might be considered, Personal Income Tax (PIT) and Corporate Income Tax (CIT). Experience in Belgium is that people are unlikely to move from one to another linguistic region for residential purposes, refrained as they are by the unavailability of schools, subsidised sport and cultural activities, provision of municipal services including police, in their own language. However they are ready to commute every day, even on a large distance in Belgian standards, between their place of residence and their place of work, or between the former and a shopping area; unlike in publicly subsidised services and municipal services as well, they may be served in their own language in shopping centres since they resort to the private sector where relations between sellers and buyers may be conducted in any language. Therefore jobs, plants and shopping areas are more mobile across regions and the transfer of the CIT to the federal level is to be considered.

Supporting evidence is suggested by Gérard *et al.* (2010) who use spatial econometrics to study the interdependencies between Belgian municipalities for the determination of surcharges to the PIT and of surcharges to the Immovable Property Tax. They show in particular that when the sensitivity of tax rates in one municipality to tax rates in neighbouring municipalities is measured taking into account regional barriers, sensitivity is only significantly different from zero for municipalities sharing the same language. Thus, although interdependencies exist, paving the way for potential tax or yardstick competition, that interdependency is stopped by linguistic barriers. In other words, there is little room for spill over effects and tax competition.

Therefore PIT is a good candidate for a regional tax while CIT is not.28 Actual financing scheme of the regions largely obeys that lesson. Another argument in favour of decentralisation may be added usefully, in particular in the field of revenues: regional responsibilities.

The second argument in favour of centralisation is the existence and exploitation of economies of scale. It is possible, in fact, that perceiving Value Added Tax (VAT), CIT and PIT at federal level is a less expensive option than doing it at a decentralised level: e.g. you can escape the computation of tax bases at regional level and therefore e.g. interregional transfer pricing issues or tax base apportionment debates.

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28 On the regionalisation of CIT see a.o. Haelterman (2010).
These arguments nonetheless have to be balanced with some others. Attributing competencies to a higher level of power implies moving away from local preferences. The federal median voter in Belgium is neither the one of Flanders – probably more right-wing oriented – nor that of Wallonia – presumably more left-wing oriented (see De Wever, 2011); there is what is called a uniformity cost (Hindriks and Myles, 2006). That heterogeneity of preferences or uniformity cost is especially important in Belgium where the median voter in the North sees himself as a hard right-wing oriented working person but views his Walloon counterpart as a lazy individual assisted by Flemish money. In contrast the median voter in the South is clearly left-wing oriented and knows very little actually about his Flemish counterpart whose he hardly understand the language, reads the newspapers and watches the TV stations, where eventually little is written and spoken about the other community. Moreover, there are no longer federal political parties in the Belgian political scope.

In conclusion, centralisation gains, like the internalization of externalities and the exploitation of economies of scale, have to be compared with the cost of the possible uniformity; if the gain exceeds the cost, there is an economic argument for transferring the competency to the level of the Federation. If this is not the case, there will be an argument for maintaining it at regional level.

**Intergovernmental cooperation between regions or a central authority**

Suppose that the two regions have decided to transfer CIT to the level of the Federation. A choice then arises that has to be done as most as possible in line with the subsidiarity principle: organizing an intergovernmental cooperation between the two regional authorities, like regular meetings between the regional ministers of finance or the heads of their respective administration; or setting up a federal service. In the latter case, the federal service may be a specialised agency or part of a true federal government.

The former solution, the coordination between regional authorities, is *a priori* the most consistent solution in view of the subsidiarity principle. If this coordination is feasible and credible, it should be preferred. On the contrary, if the content of the coordination agreement may be realised more efficiently or may only be realised through the establishment of a specialised agency, with a clear delegation of authority, for a period of time determined or undetermined, this organisation should be the preferred one.

An argument in favour of the establishment of a permanent agency, whose extreme case is the federal government, is that of avoiding inter-temporal inconsistency and other strategic behaviours, which may be developed by regions. Ederven et al. (2008) mention a number of reasons why the credibility of voluntary cooperation between regions may be low, particularly a very imperfect and asymmetric distribution of information «especially in complex policy areas, because this renders it impossible to monitor compliance». Adding «credibility is also low when the incentives to cheat are strong and the ability or willingness to impose (collective) sanctions is perceived as minimal. »

To use the terminology of the industrial economy, the choice is between a joint venture and an integrated firm or even between a credible static coordination and a long-term contract. The cooperation between regions is indeed, *a priori*, the most consistent solution given the principle of subsidiarity. Nevertheless this solution has a cost: the permanent renegotiation of specific contracts. On the contrary, the establishment of a federal government may seem less consistent with the subsidiarity principle, but it may avoid the abovementioned costs. The decision will depend on the evaluation of benefits and costs of the institutional organisations at stake.
A federal agency: in charge of what?

Suppose that, in a series of particular fields, it has been decided to establish a federal agency with a long-term responsibility. Arguments of cost have then convinced the regions to put in common these agencies so that they form a federal government.

How this federal government will exert its competences? Referring always to the subsidiarity principle, Ederveen et al. (2008) have introduced the notion of proportionality: nothing more than what is necessary to achieve the common established objectives has to be done at central level.

It is possible to imagine three ways to act for the central authority. The first way may be described as «take care of all»: the federal authority decides of the tax base and rate of CIT and is responsible for its collection and control. In a second way, the federal level may decide on tax base and tax rates but leaves the collection and control up to regions. Finally, in a third way, the central entity limits itself to decide on the design of the tax base: regions select the rate and organize collection and control.

Public failures and political economy: an extended test

So far regional governments and the federal entity have been supposed to be benevolent, i.e. driven by the desire to maximise the welfare of their region or of the two regions together. After Brennan and Buchanan (1977), economic literature includes that this may not be the case: governments may be Leviathan and rent seeking. A well-known additional argument in favour of decentralisation is then that, in a decentralised political structure, citizens have more control over their leaders: in such a structure, in fact, the management teams of the regions compete for attracting on their territory mobile activities and the tax bases they convey, and thereby for increasing the welfare of their region. Tax cuts fed by this competition force local authorities to a more efficient administration of the public services. Moreover, in a federal structure, the voters in a region can compare their provision of public services, in return for the taxes paid, with what the neighbouring region provides with the tax revenue that it collects, and thus they can threaten the re-election of incumbent leaders.

In other terms, decentralisation makes leaders more responsible, what we have already stressed above. Conversely, a centralised authority is more likely to pursue its own goals rather than those of electors, as denoted by Oates (2005) for whom «decentralization may be preferable even in cases of perfect homogeneity across local jurisdictions». On the basis of Gérard at al. (2010), this sentence however needs more elaboration. It is, in fact, contingent on the effective capacity for citizens to make comparisons. These can be made more difficult by language differences or even by the very little amount of information that the press of one region provides about what happens in the other region.

Next to that public sector failure, other issues should be investigated including lobbying – see e.g. Lockwood (2005), who talks about «traditional intuition that local government is more susceptible to capture by lobbies»; but also Gérard and Ruiz (2009) who have studied the impact of the political regime on the level of statutory tax rate for companies, using panel data for 53 or 93 countries around the world. The results show a higher tax rate in federal States, a result in line with Campos and Giovannoni (2008): for them, some forms of government are more likely to be lobbied than others and it may happen that the federal structure protects from lobbying.

Beyond that debate on unitary vs. federal state, Gérard and Ruiz (2009) insist that the form of the government deserves careful consideration. So far it has been supposed that the federal government is in the hands of a body seeking either the common interest of both regions or its own interest. This
is what Inman and Rubinfeld (1997, 2002) call the economic or centralised federalism, to be distinguished from the cooperative or decentralised federalism and from the democratic or majority rule federalism. In the first, regions decide unanimously, in the last majority wins. Democratic federalism, if not accompanied by minority protection mechanisms, may induce a dictatorship of the most populous region; a related issue indeed is whether members of the federal parliament vote in line with their ideological family or with their regional affiliation.

The form of a federal government is thus therefore important. From this discussion it follows that the centralisation of powers at federal level, justified by arguments of internalisation of externalities and economies of scale, has to be accompanied by a careful design of the form of governance and of the decision making process at federal level, in particular by the introduction of instruments for the protection of minorities. This is especially true if regions are heterogeneous and unequal in size: otherwise the risk arises that seeking the best interest of the Federation be turned into a dictatorship of the richer or the more populous region. This is especially important for a federation like Belgium where Flanders dominates in both income size and population number. That dictatorship of the Flemish majority, which, on some issue, votes linguistically rather than ideologically, is precisely a fear of French-speaking Belgians and the reason why an alarm bell system has been set forth at the Belgian Parliament – see section 2 above.

**Other applications and qualifications**

Beyond the design of taxation, other applications are straightforward. Just to mentions some: the delineation, content and competencies of the Brussels metropolitan area; the participation of regions to the financing of Brussels where Flemish and Walloon commuters produce GDP and get labour income, possibly by allowing the Brussels region to share the tax on labour income paid by those commuters at their place of residence; the policy in matter of large infrastructure or scientific research, or of social security.

Qualifications however are necessary, and especially three. First, the approach used in this section aims at efficiency. It is based on tools to organise transfer of competencies from existing countries to a Europe in progress, thus its goal is to optimise centralisation. In the case of Belgium the issue at stake is decentralisation. Therefore we should take into account the cost of dismantling existing national structures.

Second, in the actual search of optimal centralisation or decentralisation, there are more than two levels of power; next to the regions and the federal, we have the Euro-zone, the European Union, the OECD level etc... and nothing guarantees that all competencies going up from regions, will be optimally nested at Belgian federal level. Belgium may become no more than an intermediate level; this is already the case for e.g. agriculture.

Finally, federalism needs trust. One of the biggest dangers in the progressive decentralisation of a country comes from the irreversible character of decentralisation. Should you decentralise the determination of the base, rate and collection of PIT because it is an efficient design consistent with subsidiarity, what kind of guarantee do you still have that money for equalisation transfers will still be provided by the richer partner? That issue cannot be neglected since the Belgian evolutionary decentralisation is sometimes viewed as a game where each player has little trust in her partner.
4.2. Efficiency without solidarity: the second death of a nation?

A critical aspect of the Belgian federalism from a theoretical perspective is the solidarity, both interpersonal and interregional. The *fair return* principle according to which a region receives a fraction of PIT revenue in proportion of the PIT revenue produced by that region is not a solidarity device.

Interregional disparities are partly offset by an equalisation mechanism but that one is characterised by a transfer from the federal government to the poorer than average regions, average PIT per capita being the sole criterion in the formula.

On the other hand the interpersonal solidarity, which is a strong sign of belonging to the same community, has been broken for the first time at the occasion of the sixth reform of the state: children allowances and part of health care – mental health, nursing home, first line medicine – are to be put under the responsibility of the communities.

However, Schokkaert and Van de Voorde (2011) say “interpersonal solidarity is essential, but it can be reconciled with different organisational models, including a far going regional decentralization.”

On that hot subject, Drèze (2009) tends to be constructive. Decoster (2009) well presents that contribution when he writes that it consists of two central ideas: “The first one (...) emphasizes that what many politicians, and a fortiori the broader public, consider as ‘redistributive’ activities, can often (but not always of course) be interpreted as *ex post* transfers of welfare improving insurance contracts. The adjective ‘*ex post*’, used by economists, refers to the fact that, *after* an accident happened, the insured gets his damage repaid by the insurance company. The ‘donors’ are all the other insured who have paid their premiums. The ‘recipient’ is the person who incurred the loss or damage. And yet, it would be better not to speak about ‘donors’ and ‘recipients’ since this risk sharing is welfare improving or win-win for all insured parties, also for those who happen not to receive transfers since they have not been struck by misfortune. Reasoning within this insurance framework sheds a very different light on many transfers going on in the welfare state. In his text Jacques Drèze shows that also interregional transfers could be designed and/or interpreted within this framework. From this perspective and only within the context of eventual future interregional transfers (since Jacques Drèze only considers his insurance perspective to bear on future developments), a transfer from (eventually rich) Flanders to a possibly poor Wallonia should not be interpreted as Flanders who is ‘helping’ Wallonia. No, the transfer follows from an agreement by which both Flanders and Wallonia insured themselves against lower than expected growth in real GDP per capita. It means that Flanders in that case perceives (at least part of) its higher regional GDP as a matter of luck and is aware of the possibility of the reversal of fortunes.

This application at the interregional level brings us to the second central idea of the paper. The insurance framework could lead to the hasty conclusion that, other things being equal, pooling the risks at the broadest possible level is preferred. This would plead in favour of keeping social security at the federal level (or moving it even higher up). Yet, Jacques Drèze shows that one can implement efficient risk sharing in a two tier structure. The upper tier then consists of an insurance between the units of this upper tier (e.g. the regions) concerning the uncertainty of future deviations of real regional GDP’s per capita from their expected trend. This insurance gives rise to “interregional transfers”, implemented through the financial innovative instrument of bonds indexed on the regional GDP per capita. The second tier implements the interpersonal “within-region” redistribution (still to be interpreted as ex post transfers within an ex ante-efficient insurance system)”. 
5. Conclusion: lessons for Scotland Constitutional Change

As far as we know the Scottish debate has some commonalities with the Belgian one. The objective of Scotland, although the referendum is on the independence of the country, is presumably to obtain a larger autonomy or even independence but within the United Kingdom; in that latter case Westminster might end up being an empty shell in terms of authority over Scotland.

What Flanders has obtained in a similar context might be a useful guidance for Scotland. In both cases we have the richest region complaining against a resource diversion benefiting to the south or against the lack of mastering on its own actual and potential resources.

The method used in section 4 could also bring inspiration to Scottish designers of future Scottish and federal institutions.

Two big differences however exist between the two experiences. First of all, due to the referendum mechanism, the Scottish play may be closer to a one-shot game than the Belgian game where such referendum is not permitted by the constitution. That change the environment of the game e.g. in terms of trust.

Second, London is not located in Scotland. As a consequence UK has not that limitation to the separation of UK; unlike that, without the Brussels node, separation of Belgium would be much easier indeed.

(to be completed after the conference)

Brussels, August 2013

References


Bouhon, F. and M. Reuchamps (eds), 2012, Les systèmes électoraux de la Belgique, Bruylant, Brussels.


Appendix 1: Map of federal Belgium

Figure 1 – Map of federal Belgium

Regions:
- Flanders in light blue
- Brussels in red
- Wallonia in dark blue and in purple

Communities:
- Flemish in light blue and red
- French-speaking in dark blue and red
- German-speaking in purple

Source: SPF Intérieur (Home Affairs Ministry) (viewed July 2013).
Appendix 2: Results of nationalist parties since 1954

Table A1 - Results of nationalist parties since 1954

<table>
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<tr>
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Some authors call those parties ethno-regionalist parties – see Van Haute and Pilet (2006), Van Haute (2012). Those parties usually present list of candidates in the constituencies located on their own community territory.
* Total number of seats = 212 till 1993, then 150; % of votes is to be understood at the level of the whole Kingdom of Belgium; to have an idea of corresponding linguistic votes consider than Flemish electorate is about 60% of that of the whole Kingdom.

**VU is an acronym for Volksunie; VB is for Vlaams Blok or Vlaams Belang.

*When the Volksunie (VU) disappeared, before 2003 elections, it splitted into fractions whose members joined traditional parties, especially the Christian Democrats (fraction at the origin of the NV-A) and the Socialists (group Spirit); N-VA means Nieuw Vlaamse Alliantie.

**For the elections of 2007 the NV-A was in coalition with Flemish Christian Democrats (CD&V). CD&V-NVA got 30 seats and 18.51% of the votes. Those figures are to be compared with the results of the sole CD&V in 2003 and 2010, i.e. 17 and 21 seats and 10.85% and 13.25% of the votes.

***FDF is the acronym of the Front Démocratique des Bruxellois Francophones; that party is again standing alone since 2011 after being from 1991 to 2010 elections in federation with the Liberals within the MR, the Mouvement Réformateur; FW is an acronym for the Front Wallon and PWT for the Parti Wallon des Travailleurs.

****RW is the acronym of the Rassemblement Wallon which also eventually merged with the Liberals.

Source: Service Public Fédéral Intérieur, Brussels, viewed July 2013 + Renard-Dodeigne (2012)

*****LDD means Lijst De Decker after the name of its leader, this is rather an “against all” party including against Belgium and monarchy.

Source: Renard and Dodeigne (2012) and SPF Intérieur (Home Affairs Ministry) (viewed July 2013).