CCRE CEMR
Local & Regional Europe

Local Finances and the Green Transition

Managing Emergencies and Boosting Local Investments for a Sustainable Recovery in CEMR member countries

Co-funded by the European Union

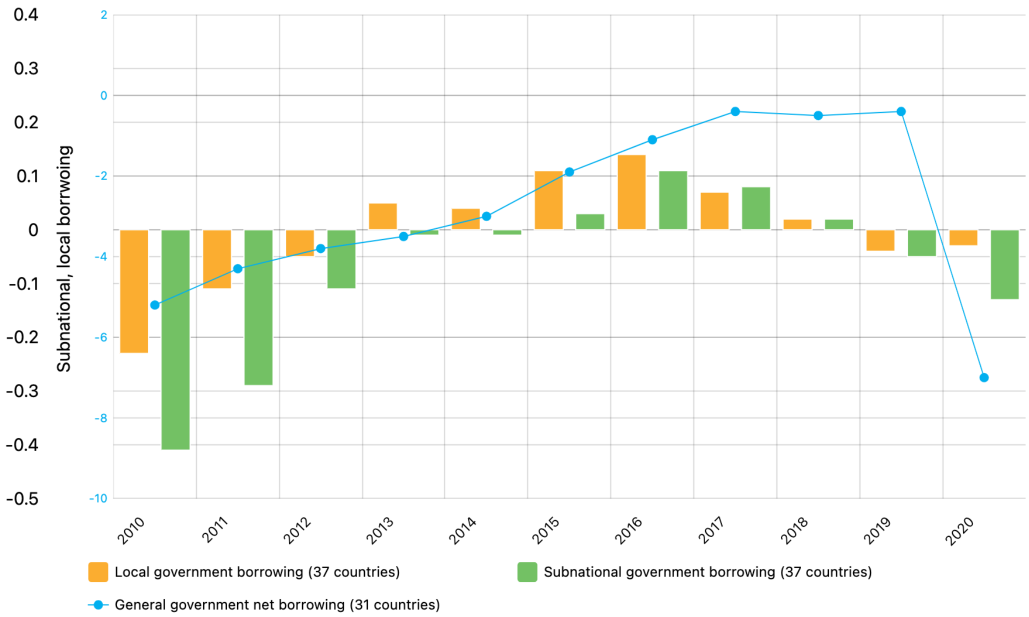
5. Budget balance and debt

As debt is widely used to finance capital investments, subnational governments' level of borrowing is a good indicator of their fiscal autonomy. Notwithstanding this, as the overall public debt is always a central concern of national fiscal policy, subnational borrowing and debt usually remain strictly controlled, even in the most decentralised systems. This was all the more true after the 2008-2009 economic crisis when central budgets became highly indebted.

Local borrowing

At the start of the past decade, local governments had to borrow amidst a restrictive fiscal environment (Figure 20). National grants and other own-source revenue had declined. Yet, borrowing by governments at the subnational level was relatively low unless the regional level was also taken into account. As larger entities, regional (state) governments are generally viewed as more creditworthy and are in a better position to secure access to credit and use loan financing. However, as the decade progressed, stricter local borrowing regulations and a steadily improving overall budget balance led to lower annual borrowing overall; by 2013, local governments were posting surpluses and only regional governments in federal countries had recourse to debt financing.

FIGURE 20 MANAGING GOVERNMENT DEFICIT, SELECTED CEMR COUNTRIES, 2010-2020
NET BORROWING(-)/NET LENDING(+) AS % OF GDP BY GOVERNMENT TIER



The turning point in the decade-long trend in subnational government budget spending was 2016. With general government budgets in a more stable position, subnational governments started to actively borrow again in 2019. However, since more conservative policies were being followed by local governments, borrowing remained at a low level. Specific forms of debt were invested in the funding of ecological investments (see Annex 3 on EU green bond standards and green loans in France).

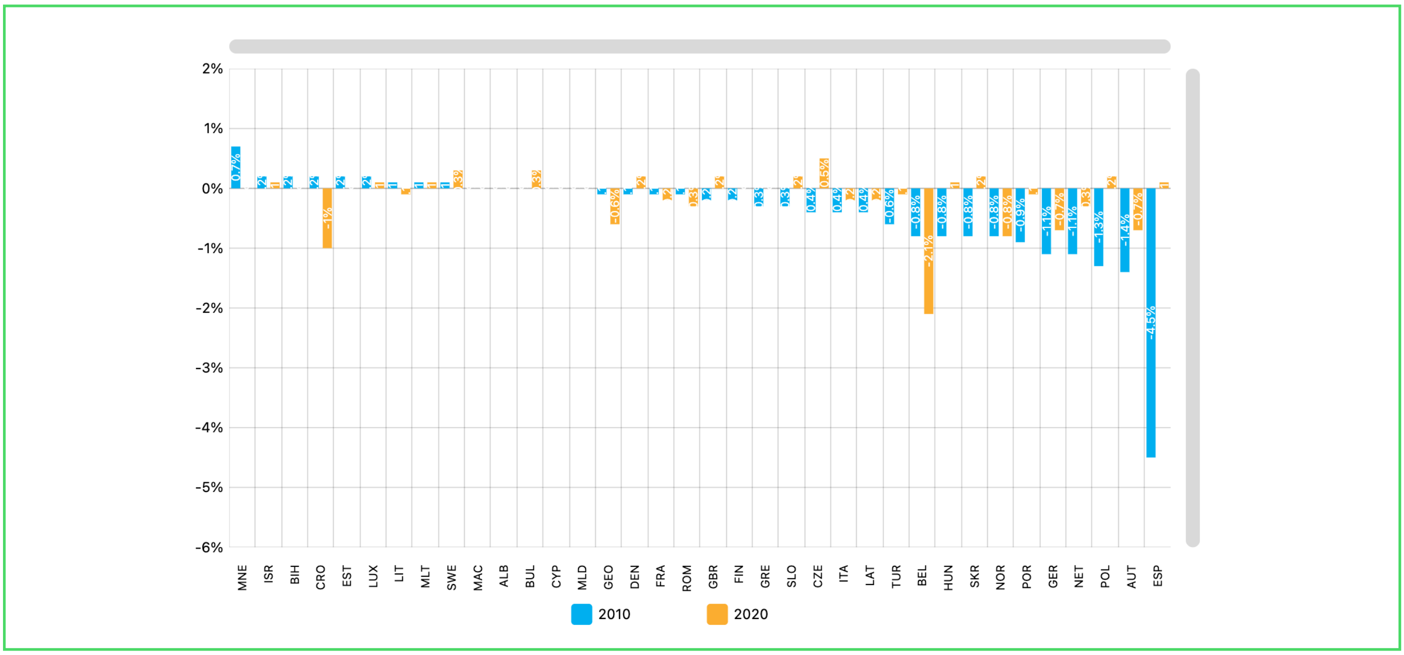
The first year of the pandemic placed the financial burden squarely on the national budget and on the regional governments. In Austria, fiscal rules specific to a federal country were developed for the subnational governments under the Austrian Stability Pact (see Box 2 above).

Local governments operate under a balanced budget requirement and borrowing is a minor source of budget revenue. Local debt policy options are partly influenced by municipal borrowing and debt regulations. Subnational governments in the CEMR countries followed a variety of borrowing policies. In most cases however, local borrowing potential was principally determined by the creditworthiness of the national budget.

In 2010, the highest level of borrowing by subnational governments was in the federal countries, with Spain, Austria and Germany coming in at the top of the list (Figure 21). Larger economies, such as those of the Netherlands, Poland and Norway, actively used loan financing as well. Countries with underfunded local governments and/or those accumulating debt to cofinance EU funds (e.g. Poland, Portugal, Slovakia, Hungary) can also be found in this group. At the other end are the small countries with controlled local borrowing opportunities that use this financing option less actively (e.g. Western Balkan countries).

FIGURE 21 LOWER IMPACT OF PANDEMIC ON SUBNATIONAL GOVERNMENT BORROWING

SUBNATIONAL BORROWING (-)/LENDING(+) AS % OF GDP, 2010, 2020



Local indebtedness

TABLE 7 CONSOLIDATED SUBNATIONAL GOVERNMENT GROSS DEBT

	Local government	*States in federal countries*
	as % of GDP	
2017	3.9	15.7
2018	3.8	15.3
2019	3.8	15.0
2020	4.8	17.5

Subnational government debt is at a manageable level in the 36 countries where comparative data was available (Table 7). As a result of strict fiscal rules and regulated borrowing procedures, accumulated debt was kept stable and below 4% of GDP at the lowest tier (see Box 20 on the progressive form of local debt regulations in Estonia). By way of comparison, general government debt had increased by the middle of the decade to 67% of GDP (and to 81% in 2020).

Box 20 – Local government debt regulation in Estonia

In 2011, the new Local Government Financial Management Act introduced, *inter alia*, a new budget structure, new balancing and debt rules, insolvency procedures and sanctions.

Local government borrowing and debt limits are regulated by balancing the operating budget. This dynamic approach calls for an operating result (amount of operating balance not lower than zero) and sets the upper limit of net government debt. At the end of the accounting year, net local government debt should be lower than the sixfold difference of the operating result, shall not exceed the total amount of the operating revenue and should be below 60% of operating revenue (if the sixfold operating result is less than the 60% of operational revenue).

Debt is broadly defined as including obligations, such as long-term debt to suppliers, leasing costs and requirements of concession agreements. Operational budgets use accrual-based accounting. Debt limits and positive operational results also apply to all local government institutions, including municipal companies. In 2010-2011, local governments faced restrictions in taking on new debt except in the case of co-financing for projects or the refinancing of existing loans.

https://www.riigiteataja.ee/en/eli/521122020004/consolide

Accumulated debt of the regional governments (the states in federal countries) reached 15% of GDP and rose even further in the first year of the pandemic (17.5%). Nevertheless, these federal regional governments, with their higher own-source revenue base and larger budgets, borrowed more actively.

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