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Fiscal Rules for Subnational Governments: The Devil's in the Details

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Abstract

Fiscal Rules for Subnational Governments: The Devil's in the Details

This paper describes and analyses the fiscal rules for subnational governments (SNGs) in OECD countries immediately prior to the COVID-19 crisis. It is based on information from the 2019 survey of fiscal rules for SNGs by the OECD Network on Fiscal Relations across Levels of Government. The paper analyses the details of the application of these SNG fiscal rules, and shows that the effective stringency of statutorily similar rules may vary greatly.

Keywords: Fiscal rules, fiscal federalism, intergovernmental fiscal relations, subnational governments

JEL classification: H72, H74, H81

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Résumé

Règles budgétaires applicables aux administrations infranationales : le diable se cache dans les détails

Ce document décrit et analyse les règles budgétaires applicables aux administrations infranationales dans les pays de l'OCDE juste avant la crise du COVID-19. Il s'appuie sur les données issues de l'enquête de 2019 sur les règles fiscales applicables aux administrations infranationales, réalisée par le Réseau de l'OCDE sur les relations budgétaires entre les différents niveaux d'administration. Le document analyse dans le détail les modalités d'application de ces règles budgétaires infranationales, et montre que le degré de sévérité effective de règles similaires du point de vue légal peut considérablement varier.

Mots-clés : règles budgétaires, fédéralisme budgétaire, relations budgétaires entre différents niveaux d'administration, administrations infranationales

Classification JEL : H72, H74, H81

Table of Contents

Tables

Figures

Boxes

1 Fiscal Rules for Subnational Governments: The Devil's in the Details

By Camila Vammalle and Indre Bambalaite[1]

Introduction

Fiscal rules (FRs) are constitutional, legislative, regulatory or other administrative rules, which directly or indirectly constrain subnational governments' (SNGs) room for financial manoeuvre (Ter-Minassian, 2007[1]). Fiscal rules are usually seen as a key policy instrument for ensuring fiscal discipline (Box 1). In the context of decentralisation, where decisions made by subnational governments (SNGs) can affect the overall macroeconomic stability, FRs for SNGs and "fiscal pacts" across levels of government are also widely used as a tool to ensure coordination of deficit and debt levels across levels of government (Eyraud et al., 2020[2]). Recently, many countries have activated general escape clauses and lifted FRs (both for central and subnational governments), following the COVID-19 global outbreak and the dramatic economic downturns generated by the lockdowns (OECD, 2020[3]).

The OECD Network on Fiscal Relations across Levels of Government carries out regular surveys of fiscal rules for SNGs. This survey was first carried out in 2005 (Sutherland, Price and Joumard, 2005[4]), i.e. in a period of high economic growth. The second survey was carried out in 2011 (OECD, 2013[5]; Fredriksen, 2013[6]; Vammalle, 2016[7]), right after the Global Financial Crisis and the Greek debt crisis. SNGs played an important role in the stimulus policies carried out during the GFC, leading to significant increases in SNG deficits and debt levels (Blöchliger et al., 2010[8]; OECD, 2016[9]). These accommodating policies were abruptly reversed after the Greek financial crisis in 2010, and subsequent general consolidation efforts in OECD countries (Vammalle and Hulbert, 2013[10]). This has led to increases in the number and stringency of FRs for SNGs, already visible in the 2011 data.

The present article analyses the data from the third survey, carried out in 2019, i.e. just before the COVID-19 outbreak. The survey was completed by 29 countries (26 OECD and three non-OECD) (Table A A.1). The paper aims to give a detailed overview of the different practices of FRs for SNGs across OECD countries. The main findings are the following:

[1] This document was discussed at the 16th Annual Meeting of the Network on Fiscal Relations, held virtually on 3-4 December 2020. It was prepared by Camila Vammalle and Indre Bambalaite of the Public Governance Directorate. The authors would like to thank Kass Forman for his inputs on the survey update and database. Comments and suggestions from Sean Dougherty (Head of Fiscal Network Secretariat), Hansjörg Blöchliger and Douglas Sutherland from the OECD Economics Department, Scott Cameron and Scherie Nicol from the Public Governance Directorate, and Teresa Ter-Minassian (Fiscal Network consultant) were much appreciated. A special thanks to Julie Corberand (Fiscal Network) for her help in finalising the paper.

- Most OECD+3 countries have at least two FRs for SNGs, and two-thirds of the countries have the three types of rules in place. However the stringency of each of these rules or their combination depends on the exact formulation of the rule and how it is calculated. Two countries may therefore have the same number or categories of rules, but with very different constraints on the fiscal behaviour and choices of their SNGs.
- Borrowing constraints are the most common FR for SNGs, followed by budget balance objectives. Expenditure limits are less used.
- For regional/provincial/state governments (RGs), FRs are often self-imposed and self-monitored, and the CG has little capacity to impose these. FRs therefore tend to vary across RGs. Frequently (in particular in EU countries) FRs for RGs result from inter-governmental negotiations and "pacts".
- In countries with three levels of government, FRs for LG are often imposed by the RGs, and therefore may vary across regions.
- The principles for FRs are often set in the constitution or constitutional laws, and often for the general government level. Details on the targets and allocation of ceilings across levels of government are often left to ordinary legislations.
- Budget balance objectives (BBOs) often target only current balances (golden rule), for realised budgets, are set on annual basis, and calculated in accruals.
- Expenditure limits are not widely used, and usually constrain only certain type of expenditures (in particular, personnel expenditure).
- Borrowing constraints consist mainly on requesting approval from the CG to borrow, restricting borrowing to investment purposes, and restricting borrowing abroad or in foreign currency. Several countries also set a maximum amount of debt stock and debt service (in general expressed as a share of SNG revenues).
- Very few countries provide CG guarantees to individual SNG loans. However, when SNG loans are approved by the CG, markets may interpret this as an implicit guarantee.
- While many countries have tax assignments which forbid SNGs to levy certain types of taxes (such as VAT or general sales taxes), very few have rules capping tax rates or tax revenues.
- Ministries of Finance, Ministries of interior and Independent Fiscal Institutions are the main institutions responsible for monitoring compliance of SNGs with FRs, identifying SNGs at risk of facing fiscal difficulties, and imposing corrective measures.
- Enforcement mechanisms range from reducing access to specific types of grants, to imposing sanctions, corrective measures, replacing SNG officials and even forcing municipal mergers. In some countries, ministers' salaries and rewards are also linked to the compliance with budgetary targets.
- Some countries have formal bailout mechanisms in place. These impose costs to bailed out SNGs in order to reduce the risk of moral hazard while ensuring fiscal sustainability of the SNGs.
- Other countries faced with structural SNG financial difficulties have reformed the revenue allocation and expenditure responsibilities of their SNGs to ensure sufficient funding for their responsibilities, and therefore prevent building up of SNG debts.
- Different mechanisms are used to deal with unexpected shocks and cyclical fluctuations such as escape clauses, rainy day funds, unallocated budget lines for emergencies, CG support.

The first section briefly describes the different types of FRs used in OECD countries, and their evolution since 2011. Sections 3 to 6 provide a detailed description of how budget balance objectives, expenditure limits and borrowing constraints are used in OECD countries. Section 7 analyses the monitoring and enforcement mechanisms for early identification of potential sustainability threats and corrective measures that the central government (CG) can take, while respecting the autonomy of SNGs as guaranteed by their national legislations. Section 8 looks at the relationship between SNGs and state-owned enterprises (SOEs), and mechanisms in place to avoid SOEs becoming a fiscal risk for SNGs. Finally, section 9 provides insights on how countries handle the trade-off between stringency of the rule and the necessary flexibility to respond to economic cycles and exceptional crises.

Given the richness of the information collected in the survey and quality of the answers provided, this article concentrates mainly on sharing practices and solutions to trade-offs. An interesting follow-up for future work could be to update the OECD indicators to analyse how these have evolved since 2006 and 2011. However, given that this version of the survey has been revised, with new questions added (in particular on rainy day funds) and others deleted or reworded, comparability of indicators will not be guaranteed. Another interesting follow-up could be to assess the effectiveness of FRs, analysing relationship between the stringency of the rules (as captured by the indicators) and outcomes, such as SNG deficits, debts and investment levels.

Box 1. Potential risks for subnational government debts

Decisions by SNGs on their expenditure and debt levels enter in the general government calculations, and if not regulated properly, may threaten national fiscal sustainability. In particular, SNG debts trigger four types of risks:

- **Common pool problem: debt creates externalities across levels of government**. Sustainability of debt is determined by the joint actions of all government levels. Increases in debt by some part of government may increase general government debt, thereby affecting budget balances and potentially interest rates on public debt.
- **The risk of contagion can disrupt financial markets**. Financial problems of one, even small, SNG can have large contagion effects on markets for municipal and regional bonds and lead to a rise in risk premia for all SNGs and even the central government.
- **SNGs often own public enterprises whose debt is not accounted for in the national accounts and which create contingent liabilities**. Indeed, if these companies face financial difficulties, SNGs will be expected to bail them out, which could affect their fiscal position.
- **Central governments are usually held politically responsible for SNG debt, often taking on the form of implicit or explicit bailout guarantees.** This may generate moral hazard, as SNGs expecting a bailout may engage in unsustainable fiscal policy, thereby increasing general government debt.

2 Overview of fiscal rules for SNGs and their evolution since 2011

There are four main types of FRs which are commonly used for SNGs: budget balance objectives, expenditure limits, borrowing and debt rules (Box 2).

Box 2. Description of the FRs for SNGs

Budget balance objectives (deficit rules)

Budget balance objectives (BBO) are constitutional, legislative, regulatory or other administrative rules that directly or indirectly impel a SNG to achieve or attempt to achieve one or more of the following:

- A balanced budget, in particular a balanced current (operating) budget, or a deficit target approaching zero.
- An aggregate expenditure target that is somehow related to revenue receipts.

Budget balance objectives may be applied to individual SNGs, or to the aggregate balance of all SNGs. In the latter case, there must be a mechanism for allocating deficit authorisations across SNGs.

Borrowing and debt rules

Borrowing and debt rules are constitutional, legislative, regulatory or other administrative rules that directly or indirectly limit how much a SNG may borrow and/or for what purpose. Borrowing and debt rules can forbid SNGs from borrowing (as for LGs in Portugal), require authorisation from the CG before borrowing (as in Hungary), or oblige SNGs to borrow from the CG (as in Ireland). Borrowing and debt rules may also impose other constraints on SNG borrowing such as forbidding borrowing on foreign markets or in foreign currency (as in Mexico). As for BBOs, borrowing and debt rules can be applied to individual SNGs or to all SNGs on aggregate.

Expenditure limits

Expenditure limits are constitutional, legislative, regulatory or other administrative rules that directly or indirectly constrain an SNG's level of expenditure, including but not limited to:

- Linking spending levels to demographic or economic indicators (population, inflation, etc).
- Ceilings on expenditure growth.
- The requirement to hold referenda for expenditure above a certain threshold or for certain types of spending.

All budgets and multi-year budgets set out annual (or multi-annual) authorisations for SNGs expenditures. However, as long as the level of expenditure results from a regular budget process without a specific legal constraint on how these levels are set (such as a ceiling on the possible growth rate compared to the previous year, or a ceiling imposed by a separate regulation or higher level of government), budget appropriates are not considered as an expenditure limit fiscal rule.

Tax limitations

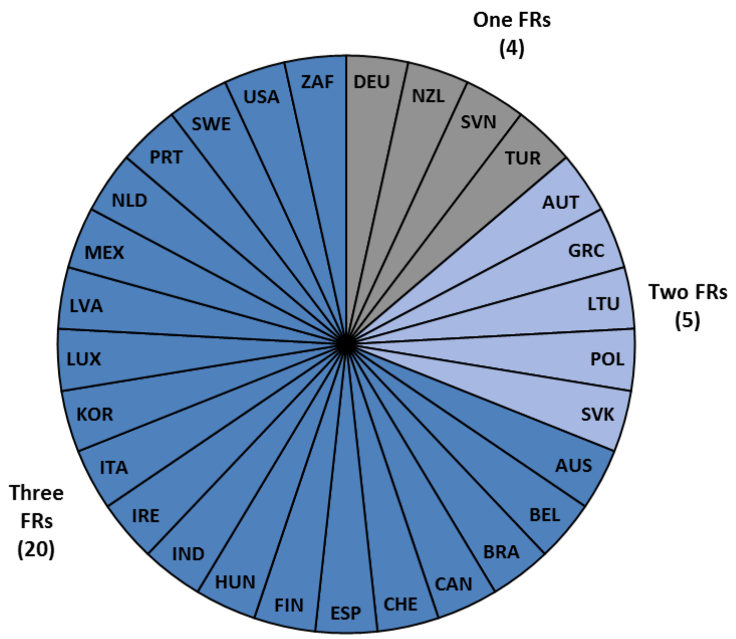
Tax limitations have very different objectives than deficit rules, debt rules and expenditure limits, as they do not directly aim at ensuring the fiscal sustainability of SNGs. Rather, tax limitations either set minimum rates to avoid tax competition among SNGs, or maximum rates to avoid competing on tax bases with the CG and overburdening tax payers (Blöchliger and Pinero Campos, 2011[11]).

In many countries, national regulations forbid SNGs from levying specific taxes (such as VAT, income taxes, sales taxes, etc). These are considered as tax assignments, rather than as tax limitation types of fiscal rules. Limitations on the ability of SNGs to set the rate or base of their assigned tax rates are however very frequent (Dougherty, Harding and Reschovsky, 2019[12]). In Poland for example, the ALTF Law describes the taxes and fees assigned to SNGs and sets the maximum tax rates and fee levels. These maximum rates and levels are revised annually through an indexation mechanism based on the CPI. In Luxembourg, LGs need to submit the tax rate for the municipal tax for the upcoming year to the Grand-Duke for approval. If the proposed rate does not comply with the tax limit (according to the Ministry of Interior), the Grand-Duke can refuse the proposed tax.

Tax limitations are not analysed in this paper.

The use of FRs for SNGs is very widespread in OECD countries, with all surveyed countries having at least one rule, and 20 out of 29 surveyed countries having three (Figure 1 and Table A B.1).

Figure 1. Number of SNG fiscal rules per country



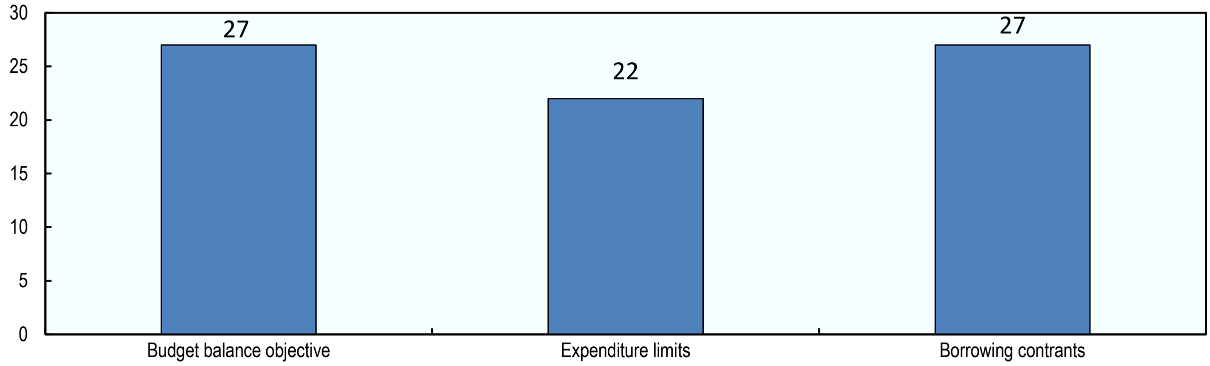
Note: FR – fiscal rule. All 29 countries responded to this question. Detailed country answers are provided in Table A B.1 in Annex B.
Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 1.2.

Borrowing constraints and budget balance objectives are the most frequently used rule, with all respondent countries except Austria and Slovenia having borrowing constraints in place (Figure 1 and Table A B.1) and all countries except Latvia and Turkey use budget balance objectives. Expenditure limits are slightly less frequent, with only 22 out of 29 surveyed countries having it in place.

Among participants in both vintages of the survey (2011 and 2019) (16 countries), 18 new rules were introduced and only one fiscal rules was suspended. In the vast majority of cases (11 out of 18), countries introduced expenditure limits. Indeed, most of the countries already had a balanced budget rule and certain borrowing constraints in place.

Figure 2. SNGs fiscal rules in OECD countries

Number of countries



Note: FR – fiscal rule. All 29 countries responded to this question. Detailed country answers are provided in Table A B.1 in Annex B.
Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 1.2.

3 Deficit rules: Budget balance objectives

As the previous section showed, budget balance objectives (BBOs) for SNGs are a very widely used instrument. However, the devil lies in the details, and these BBOs are actually very different from country to country, with some being much more stringent than others.

Application of the BBO: to individual SNGs or for all SNGs on aggregate?

The BBO applies most of the time to individual SNGs. However, in some countries, it is applied to the aggregate of all SNG budgets. For example in Slovenia, the budget balance objective is set for the 212 municipalities in aggregate. However, there is no mechanism for distributing this objective across municipalities.

Coverage of the BBO: current or capital expenditure as well as off-budget funds?

The BBO may apply to different accounts. In particular, they may apply to the current budget only (often called "golden rule") or to the current budget and off-budget funds (strong golden rule). In this case, the capital account is allowed to be in deficit, i.e. borrowing is allowed only to finance public investment.

In some countries, the BBO covers both the current and capital accounts (in aggregate terms), thus allowing deficits in one to be compensated by surpluses in the other. In particular, public investment may be financed with a deficit in the capital account, as long as the current account shows an equivalent surplus (as in Luxembourg). Some countries require that the current and the capital accounts are balanced in aggregate, and the current account is not in deficit (i.e. a deficit in capital account could be financed with a surplus in the operating account, but not the opposite). Finally, the strongest BBO covers both current and capital budgets, and off-budget funds.

The most commonly used rule in OECD countries is the golden rule, i.e. only the current budget needs to be balanced, and the capital budget may be in deficit to finance public investment (Table 1). In the USA, while most states (all except Vermont) have a balanced budget rule in their constitution, how this rule is understood and implemented is not always clear or the same across states. The requirement of a balanced budget largely refers to the operating budget. Bond finance for capital projects, the purpose of which is borrowing against future revenues, is generally not considered by policymakers to fall within any constraints of a balanced budget requirements (NCSL, 2010[13]).

Table 1. Coverage of budget balance objectives for LGs in OECD countries

Not used	Current budget ≥ 0 only (golden rule)	Current budget including off-budget funds ≥ 0 (strong golden rule)	Current and capital budget in aggregate ≥ 0 (budget balance rule)	Current budget ≥ 0 and aggregate budget ≥ 0 (strong budget balance rule)	Current and capital budgets and off-budget funds (Very strong BBO)
AUS	IRE		CAN	USA	BEL
TUR	FIN		ESP	CHE	AUT
ZAF	HUN		LTU	LUX	GRC
	LVA		KOR		NLD
	MEX		IND		
	NZL				
	POL				
	PRT				
	SVK				
	SWE				
3	**10**	**0**	**5**	**3**	**4**

Note: Only countries that answered this specific question are shown (25). ZAF has a BBO which is negotiated between levels of government, but not binding, as the present table refers to binding commitments, it is classified as "not used". In Brazil, the BBO applies both to current and aggregate budget (strong budget balance rule), but only on the primary balance (i.e. net of interest payments) rather than the overall balance, which makes the rule less tight than a normal strong budget balance rule.
Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 2.4.

Target of BBOs: submitted, approved, or realised budgets?

BBOs can target different stages of the budget process. The weakest rule would target only the submitted budget, letting the Parliament/Municipal Council vote a budget in deficit (no OECD country uses this). One country (New Zealand) only requires the approved budget to be balanced (thus accepting deviations in realised budgets).

Most countries, require that the realised budgets are balanced, but differ on the treatment of realised deficits, with some countries only requiring LGs to take corrective actions to avoid further deficits in the future (9 countries in the 28 country sample), while other countries require them to compensate realised deficits with equivalent surpluses in the following years (13 countries in the 28 country sample) (Table 2). In Poland for example, each SNG budget must be at least balanced (zero deficit) on the submitted, adopted and realised operating budgets. However, the Act on Public Finance provides some flexibility with regards to the executed budget in case of current expenditures financed from EU funds, if these funds were not transferred within the budget year. In the Netherlands, realised budget deficits must be compensated within four years (in a recent change, this period can be extended to ten years in case the negative general reserve was caused by recognizing losses on property development activities).

In federal countries where FRs are self-imposed by SNGs themselves, practices may vary from one RG to another. For example in Canada, Quebec imposes that overruns of less than CAN 1 billion must be offset by an equivalent surplus the following fiscal year. Overruns greater than CAN 1 billion must be offset over a maximum period of five years.

Table 2. Target for balanced budget rules

Not used	Submitted budgets only	Approved budgets only	Realised budgets	
			Deficit does not have to be corrected	Deficit to be corrected by offsetting surplus during the next budget period(s)
AUS	IND	NZL	BEL	AUT
ZAF			BRA	CAN
ITA			HUN	CHE
TUR			LTU	ESP
			LVA	FIN
			NLD	GRC
			POL	IRE
			SVK	KOR
			SVN	LUX
				MEX
				PRT
				SWE
				USA
4	**1**	**1**	**9**	**13**

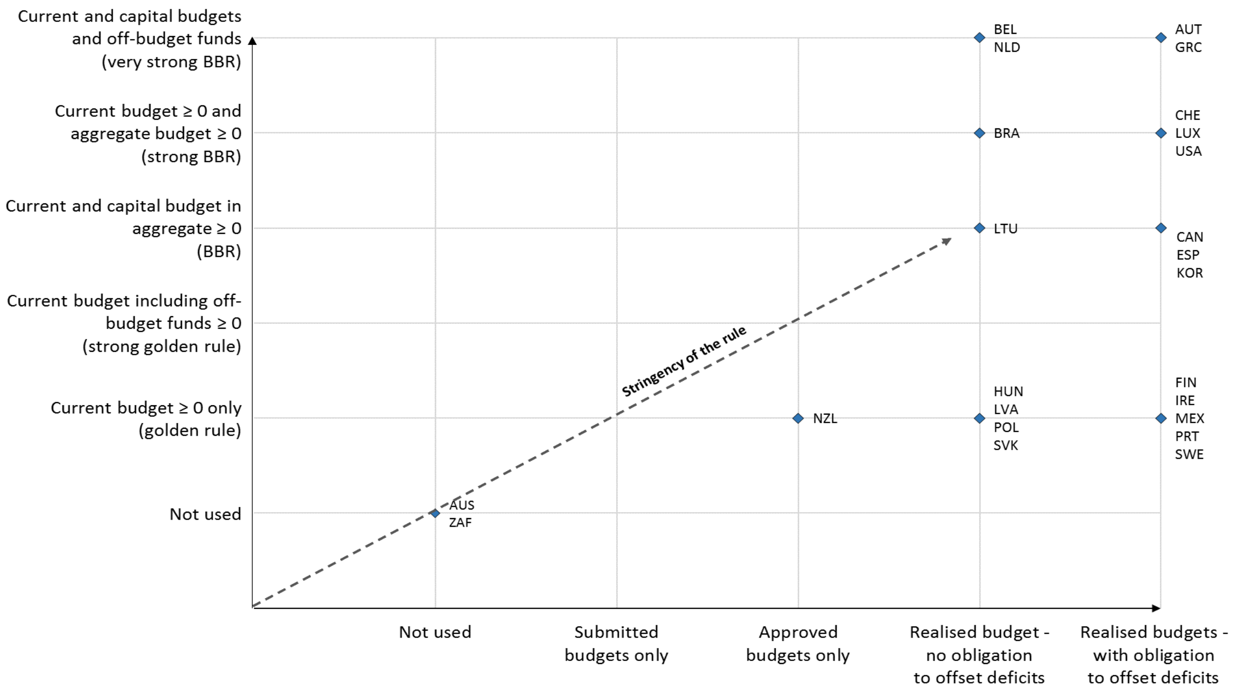
Note: Only countries that answered this specific question are shown (28).
Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 2.1a and 2.1b.

Stringency of the BBOs based on coverage and target of the rule

The stringency of the BBO depends on the combination of the target for the BBO and the coverage of the rule. The weakest OECD BBO for SNGs is in New Zealand, where the BBO only applies to approved current budgets,[2] and the tightest BBO is found in Austria and Greece, where the BBO applies to capital, current and off-budget funds, to realised budgets, and SNGs have an obligation to compensate any realised deviation in the following budget years (Figure 3).

[2] Please note that this does not mean that SNGs can borrow freely: local governments in New Zealand face a very strict debt ceiling of net debt to revenue ration below 250% (increased to 300% recently due to the COVID-19 response). However, unlike most countries, this ceiling is not imposed by the central government, but freely accepted by the local governments in exchange for borrowing from the Local Government Funding Agency.

Figure 3. Stringency of the BBO according to the coverage and target of the rule



Note: Only countries that answered this specific question are shown (24).
Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, questions 2.1a, 2.1b, 2.4 and 2.5.

Cyclicality of BBO: actual or structural balances? Annual or multi-annual?

Using a structural BBO helps to mitigate the pro-cyclical effects of the cycle of SNGs' expenditures. However, calculating the potential GDP of SNGs may be complex and unreliable, except for large SNGs. Some countries use the same potential GDP for SNGs as for the CG, but this implies there are no large asymmetric shocks. A more pragmatic approach is to use a multi-annual budget balance rule (6 countries out of the 28 in the sample). Most countries rely on annual BBOs for SNGs (20 out of 28 countries in the sample) (Table 3). In the Netherlands, municipalities are required by law (Municipalities Act) to set budgets balanced in structural and real terms, not only for the budget year, but also for at least the three following budget years. This is monitored by the Provincial executive.

Definitions of what is considered as a structurally balanced budget also differ among countries, and sometimes within countries between different levels of government. In Austria for example, the Austrian Stability pact requires the general government budget to be structurally balanced. Structurally balanced is defined as a structural general government deficit not exceeding 0.45% of GDP. There is then a mechanism that divides this over the three levels of government: CG is allowed a 0.35% structural deficit, and states and municipalities a 0.1% structural deficit together. In Germany, the constitution (Basic Law) states that the budgets of the *Länders* shall in principle be balanced without revenues from credits, i.e. structural balance refers to net borrowing below 0% of GDP.

Table 3. Cyclicality/timeframe of the BBOs

Not used	Varies with the length of the economic cycle	Pre-determined multi-annual period (years)	Annual	Other
USA***		CAN*	BEL	AUT
TUR		GRC (4)**	BRA	
		USA (2)***	CAN*	
		ESP (3)	DEU	
		FIN (4)	GRC**	
		SVN (3)	HUN	
			IND	
			IRE	
			KOR	
			LTU	
			LUX	
			LVA	
			MEX	
			NLD	
			NZL	
			POL	
			PRT	
			SVK	
			SWE	
			USA***	
2	**0**	**6**	**20**	**1**

Notes: * Depends on a province, for some the BBO applies annually, for others it may range from 3 to 5 years; ** The medium-term target refers to the total local government subsector and instructions for the preparation of the annual budgets of local governments take into consideration the targets set by the medium-term fiscal strategy; *** Federal reimbursements and aid happen for specific purposes, tax collections do not always go through the appropriations process, and some states do not require universities to collect money on an annual or biennial basis. Only countries that answered this specific question are shown (25).
Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 2.2.

Accounting standards: fiscal rules calculated in cash or accruals?

BBOs can be calculated and compliance checked on accounts prepared in cash, or in accruals (Box 3). When using accruals accounting, only the depreciation of assets is taken into account in the operating or capital budget balance, rather than the full cash disbursement for the asset. This allows distributing the cost of the public investment over several budget periods, thus reducing the budget deficit in the year of building/purchasing the asset.

Most countries calculate their BBO for LGs in accruals (12 out of 15 in the sample) (Table 4). In Lithuania for example, BBOs are calculated in accruals (and in structural terms) for the four largest municipalities (with expenditures above 0.3% of GDP), and in cash (and annual basis) for the remaining municipalities.

Box 3. Pros and cons of cash basis vs. accrual basis accounting for SNGs

As noted in a recent study of the fiscal network (Irwin and Moretti, 2020), accounting standards can be classified as "cash basis" or "accrual basis". Common wisdom is that cash-based accounts are easier to prepare because they are simpler and require fewer judgements and estimates. That means they are also easier to understand and less vulnerable to manipulation by means of dubious judgments or optimistic estimates. However, the merits of accrual accounting is in providing a more comprehensive picture of the finances of local government.

First, accrual-based accounting standards requires the recognition of economic events at the time at which they occur, regardless of when the related cash receipts and payments change hands. Economic events can include the delivery of a taxable service by a private company (for which the government accrues tax revenue), performance of a public service by a government employee (for which the government accrues a salary and perhaps a pension expense), or the loss or theft of a government asset such as a vehicle or equipment (for which a reduction in the asset stock will be recognised). These economic events may generate a corresponding or simultaneous cash flow, but in many cases – such as depreciation, revaluations, or impairment - they do not. This is an important difference between cash and accrual bases.

Second, the recognition of all stocks of assets and liabilities in balance sheets. Under accrual accounting, governments recognise all assets and liabilities including financial assets (such as equities), non-financial assets (such as land and buildings), and all liabilities including debt securities and bonds and other liabilities (such as payment arrears and civil service pension obligations). These stocks may be recorded at their historic cost, current market value, or some approximation, that is regularly revalued to ensure the balance sheet reflects the government's true financial position at a given point in time. Governments that follow pure cash accounting typically account only for their cash holdings on the assets side and, possibly, debt on the liability side of their balance sheets. These are often valued at "book value" or the value at which they were initially acquired or issued.

Source: Irwin and Moretti (2020[14]), "Can subnational accounting give an early warning of fiscal risks?", *OECD Journal on Budgeting*.

Stringency of the BBO according to the accounting standard and cyclicality

Rules calculated in cash are more stringent than in accruals (since accruals only take into account **the depreciation in the annual accounts), and annual rules are more stringent than multi-annual or structural rules**. The most stringent combination is the annual BBO calculated in cash, as in India, Lithuania (for all municipalities except the four largest ones), Luxembourg and Poland. The weakest combination is accrual-based and multi-annual, as in Finland, where local governments' budgets must be balanced in accruals terms, over a four-year period (Table 4).

Table 4. Stringency of the rule depending on the accounting standard and the cyclicality of the rule

	Accrual	Cash	Total
Annual	IRE, NZL, SVK, KOR, MEX, PRT, NLD, IRL	IND, LTU (small)*, LUX, POL	**12**
Structural	FIN, LTU (4 large)*, NLD		**3**
Multi-annual (years)	FIN (4)	ESP (3), SLO (4)	**3**
TOTAL	**12**	**6**	**18**

Stringency of the rule

Note: Large LGs in LTU refer to LGs, whose expenditure exceed 0.3% of GDP; this applies only to four out of 56 LGs in Lithuania. Only countries that answered this specific question are shown (15).
Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 2.2 and 2.3.

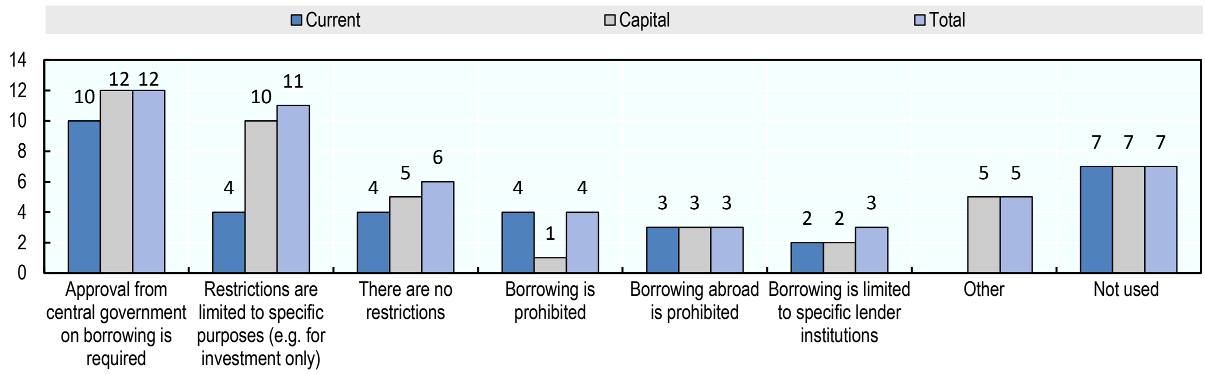
4 Debt rules: Borrowing constraints

Limits to SNGs access to borrowing

Restrictions on SNG borrowing may apply only to borrowing for current expenditure, capital expenditure or both. Restrictions on SNG borrowing are very frequent, with only nine countries in the sample not having any (Table A B.4). These are generally federal countries (such as Austria, Belgium, Germany, Canada or Switzerland) or highly decentralised countries (such as Finland). New Zealand does not have any formal borrowing constraint either, as New Zealand is a country following the "market based" approach, with very little FRs from the CG.

Figure 4. Restrictions on SNG borrowing

Number of countries



Note: Only countries that answered this specific question are shown (29). Detailed country answers are provided in Table A B.4 in Annex B.
Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 4.1.

The strongest type of restriction is requiring an approval from the CG (12 countries) (Figure 4). In Ireland, not only LGs must request ministerial approval for borrowing, but they also can only borrow from the CG. In Hungary, to get the approval of the Cabinet, LGs must show they have analysed all other possible funding sources (such as raising local business tax, some property tax or personal communal tax). Korea only requires approval from the Ministry of Public Administration and Security for borrowing on foreign markets. In Latvia, the Ministry of Finance has established a Local Government Borrowing and Guarantee Control and Supervision Council to address borrowing and guarantee requests by LGs.

In some countries, all SNGs must be consulted and must approve individual SNG borrowing. South Africa for example require a consensus from all provinces and the national Minister of Finance to allow provincial borrowing. However in practice, this rarely happens provinces do not often engage in long-term borrowing.

Limiting borrowing to specific purposes (generally to finance public investment) is very frequent (11 countries). In Mexico for example, long-term loans (more than 12 months) are only allowed to finance productive public investment. Productive public investment is defined as expenditure which generate a social benefit (directly or indirectly), and the purposes for which long-term borrowing is allowed are also strictly defined. On the other side, short term loans (less than 12 months) can be used for liquidity, but shall not exceed 6% of the total incomes approved by their local congresses.

Borrowing abroad or in foreign currency is sometimes forbidden for SNGs (3 countries). In New Zealand, only Auckland is allowed to borrow abroad, as its borrowing needs are too large for the local market. Many countries do not allow SNGs (in particular LGs) to issue bonds. Following some bad experiences during the 2008-09 crisis, several countries have put in place rules to limit speculation and use of derivatives by SNGs (as in the Netherlands). Finally, some countries do not allow SNGs to borrow for current expenditures at all (4 countries).

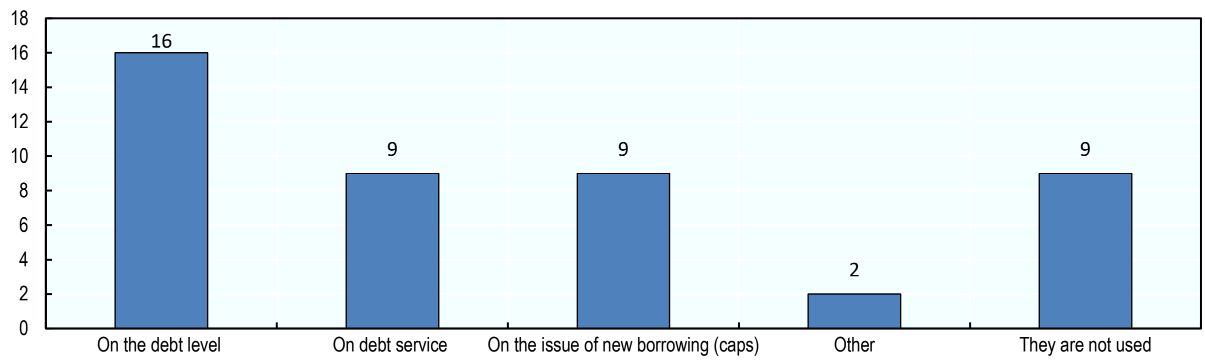
No country in the sample totally forbids borrowing for capital expenditure.

Limits on SNG debt level, new borrowing and deb service levels

About two-third of surveyed countries have some type of restriction on the level or growth rate of debt or debt service (Figure 5, Table A B.5). However, making international comparisons is very difficult, as the ratios on which these limits are set vary across countries, and the definitions of debt used are not homogeneous either (Maastricht definition, Maastricht definition plus commercial debts, include or not debts of SOEs, etc.). Country examples are discussed below, but a more detailed comparative analysis of the stringency of the rules would require developing a full survey on this topic, to collect information from all countries in a comparable way.

Figure 5. Restrictions on SNG new debt and debt servicing

Number of countries



Note: Only countries that answered this specific question are shown (28). Detailed country answers are provided in Table A B.5 in Annex B.
Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 4.2.

Restrictions on the stock of debt

Debt stock ceilings are sometimes calculated as a share of budgeted spending or as a share of revenues. In the Netherlands for example, the average short-term debt cannot exceed 8.5% of budgeted spending and long-term debt 20%. Debt stock cannot exceed 15% of non-earmarked revenues in Mexico, and 1.5 times the average net current revenues of the previous 3 years in Portugal.

Some countries set different limits depending on the financial strength of the SNG. In Mexico for example, the Ministry of Finance has a system of alerts that evaluates/measures the debt level of SNGs, and classifies SNGs into a sustainable level (green), an observation level (yellow) and a high debt level (red). Sustainable level SNGs can borrow up to 15% of their non-earmarked revenues, observation level can borrow up to 5% of their non-earmarked revenues and high debt level SNGs are not allowed to borrow.

The maximum debt stock allowed as a share of revenues varies greatly across countries, from 200% of net revenues for Brazilian states (120% for Brazilian municipalities), 150% of average revenues collected in the past three years in Portugal, 50% of current revenues of previous year in Slovakia, and only 20% of basic budget revenues in Latvia.

Some countries define the maximum debt stock for SNGs annually. Lithuania for example defines the maximum debt stock to LG revenue ratio each year in its Law on the Approval of the Financial Indicators of the State Budget and Municipal Budgets. This ratio was decreased gradually from 70% or projected revenues in 2016 to 60% in 2020 (135% to 75% for Vilnius city).

Debt service limits and limits of new SNG borrowing

Debt service limits are also frequently used (9 countries in the sample) (Figure 5, Table A B.5). These vary from 50% of annual own revenues in Hungary, to 11.5% of net revenues in Brazil.

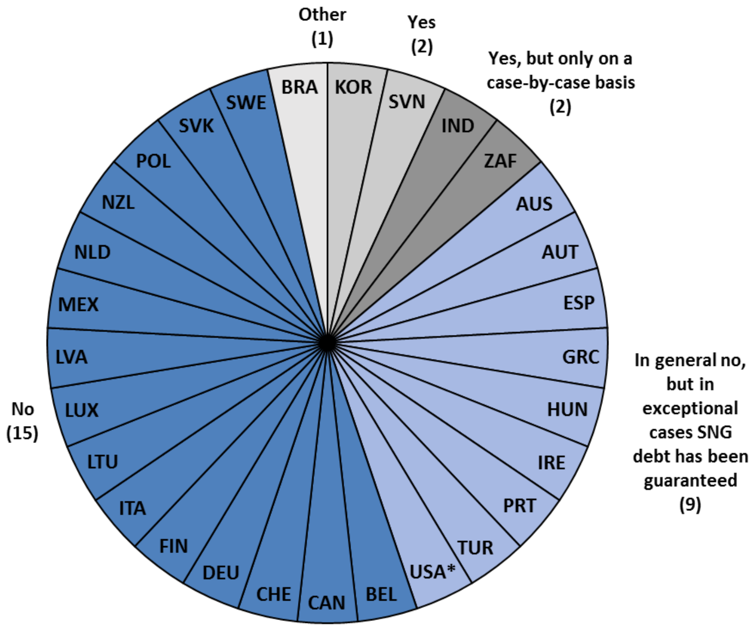
Several countries constrain new SNG borrowing: in Brazil, new SNG borrowing is limited to 16% of net revenues, and in Portugal, new borrowing must remain below 20% of the available borrowing margin (i.e. to reach the borrowing ceiling).

As for the debt ceiling, some countries set every year the amount of new borrowing allowed in the coming budget year. This practice reduces the predictability of financing and therefore the capacity of SNGs to plan beyond the budget year. These limits can either be set on aggregate for all SNGs (as in Latvia, where CG budget law annually sets maximum amounts for the total increases in LG debt and guarantees), or for each SNG (as in Lithuania, where the CG sets annually net borrowing limits for SNGs, as a share of projected revenues.

CG guarantees of SNG debts

CG guarantees of SNGs can either be explicit (through an approval process or formal guarantee endorsement), or implicit, as a general bailout expectation. Commonly agreed good practice is to avoid setting bailout expectations, as these could lead to freeriding and over-indebtedness of SNGs. This is reflected in the fact that half the countries in the sample do not provide CG guarantees to SNG debts (Figure 6). In some countries, CG guarantees to SNG debts is forbidden by the constitution (Slovakia). However, some countries do provide CG guarantees in exceptional cases (nine countries) or on a case by case basis. Only two countries regularly provide guarantees to SNG debts (Korea and Slovenia).

Figure 6. SNG debt guarantee by CG



Note: * The US federal government does not guarantee general obligation debt of the states. However, there has been a particular instance when the federal government has issued a Special Community Disaster Loan for Puerto Rico and The United States Virgin Islands, which are not states but territories; otherwise loans/loan guarantees provided by the federal government to lower levels of government are typically offered to municipalities or special purpose districts. All 29 countries answered this question.
Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 4.3.

Countries usually carry out a careful assessment of the financial health of the SNGs before granting a guarantee. In Brazil, since 2017, the federal government uses a new Payment Capacity Analysis (CAPAG) methodology to assess SNGs to grant them guarantees and avoid discretionary decisions and improving transparency. CG guarantees cannot be given to SNGs with C and D credit ratings. The new Payment Capacity Analysis methodology uses three indicators: (i) The indebtedness indicator evaluates the consolidated debt to net current revenue ratio. It aims to assess the level of solvency of the government by comparing the stock of liabilities and revenue. (ii) The current savings indicator assesses whether the SNG is making enough savings to fund their investments through savings. (iii) The liquidity index assesses whether the SNG has enough cash resources to meet the already incurred financial obligations.

Guarantees can also be used to provide relieve to states in financial difficulties, in exchange for taking action to solve the issue. In Mexico, when states face serious financial difficulties and need to borrow above the threshold set in the system of alerts indicators, the Federal Government can provide them support through the Guaranteed State Debt mechanism. In exchange for the support, states must commit to comply with financial discipline specific agreements.

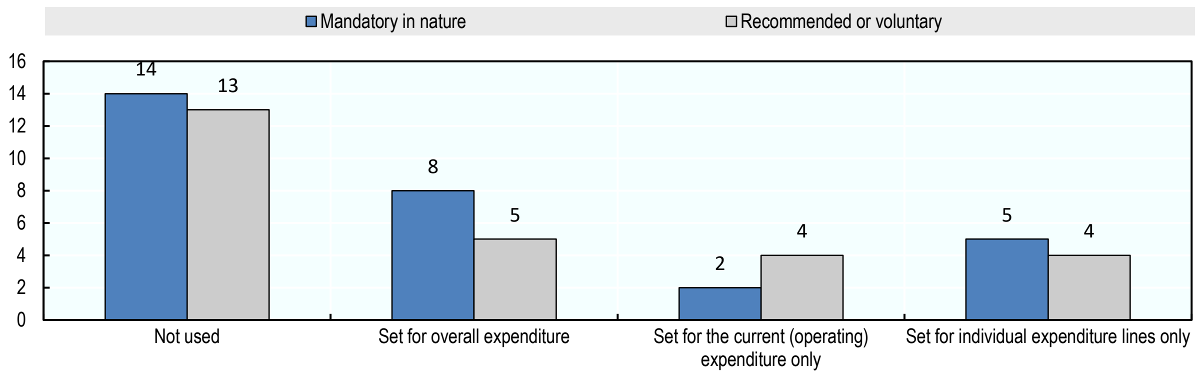
5 Expenditure limits

Characteristics of expenditure limits

Only about half the countries in the sample use expenditure limits for their SNGs (Figure 7). Expenditure limits are rules which constrain either the level or growth rate of SNG expenditure.[3] They can be applied to individual SNGs on overall expenditure (8 countries in the sample), only on operating expenditure (2 countries in the sample), or for specific budget lines (often personnel expenditure) (5 countries in the sample) (Table A B.2). In Brazil for example, the Fiscal Responsibility Law sets limits to personnel expenditure. States that had their debt renegotiated also get specific limits on their current expenditures as part of the renegotiation deal. Some states have their own fiscal responsibility laws, which impose limits on current expenditure. However, due to the lack of uniform national accounting standards, different states implement this limit in different ways, and in some cases, payroll expenditure have exceeded the allowed limit. In Turkey, the Municipal Law caps the total annual personnel expenditures of a municipality at 30% of the revaluated previous year's revenues (40% for municipalities with a population below 10 000).

Figure 7. CG limitations on SNG expenditures (both increases and reductions)

Number of countries



Note: All 29 countries responded to this question. Detailed country answers are provided in Table A B.2 in Annex B.
Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 3.1.

Expenditure limits are sometimes applied to all SNGs on aggregate, and thus require a negotiation on how to allocate the aggregate expenditure limit among the individual SNGs. In Denmark for example, the CG sets the targets (expenditure limits, tax revenues and debt level) for all municipalities on aggregate terms, and the municipalities then need to discuss to allocate these ceilings amongst them (Box 4). The Local Government Association plays a major role in these negotiations.

[3] Please note that expenditure allocations set out in the annual budget law are not considered as expenditure limits if there is not an overarching rule which constrains the possible choices in the allocation of resources (either their growth rate, nature, etc.).

Box 4. Aggregate fiscal rules in Denmark and Economic Agreement of 2021

A particularity of the Danish multi-level financing system is that the CG sets every year aggregate expenditure ceilings, a "tax stop" (tax revenue ceiling) and determines a "loan pool" (aggregate municipal debt ceiling). The local government association (LGDK) represents the municipalities in the negotiations of these ceilings, called "economic agreement", with the CG.

Economic Agreement of 2021

The agreement foresees the following limits on expenditure, taxes and borrowing for Danish municipalities for the budgetary year of 2021.

Expenditure caps in 2021:

- Net expenditure cap on services: 267.2 billion DKK.
- Gross expenditure cap on investments: 21.6 billion DKK.

In addition to the expenditure caps above, municipalities spend on income transfers/social benefits and on co-financing of the specialised regional healthcare system. The total sum of local expenditures is estimated to be 409.4 billion DKK in 2021.

Loan pool limit in 2021:

Loan pool for investments subject to CG approval: 0.65 billion DKK.

Note: 100 Euros equals approximately 745 DKK (July 2020).
Source: Vammalle and Bambalaite (2021[15]), "Financing and funding municipal public investment: analytical framework and application to five OECD countries", *OECD Working Papers on Fiscal Federalism*, forthcoming.

In some countries, expenditure limitations can only be set by SNGs themselves. In Austria for example, the Internal Stability Pact states that expenditure limits can only be self-imposed by states. In Latvia, according to the Law on Local Government Budgets, local governments prepare, approve and execute their budgets independently. Expenditure limits can therefore not be imposed by the central government. However, some LGs voluntarily set expenditure limits.

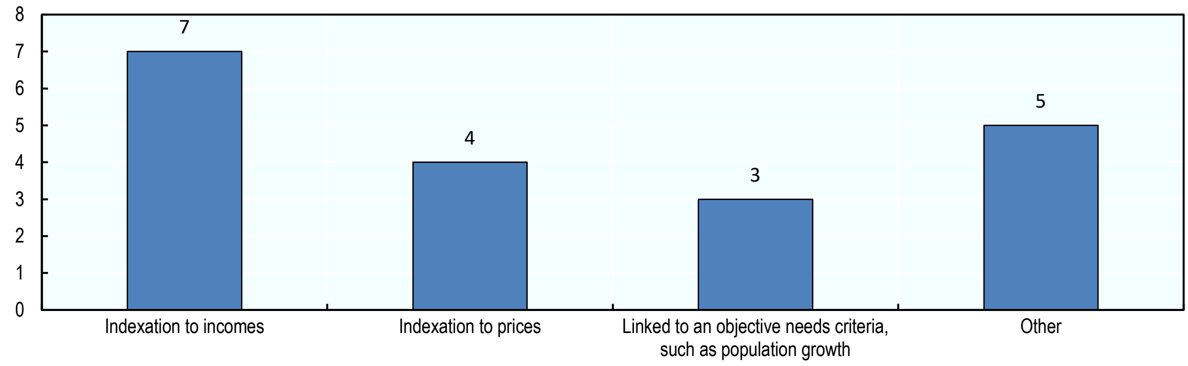
Finally, in some countries, expenditure limits define minimum expenditure rather than ceilings. Such a requirement may however reduce flexibility in SNG budgets. In Brazil for example, states have a minimum mandatory spending of 12% of their tax revenues in health, and 25% in education. This is a mechanism set in the Constitution to avoid incentives to free-ride on responsibilities which are shared by all three levels of government (federal, states and municipalities). Such minimum spending requirements have been eliminated for the federal government when they conflict with the expenditure ceiling.

Adjustment of expenditure limits

When they define expenditure ceilings (rather than growth rates), expenditure limits must be regularly adjusted to take into account prices and income changes. In most countries in the sample (seven), expenditure limits are indexed to incomes. Four countries index these to prices (Figure 8 and Table A B.3). In Brazil for example, limits on primary expenditures are generally indexed to net current revenues (and to consumer prices for the federal government). Limits on personnel spending are indexed to revenues. Minimum expenditure (ex. On education, health, etc.) are indexed to revenues.

Figure 8. Adjustment of expenditure limits

Number of countries



Note: Only countries that answered this specific question are shown (14). Detailed country answers are provided in Table A B.3 in Annex B.
Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 3.2.

6 Monitoring and enforcement mechanisms

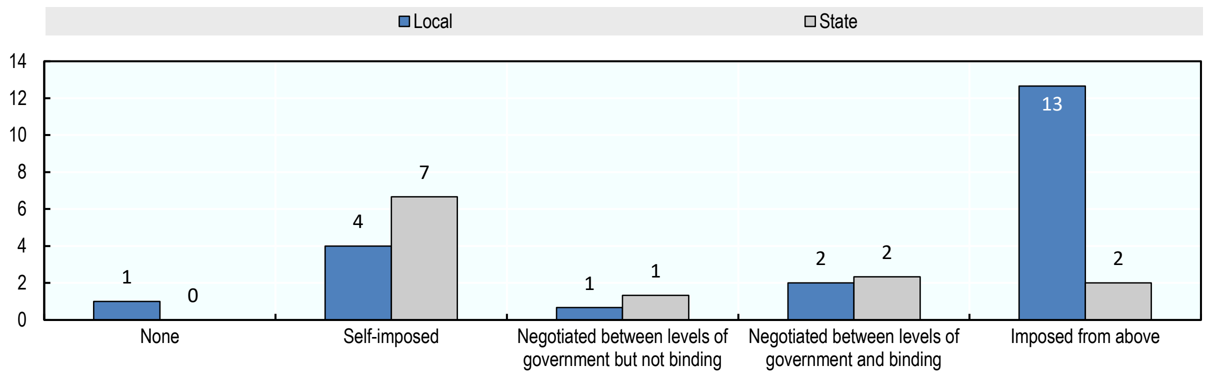
Origin and statutory basis of the FRs for SNGs

Origin of FRs for SNGs

FRs can be imposed by higher levels of government, self-imposed by a level of government itself, negotiated between levels of government, and binding, or negotiated between levels of government, but with no enforcement mechanism and not binding. The origin of FRs depends on the level of government. Indeed, for regional/provincial/state governments, FRs are generally self-imposed (Figure 9). In most federal states, the CG would not have the authority to impose a FR on a regional/provincial/state government, and FRs often derive from intergovernmental negotiations and "pacts" (e.g. Austrian Stability Pact, 2012). For LGs however, the picture is different, as most of the time, FRs are imposed by higher levels of government (Figure 9). In federal countries, it is frequently the state/provincial government which sets the FRs for their LGs, so FRs for LGs frequently vary across states/provinces (Table A B.6).

Figure 9. Origin of SNGs Fiscal Rules

Average number of countries per fiscal rule



Note: A mix of different natures of fiscal rules is possible. All 29 countries responded to this question. Detailed country answers are provided in Table A B.6 in Annex B.
Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 1.2.

Box 5. Reform of the municipal finance and responsibilities system, and vote of the Economic Stability of Hungary Act in Hungary (2011)

In 2010, the municipal sector was facing very unsustainable levels of debt (80% of which was long-term and 75% denominated in foreign currency, in particular CHF) and debt service was putting a heavy burden on municipalities, narrowing their capacity to finance their responsibilities. It was assessed that this high level of debt was partially caused by the lasting under-financing of municipal tasks, and the municipalities' disproportionate task service obligations.

The 2010 elected government therefore set correcting this situation as one of its priorities, and implemented an important reform of LGs responsibilities and obligations and funding sources, and consolidated and restructured their debts. It also put in place a new system of fiscal rules to prevent debts from building up again.

From 2010 to 2013, tasks were redistributed, with CG taking over the debt of the council local governments and the Municipality of Budapest, as well as institutions which were under council LG responsibility, such as healthcare or education.

On the funding side, a system of "task-based finance" was put in place, and new regulations and rules on municipal debt transactions laid down in the Act CXCIV of 2011 on the economic stability of Hungary (Stability Act). This act stated that:

- Municipalities must get prior approval from Cabinet for new debt transactions. The Cabinet can deny this authorisation for transactions not related to improving the delivery of municipalities' tasks and obligations;
- Debt service should not exceed 50% of the annual own revenues of the municipality in any year during the maturity of the transaction.

Prior to requesting authorisation for borrowing, municipalities must assess at least one of their local taxes, to ensure that they cannot use other sources of income than debt to finance the needed transaction.

Statutory base for deficit and debt rules for SNGs

The flexibility of FRs, in particular the ease of reforming these in case of need, depends very much on the type of legislation where they are defined. The strongest statutory FRs, in particular deficit and debt rules, are those set in the constitution or constitutional laws. Indeed, these are extremely difficult to modify. In Lithuania for example, the BBO for LGs is set in the Constitutional Law on the Implementation of the Treaty, voted in 2015 after joining the European Union. This constitutional law distinguishes between the four largest municipalities (whose expenditure exceed 0.3% of GDP), which must present a balanced budget (zero deficit) calculated on the structural budget in accruals, and all other municipalities, which must present an annual balanced budget (zero deficit) calculated in cash. In the USA, all states except Vermont have a balanced current budget principle set out in their own constitution (i.e. self-imposed, but how this rule is understood and implemented is not always clear or the same across states). These constitutional requirements strongly reduce the capacity of states to address large economic crises, and contributed to worsening the situation for example during the 2008-09 crisis (Blöchliger et al., 2010[8]).

While many countries have sustainable finances objective or a balanced budget principle for general government in their constitutions, most countries delegate to ordinary legislations the precise regulation of how these objectives are to be met, and in particular, the actual targets for each level of government. Spain for example reformed its constitution following the 2008-09 financial crisis and the 2010 EU financial crisis, setting the principle of fiscal sustainability, but requiring ordinary legislations to define the actual targets (Box 6).

Box 6. Spain's constitutional reform following the 2008-10 financial crises

In Spain, following the 2008-09 Global Financial Crisis and the 2010 European debt crisis, the country was facing very high levels of deficit and debt, at all levels of government. In September 2011, the two largest political parties in Spain, the ruling Socialists (PSOE) and the opposition Popular Party (PP) agreed on a constitutional amendment of the Article 135 on budgetary stability. This amended constitutional article states that "neither the State nor the Autonomous Communities shall enter into a structural deficit beyond the limits stipulated, if applicable, by the European Union for its Member States" and that "Local authorities shall present a balanced budget". The constitution requires an organic law to describe the implementation of this objective, setting the structural deficit ceilings allowed for the State and Autonomous Communities, according to their GDP.

According to the Organic Law 2/2012, budget balance objectives are negotiated in a multilateral basis through the Regional Fiscal Policy Council and National Commission of Local Entities. This law states that the preparation, approval and implementation of the budgets and other actions that affect the revenue or expenditure shall be carried on within a framework of fiscal stability, in line with the European regulations, i.e. a situation of equilibrium or structural surplus.

No Public Administration may incur a structural deficit, defined as a deficit adjusted to the cycle and not including exceptional or temporary measures. However, in accordance with European regulations, in the case of structural reforms with long-term fiscal effects it shall be allowable to incur a structural deficit for all public administrations together equivalent to 0.4 per cent of the national GDP expressed in nominal terms, or the level laid down in the European regulations where this percentage is smaller.

Brazil also voted a Fiscal Responsibility Law following a debt crisis, in exchange for bailing out defaulting states (Box 7). In Slovenia, the Constitution defines a balanced budget rule for the general government. Details on how this rule translates into FRs for SNGs are given in ordinary legislations.

Many countries only have the FRs for SNGs in ordinary legislations (Table 5). In Sweden for example, the local government balanced budget requirement is regulated by law in the Local Government Act and stipulates that every municipality and county council must budget so that revenue exceeds costs. The act also stipulates that municipalities and county councils must have sound financial management of their activities and adopt financial targets to support the sound financial management. The SNGs are required to have financial targets but the SNGs determine these themselves (self-imposed). In Mexico, the FRs for states and municipalities are set in the Law of Financial Discipline for States and Municipalities, voted in 2016 and reformed in 2018.

Box 7. Fiscal Responsibility Law in Brazil

In Brazil, after repeated debt assumptions and renegotiations in the 1980s and 1990s, the Federal Government developed a complex system of debt control in order to align the fiscal policies of the SNGs with the guidelines of federal macroeconomic policy. In 2000, Brazil enacted the Fiscal Responsibility Law (LRF) that represented a high level of innovation in relation to the degree of transparency and austerity required of SNGs. The Fiscal Responsibility Law is an important statute in the Brazilian legal framework that provides orientation and guidelines for budgetary and financial affairs at the three levels of government. It contains conditions for public debt assumption, loan guarantees, budget deficits and tax exemptions and limits government expenditures, in particular on government employees and retirees. It also mandates that certain documents related to accounting and planning must be published by governments periodically, to ensure the transparency of public accounts. Finally, the law carries clear penalties for non-compliance.

Table 5. Statutory basis for FRs for SNGs

Country	Ceilings and targets set by	Reference to the legislation
Austria	Intergovernmental agreement	Austrian Stability Pact (2012)
Brazil	Complementary Law (1)	Fiscal Responsibility Law (2000)
Germany (BBO)	Constitutional Law	Basic Law (2009, art. 109, 115, 143dGG)
Hungary	Ordinary Law	Act on the economic stability of Hungary (2011)
Latvia	Ordinary Law	Law on Local Government Budgets
Lithuania (BBO)	Constitutional Law	Constitutional Law on the Implementation of the Treaty (CLIFT)
Lithuania (Borrowing limits)	Ordinary law	Annual budget law
Mexico	Ordinary Law	Law of Financial Discipline for States and Municipalities
		Law of Fiscal Coordination (2018 reform)
Netherlands	Ordinary Law	Municipalities act
	Ordinary Law	Governments Accounts Act (*Comptabiliteitsewet*)
Poland	Ordinary Law	Act on Public Finance
Portugal	Ordinary Law	Local and Regional Finance Laws (2013)
Sweden	Ordinary law	Local Government Act
ZAF (state)	Ordinary Law	Borrowing Powers of Provincial Governments Act
Spain (state)	Ordinary law	Organic Law 2/2012, Budgetary Stability And Financial Sustainability and Amendment Law 4/2012.

Notes: (1) the Fiscal Responsibility Law in Brazil is a complementary law that can only be changed with a qualified majority of the Congress.
Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 1.2.

In some countries, FRs for SNGs result from negotiations across levels of government and fiscal "pacts" across levels of government. For example in Austria, the national budgetary coordination between the Federal Government, states and municipalities is regulated in the Austrian Stability Pact, which entered into force on January 1st 2012. This pact integrates the EU regulations (sixpack, twopack and fiscal compact), and sets a system of multiple fiscal rules, which aimed at reaching a balanced budget in structural terms from 2017. In the Netherlands, formally, FRs are imposed by the CG. However, in practice, it has been a long-standing tradition that different levels of government have discussions on these, in order to guarantee support.

The risk when FRs must be negotiated across levels of government is that negotiations may not reach results, and FRs for SNGs are not implemented. In Belgium for example, the procedure for implementing the BBO is described in the Cooperation Agreement. However, it has never been implemented, because there has never been an agreement on the objectives of each individual region or community.

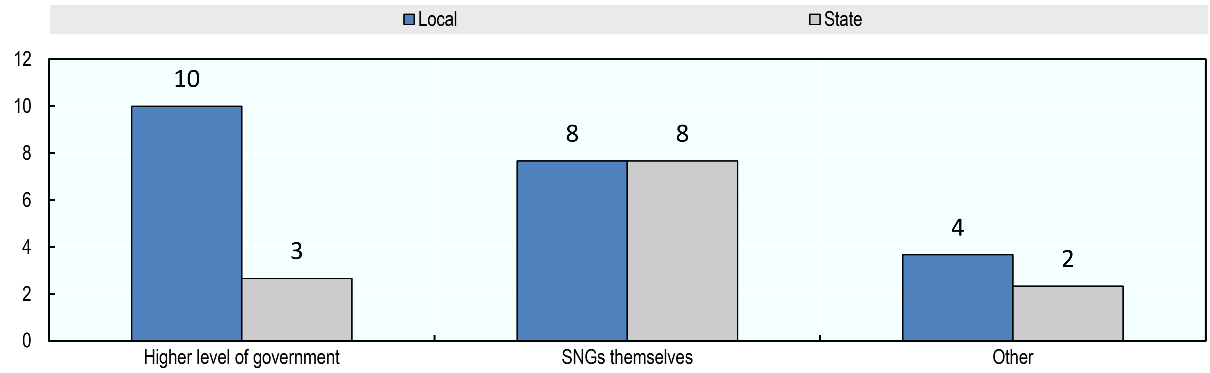
Monitoring mechanisms

Responsibility for monitoring compliance with FRs

Regular monitoring and credible enforcement mechanisms are essential to ensure that FRs are applied correctly. As for FRs, monitoring is mostly carried out by higher levels of government (often the state/province/region) for LGs, while most RGs are responsible for monitoring their own compliance with the FRs (Figure 10 and Table A B.7).

Figure 10. Who monitors the compliance with fiscal rules?

Average number of countries per fiscal rule



Note: Only countries that answered this specific question are shown (27). Detailed country answers are provided in Table A B.7 in Annex B.
Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 1.3.

Depending on the country, the Ministry of Finance and the Ministry of Interior are the two ministries frequently responsible for monitoring SNG compliance with FRs (Table 6). In Denmark for example, the Ministry of Interior has the responsibility for monitoring compliance with the FRs, and uses an "early warning" signal to identify municipalities at risk (when the municipal net average liquidity is less than DKK 1 000 per inhabitant). In Latvia, it is the Ministry of Finance which supervises LGs' activities according to regulations and procedures.

Table 6. Institution in charge of monitoring compliance with FRs and identifying SNGs facing possible fiscal difficulties

Ministry of Finance/Treasury	Ministry of Interior	Independent fiscal institution	Other
Hungary	Denmark	Slovenia	
Latvia	Netherlands (provinces)	Spain	Germany: Stability Council (joint body of German Federation and Länders)
Lithuania	Luxembourg	Sweden	South Africa: also provincial legislatures
South Africa			Netherlands (municipalities): provinces
Slovak Republic			Poland: Regional Accounting Chambers

In federal or decentralised countries, the regional/provincial level of government frequently monitors FRs for their LGs. In the Netherlands for example, the Ministry of Interior supervises the finances of provinces, and provinces supervise the finances of the local governments under their jurisdiction (as in the Netherlands for example).

Some countries have set up special inter-governmental bodies to carry out this monitoring. In Poland, the Ministry of Finance oversees overall fiscal management of SNGs, including adherence to fiscal rules. However, as LGs are self-governing, their financial management, including adherence to fiscal rules, is subject to oversight and control by Regional Accounting Chambers (RACs). The Regional Accounting Chambers are functionally independent from CG, only subject to a legality check by the Ministry of Public Administration. They analyse draft budget resolutions and budget execution statements of SNGs and carry out comprehensive controls of financial management of each SNGs, at least once every four years. In Germany, the Stability Council (*Stabilitätsrat*) is a joint body of the German Federation and the federal states. It was established in 2010 as part of the second stage of Germany's federal reforms and is enshrined in the Article 109a of the Basic Law, Germany's constitution. The Stability Council is comprised of the Federal Minister of Finance, the Länder finance ministers and the Federal Minister for Economic Affairs and Energy. Its main task is to monitor the budgets of the Federation and Länder on a regular basis. It aims at recognising impending budgetary emergencies at an early state so that appropriate countermeasures can be initiated in a timely manner. It also monitors the budgets of the Federation, Länder, local authorities and social insurance funds, to make sure that these, taken together, comply with the upper limit of the general government structural deficit of 0.5% of GDP, as stipulated in the Budgetary Principals Act (The Stability Council, 2020[16]).

Independent fiscal institutions or inter-governmental institutions are also sometimes tasked with monitoring compliance of SNGs with FRs. In Spain for example, the Independent Authority for Fiscal Responsibility (*Autoridad Independiente de Responsabilidad Fiscal*, AIReF) is mandated to monitor the compliance of Spain's 17 autonomous communities and 8,000 municipalities with FRs throughout the budget cycle: assessing the reasonableness of targets and plans to achieve them, assessing risk of non-compliance, requesting activation of corrective mechanisms, and assessing the progress of corrective action. In Lithuania, the Independent Fiscal Institution (IFI) monitors *ex-ante* and *ex-post* compliance of municipalities with fiscal rules. However, overall responsibility for compliance lies in the Ministry of Finance, which conducts in-year monitoring of municipal debt levels and the adherence to borrowing limits by assessing quarterly financial statements and conclusions from the IFI and the audit office.

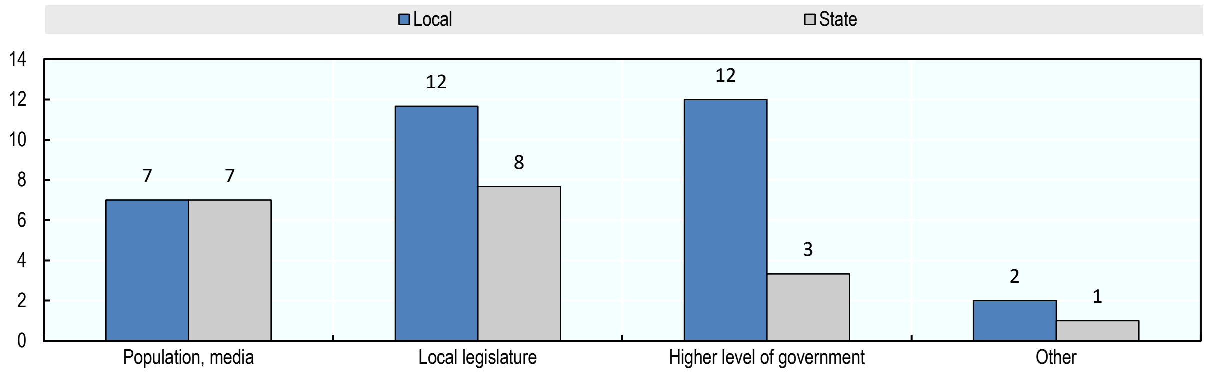
Finally, in some cases, the rule is not monitored ex-post, but rather ex-ante, as the CG must approve ex-ante SNG borrowing. This is the case for example in Turkey, where borrowing constraints and expenditure limitations (personnel expenditure) are not monitored ex-post, but when applying for recruitment or borrowing permissions, municipal councils and supreme authority take into account the relevant data.

Oversight of compliance with FRs

Once the monitoring process is done, compliance reports can be shared with different stakeholders and institutions, for the necessary corrective measures to be taken. The most frequent institution to whom compliance with FRs is reported are the local legislatures (Figure 11 and Table A B.8). In the case of LGs, higher levels or government are also important players (on average, 11 countries per fiscal rule), while few regional governments report to the CG (only 3 countries on average per fiscal rule). In Poland for example, in case of negative opinions on budget execution statement, the Regional Accounting Chambers also informs relevant voivode (CG representative in the region) and the Ministry of Finance. In Switzerland, the cantons are autonomous and have no specific reporting obligations under federal law. However, they have a (limited) obligation to make data from their financial statistics available to the Confederation (accounts, budgets and planning of public finance flows). Compliance with the debt brake of the SNG is an important reporting issue for both parliaments and the public.

Figure 11. To whom the compliance with fiscal rules is reported?

Average number of countries per fiscal rule*



Note: *Most of the time, all FRs are reported to the same authority, however in some countries, reporting authorities vary according to the FR. The figure shows the average number of countries for each authority across the different types of FRs Only countries that answered this specific question are shown (28). Detailed country answers are provided in Table A B.8 in Annex B.
Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 1.4.

Many of these reports are also shared with the population, through media for example or published on the SNGs' websites. This allows for citizens to also put pressure on their LGs if they fear for the financial position of their LG. In Mexico for example, compliance with all four FRs is published in the Official Bulletin, and LGs are also obliged to publish their budgets and the state of their public finances on their webpage. In Poland, SNGs need to publish within seven days the opinion of the Regional Accounting Chambers on their financial position.

On reporting practices, New Zealand again is a special case, as reporting is done to the Local Government Funding Agency. Indeed, in New Zealand, the strongest FRs are not imposed by the government, but are a condition set by the Local Government Funding Agency (LGFA) for LGs who wish to benefit from their very competitive interest rate loans. Almost all local authorities borrow through the LGFA, and thus report their performance against the rules to the LGFA.

Monitoring compliance with FRs and identifying SNGs which may face difficulties is easier when all SNGs follow the same accounting standards. Hopefully, this is the case in a majority of OECD countries (Table 7).

Table 7. Consistency of standards across national and sub-national governments

Subtotals for unitary states and federations

	Similar for all national and all sub-national	Similar for all sub-national	Not similar
Unitary countries	**10:** Czech Republic, Estonia, Latvia, Lithuania, New Zealand, Portugal, Slovak Republic, Turkey, United Kingdom, China	**12:** France, Greece, Iceland, Ireland, Israel, Japan, Korea, Luxembourg, Netherlands, Norway, Poland, Sweden	**2.** Italy, South Africa
Federal countries	**5**: Australia, Austria, Canada, Spain; Brazil	**2:** Switzerland, United States	**2**: Belgium, Germany

Note: For Italy, the harmonisation of standards within subnational government is only partially done.
Source: Irwin and Moretti (2020[14]).

Enforcement mechanisms and procedures to address serious difficulties

Actions CGs can take when SNGs face financial difficulties and break FRs

Enforcement mechanisms such as possible sanctions in case of breaching FRs are essential for the FRs to be credible and respected. Here again, there are more tools available to enforce FRs on LGs than on RGs. Different tools are analysed in this section: imposing financial sanctions and corrective measures, institutionalised bailout procedures, holding ministers personally accountable. Some countries also have developed early warning and response mechanisms to identify and address SNGs' financial difficulties, or redesigned the revenue mix and expenditure responsibilities of SNGs to ensure sufficient funding for the mandatory tasks. Finally, some countries have weaker or no instrument at all for enforcing SNG FRs, or rely on financial markets to ensure fiscally sound decisions.

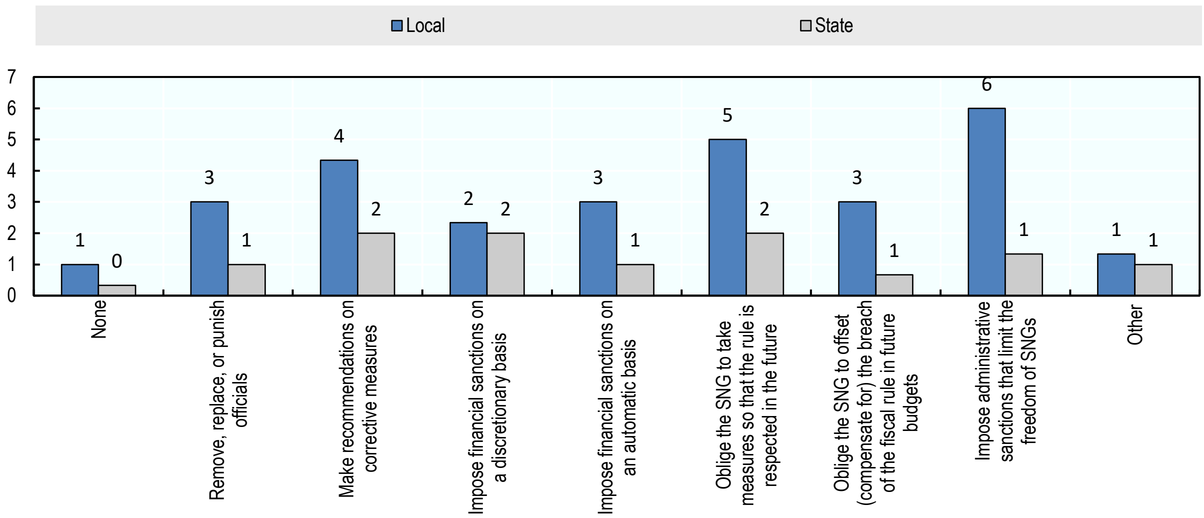
Financial sanctions and corrective measures

Very few countries have possible sanctions for RGs breaching FRs. The main tool is to impose financial sanctions, either on discretionary basis or on an automatic basis. In Austria for example, the FRs are backed by a sanction mechanism similar to the excessive deficit procedure on EU level, and the sanctions can be 15% of the amount exceeding the respective rule, to be paid to the well-performing SNGs.

Enforcement mechanisms for LGs are often stronger, as several countries can oblige SNGs to take measures so that the rule is respected in the future, or even remove, replace of punish LG officials (Figure 12 and Table A B.9). CGs (or sometimes RGs) can impose financial sanctions to LGs, either on discretionary basis or through automatic mechanisms, or provide recommendations on corrective measures. In Hungary for example, in case of violation of law, controlling bodies enact a resolution. If the local government does not accept the resolution, then in the final case, the court decides. The Government Office may re-write local government's unlawful decrees. The State Audit Office may initiate suspension of disbursement of budgetary appropriations, while the Hungarian State Treasury may impose a fine. Finland likely has one of the most severe enforcement mechanisms, as the CG can impose municipal mergers in case a municipality does not succeed in re-establishing a sound fiscal situation (Box 8).

Figure 12. Possible actions by the CG in case of infringement of FRs by SNGs

Average number of countries per category



Note: Only countries that answered this specific question are shown (19). Detailed country answers are provided in Table A B.9 in Annex B.
Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, questions 1.5, 1.5b and 1.6.

Box 8. Municipal mergers in case of fiscal rule infringements in Finland

The Finnish SNG system is considered having tight fiscal rules coupled with robust and highly enforced monitoring. There are no formal borrowing rules. However, Finnish municipalities are subject to a balanced budget rule: they must present financial plans in balance or surplus and must cover any deficit within a period of four years.

Breaching specific financial sustainability criteria* set by the Ministry of Finance triggers a special assessment process: officials from the Ministry of Finance visit municipalities "in crisis" providing advice on how to improve their financial situation and assist them in developing correction plans. In case of severe non-compliance, CG has the legal authority to force municipal mergers.

Such forced mergers have happened four times since the introduction of the mechanism in the year 2015 and being a municipality "in assessment" carries a negative connotation in terms of public image. In order to avoid this situation, some municipalities self-impose even tighter financial sustainability indicators. These tight fiscal rules, coupled with a robust and highly enforced monitoring, acts as a strong preventative measure incentivising Finnish municipalities to manage their finances sustainably.

Note: * a full list of criteria can be found in Vammalle and Bambalaite (2021[15]), Box 5.3.
Source: Vammalle and Bambalaite (2021[15]), "Financing and funding municipal public investment: analytical framework and application to five OECD countries", *OECD Working Papers on Fiscal Federalism*, forthcoming.

Institutionalized bailout procedures

Some countries have well established and institutionalized bailout mechanisms, which aim to infringe sufficient cost on SNGs and SNG officials to reduce risk of moral hazard and free-riding. This is the case for example in Denmark, where municipalities in economic distress can be "put under administration" (Box 9), or in the Netherlands (Box 10). However, the Dutch procedure has been implemented much less frequently since the 1994 reform of their grant system for SNGs.

Box 9. Danish municipalities in economic distress are "put under administration": institutional mechanism

The Danish Ministry of Interior has both "the right and the obligation to react" to a violation of the rule. This is done in a standardised manner, i.e. automatically with a minimum of discretion: if the rule is broken, the procedure starts and cannot normally be stopped before a plan of re-establishing a healthy financial situation has been agreed upon.

The mechanism follows a specific procedure established in 2008:

- The procedure is initiated at a meeting in the Ministry of Interior. The "administrative" character of the procedure is underlined by the fact that the municipal participants typically are politicians and civil servants whereas the Ministry participates solely with civil servants;
- In this and subsequent meetings, the deeper roots of the financial problems are analysed and the room for manoeuvre for the municipality is discussed;
- The municipality in difficulty is granted a temporary approval to deviate from the overdraft rule for a certain limited period, normally three years maximum;
- This approval is given on the condition that the municipality takes steps to restore the economic situation and that such steps result in cash reserves of a

certain “robust” magnitude, and that it possibly also takes steps to improve the economic management of the municipality;

- The central government may or may not add some discretionary grants – to a limited amount – to ease the immediate economic situation;
- The municipality must report to the Ministry every three months on the economic (liquidity) situation.

The Ministry of Interior also uses an “early warning” signal when the municipal net average liquidity is less than DKK 1 000 per inhabitant.

Source: Mau (2015[17]), “Municipal bailouts in Denmark – and how to avoid them”, in Kim and Blöchliger (eds.) (2015[18]), *Institutions of Intergovernmental Fiscal Relations: Challenges Ahead*, http://dx.doi.org/10.1787/9789264246966-en and in Vammalle and Bambalaite (2021[15]), “Financing and funding municipal public investment: analytical framework and application to five OECD countries”, *OECD Working Papers on Fiscal Federalism*, forthcoming.

Box 10. A bailout system for municipalities in financial difficulties in the Netherlands

Dutch municipalities cannot declare bankruptcy. Nonetheless, there is a well-established procedure for municipalities in financial distress, which limits the risks of defaulting on debts (Ministry of Finance, 2019[19]). The Financial Relation Act (Section 12) lays out special measures for CG intervention and determines certain criteria municipalities must fulfil to be eligible for such procedure.

Importantly, the financial difficulties of an individual municipality are covered collectively through a supplementary grant, often referred to as "Section 12 grant" or "bailout grant". These special grants are paid to municipalities from the Municipal Fund, from which general-purpose grants are paid out. Hence, the incidence falls not on the CG budget, but it proportionately reduces grants allocated to other municipalities. However, the Ministry of Interior claims it does not observe lower market premium for well-run municipalities.

Municipalities wishing to apply to the bailout procedure must fulfil certain criteria and must comply with the rules for the whole period covered by the bailout procedure. Municipalities must apply themselves to the procedure, and CG decides whether municipalities quality and should be allocated supplementary grant.

Criteria for the bailout procedure:

- A municipality must have a significant and structural deficit, which is larger than 2% of the sum of the general-purpose grant and the local property tax capacity (calculated as tax revenues given a certain standard tax rate). Structural deficit refers to a situation when a municipality is unable to balance its budget in a given year and a forecast of budget balance for the next three years is negative.
- A municipality must have above average local property tax rate. Since 2002, this is defined as 120% higher than the national average.
- In 1997 a new formula-based grant scheme equalisation system was introduced and the bailout system is used very rarely.

Source: Vammalle and Bambalaite (2021[15]), “Financing and funding municipal public investment: analytical framework and application to five OECD countries”, *OECD Working Papers on Fiscal Federalism*, forthcoming.

Other interesting examples of responses to SNG’s financial difficulties include:

- In Hungary, SNGs can be a subject a “debt-settlement procedure”, which is inspired by the insolvency procedures of companies, with the important difference that municipalities cannot cease to exist at the end of this procedure (Herold, 2020[20]). The purpose of the debt-settlement procedure is to restore the solvency and to payback obligations. During the procedure municipalities still have to provide compulsory services. During the debt-settlement procedure, the court appoints a financial curator, who monitors the financial management of the local government, and assesses if they provide the mandatory duties and competences. The LGs develops a proposal for re-establishing solvency and presents it to the curator who provides its opinion. Curator’s countersignature is necessary during the procedure for assuming commitments and payments.
- In Poland, SNGs cannot declare bankruptcy or be declared bankrupt (art. 6 LIR). If a SNG cannot adopt a budget or multi-year fiscal framework compliant with fiscal rules concerning budget balance and borrowing constraints, and there is a danger to execution of public tasks by SNG, the Regional Accounting Chamber calls on the SNG to prepare and adopt a remedial program within 45 days. Remedial program is prepared for a period of no longer than three consecutive budget years and is subject to scrutiny of the Regional Accounting Chambers.

  If the SNG does not prepare a program or if the program adopted by the SNG is not approved by its Regional Accounting Chamber, the SNG budget is established by the Regional Accounting Chamber. Such a situation may entail suspension of both legislative and executive organs of the SNG and the establishment of a forced administrator (government commissioner) nominated by the Prime Minister. In such case, the remedial program is prepared and adopted by the forced administrator.

  When the remedial program is implemented, the SNG can be granted a loan from the state budget. To be granted such loan, the assessment of remedial program must prove a high probability of: 1) improvement of the SNG's financial condition and SNG's effectiveness in executing statutory tasks, 2) return to fiscal rules adherence no later than by the end of the budget year in which such loan is to be repaid, and 3) repayment of the loan and associated interest.

  Additionally, in the period in which the remedial program is implemented, the Act of Public Finance envisages additional constraints. For example, the SNG cannot issue new debt, issue guarantees, or incur expenditures for the promotion of SNG. In addition, the remuneration fund for the members of legislative and executive bodies of the SNG cannot be higher than in year preceding the adoption of the remedial program.
- In South Africa, the Constitution (section 216) allows stopping the transfers to the provinces where there is a serious and persistent breach of generally recognised accounting practices, uniform expenditure classification or uniform treasury norms and standards. The Constitution (section 100) also allows national government to intervene in a province if the province “cannot or does not fulfil an executive obligation in terms of the Constitution or legislation”. Where provinces run into fiscal trouble, for example, if they are at risk of not being able to fulfil financial commitments, interventions have been triggered and the problem resolved. This takes the form of national government issuing directives, or national government assuming executive responsibility for a provincial function (by appointing an administrator).

Holding ministers personally accountable

In some countries, the pay of the Ministers is directly linked to the achievement of the agreed fiscal objectives. In Canada for example, several provinces provide financial rewards to their ministers for achieving agreed budget objectives, or impose fines if objectives are not met. For example in New Brunswick, Ministers are required to place on a deposit CAN 2 500 each fiscal year. The funds would be reimbursed to the ministers only if they achieve a deficit reduction in the fiscal year in question. In Manitoba, 20% of ministerial salaries are withheld each year until an improvement in the budgetary deficit is shown. This percentage is increased after the second consecutive year with a budget deficit, and withheld pay would be paid out if the deficit is cut by CAN 100 million or more. If the budget is balanced before 2026, all money withheld since 2017 will be paid out. In Turkey, mayors are ultimately responsible for the compliance with the rule. Indeed, the Municipal Law caps the total annual personnel expenditures of a municipality at 30% of the revaluated previous year's revenues (40% for municipalities with a population below 10,000). If the personnel expenditures exceed such percentages as a result of an unexpected increase in salaries and wages during the year, no further staff may be recruited during the current year or subsequent years until the personnel expenditures fall below such percentages. Any public loss caused by such percentages being exceeded as a result of the recruitment of new staff shall be collected, together with the statutory interest calculated as of the date on which the loss occurred, from the mayor.

Early warning mechanisms

Some countries closely monitor SNGs finances and have a set of indicators for "early warning" of financial difficulties, which allows them to take early corrective actions. This is the case for example in Finland, where the Ministry of Finance monitors several indicators to identify SNGs facing difficulties (Box 11) and in Portugal, where the debt to revenues ratio is monitored, and passing certain thresholds trigger predetermined actions (Box 12).

Box 11. Early warning mechanism: criteria for triggering the assessment mechanism in Finland

Criteria laid down in the Local Government Act:

1. The assessment procedure may be started if a municipality has not covered the deficit in its balance sheet within the four-year period.
2. The assessment procedure may also be started if the latest consolidated financial statement of the municipality shows a deficit of at least EUR 1 000 per resident and the preceding financial statement a deficit of at least EUR 500 per resident, or if the financial key figures for finance adequacy or solvency have reached the following limits in two successive years:
    a. The ratio between the annual contribution margin and the depreciations falls below 80% in the consolidated income statement of the municipality;
    b. The municipality's rate of local income tax is at least 2 percentage points higher than the weighted average rate of local income tax of all municipalities;
    c. The amount of the loans and rental liabilities in the consolidated financial statement of the municipality per resident exceeds the average amount of loans and rental liabilities in the consolidated financial statements of all municipalities by at least 50%;
    d. The computational loan coverage ratio of the consolidated financial statement falls below 0.8%.

Note: the computational loan coverage ratio is calculated using a formula where interest income is added to the annual contribution margin of the consolidated income statement and the resulting amount is divided by the amount of interest income and computational loan repayments. The computational loan payments shall be arrived at by dividing the amount of loans by eight.
Source: Vammalle and Bambalaite (2021[15]), "Financing and funding municipal public investment: analytical framework and application to five OECD countries", *OECD Working Papers on Fiscal Federalism*, forthcoming.

Redesigning SNG revenue and expenditure allocation to ensure fiscal sustainability

Perhaps the most effective enforcement mechanism is avoiding problems in the first place. For this, some countries have reformed their financing systems for SNGs to ensure these get sufficient funding to carry out their tasks, and ensure that financial difficulties are not caused by insufficient funding (as in the Netherlands). In 1997 for example, the Netherlands introduced an elaborate grant equalisation system. Since then, bailouts of LGs have become extremely rare. This equalisation grant is formula-based and designed to prevent any influence of local governments on the grant they receive. Before the new equalization scheme was in place, bailouts were frequent (Box 10), and believed to result from insufficient means for LGs to deliver their responsibilities according to the nationwide minimum standards for local public services. Since the 1997 grant equalisation reform, each municipality is should be able to finance the standard package of local services while levying a standard tax rate. A similar reform was carried out in 2010-13 in Hungary, which carried out an important reform of its municipal financing system and responsibilities, to ensure LGs have sufficient revenues to carry out their tasks without incurring into debt (refer to Box 5 and section 7.1.1).

Box 12. Early Warning and municipal financial recovery mechanism in Portugal

In Portugal, the procedure for SNGs breaching the rule differs for regional and local governments.

- For regional governments, if the debt ceiling is exceeded, the region must reduce its debt level by 1/20 per year over the upcoming years. If regions do not comply with this criterion, the budget transfers to the regions can be retained by the amount of the excess.
- For local governments, municipalities which do not comply with the debt ceiling must reduce their debt level by at least 10% of the excess debt each year, until it is back under the ceiling. The 2013 Local Finance Law specifies penalties applied by the Court of Auditors for municipalities that do not comply with the debt limits. An early warning and municipal financial recovery mechanism is in place (Table 8).
- In the financial reorganisation mechanism, municipalities get CG support to restructure their debt, through a 14-year loan with a one year grace period; The Municipal financial recovery mechanism involves expenditure limitations, revenue maximization and debt reduction.

Table 8. Early warning and municipal financial recovery mechanism in Portugal

Total debt ratio	Measures to be taken
75% to 100%	1. Informing the members of the Government responsible for finance and local authorities, as well as the presidents of the executive and deliberative bodies of the municipalities
100% to 150%	1. Informing the previously mentioned entities 2. Possibility of adhering to financial reorganisation (borrowing)
150% to 225%	1. Informing the above mentioned entities plus the Bank of Portugal 2. Compulsory adherence to financial reorganisation (borrowing)
225% to 300%	1. Informing the above mentioned entities plus the Bank of Portugal 2. Mandatory adherence to financial or voluntary sanitation of the municipal financial recovery (FAM)
Exceeding 300% (financial rupture)	1. Informing the above mentioned entities plus the Bank of Portugal 2. Mandatory membership of the municipal financial recovery (FAM)

Note: The total debt ratio is calculated in relation to the average net current revenues collected in the three previous years.
Source: Conselho das Finanças Públicas (2018[21]).

Another way to avoid problems is to ensure ex-ante that the rules are applied. In Luxembourg, the Ministry of the Interior can amend LG drat budgets if these do not comply with the applicable laws and regulations.

Weaker enforcement tools or no enforcement possibilities

Finally, some countries have only weaker enforcement tools, such as not granting the permission for new borrowing, or ineligibility to specific types of CG support. In Turkey for example, the CG cannot impose sanctions on LGs in case of failure to adhere to fiscal rules. However, municipalities which exceed their limits on debt stock or personnel expenditures will not be granted permission to borrow or to hire new staff. If they did, the municipal administration could be punished within the framework of the Criminal Code. In Lithuania, breaching FRs is subject to "moral sanction" (i.e. the LG must submit to the Ministry of Finance a letter explaining the reasons for the infringement), and will not be eligible to co-financing grant from CG for EU structural funds.

In some countries, SNGs are legally/constitutionally autonomous and higher levels of government cannot force them to take any corrective measures. While in some of these countries, SNGs are sufficiently committed to the rule to implement their own monitoring and corrective measures (such as in USA), in other countries, this implies that the FRs are often broken (as in Slovenia). Other countries rely on the private market, in particular SNG banks, to discipline SNGs (New Zealand). In Slovenia, the CG does not have any legal action to punish municipalities which break the expenditure ceiling. The ceiling is therefore frequently broken, and no corrective action can be imposed from the CG. In the USA, balancing the budget is widely considered to be the foundation of state fiscal practices. However, enforcement structures are often lacking. It appears that the political convention that state budgets are supposed to be balanced is its own enforcement mechanism (NCSL, 2010[13]). In Germany, the Länder are independent and the Federal Government cannot impose any corrective measure.

Market based enforcement mechanisms

In some countries, the main actor for enforcing fiscal rules is not the government, but rather rely on the market to put pressure on SNGs to adhere to sound fiscal policies. In New Zealand for example, local authorities cannot declare bankruptcy. If financial performance is poor, the Local Government Funding Agency would refuse to lend to the LG, which is a strong market-based mechanism to ensure compliance with the debt limits set by the LGFA (as alternative borrowing is more expensive). In the event of serious difficulties, it is probable that the CG would appoint a commissioner to manage the LG back into a sound position. In the USA, states can borrow for low-risk or high-risk projects, depending on the type of investment and program. Financial markets charge a premium for sub-optimal SNG performance. Credit rating agencies provide an assessment of the creditworthiness of SNGs periodically, and bond underwriters take those ratings into consideration when preparing the terms of a bond issue. Lower credit ratings are directly associated with higher interest rates and therefore a higher cost of capital for those SNGs.

7 Relations with banks and state-owned enterprises (SOEs)

SNG-owned banks

Many SNGs have created local government financing institutions, which are banks owned (or partially owned) by SNGs, and which specialise in lending to SNGs (Table 9). Local government financing institutions are very useful to pool LG borrowing needs and issue bonds on national and international markets, for re-lending to SNGs at lower interest rates and longer maturities than in LGs approached commercial banks individually.[4]

Table 9. Countries which have a SNG-owned bank

Country	Name of the bank	Year of creation
Denmark	KommuneKredit	1899
Finland	MuniFin	1989
Netherlands	BNG Bank	
New Zealand	Local Government Funding Agency (LGFA)	2011

Source: Vammalle and Bambalaite (2021[15]), "Financing and funding municipal public investment: analytical framework and application to five OECD countries", *OECD Working Papers on Fiscal Federalism*, forthcoming.

In some countries, SNGs may own local banks, but the regulations do not allow these banks to lend to the SNG. In South Africa for example, one province owns a local bank. This bank specialises in lending to rural households, so would not be in a position to lend to the province. In addition, the Borrowing Powers of Provincial Government Act (1996) does not allow provinces to borrow from their entities or have a special borrowing relationship with local banks. In Korea, local governments cannot own banks or control banks, and they do not have any special relationship with local banks.

Relations between SNGs and their SOEs

SNGs' SOEs can sometimes generate profits which increase the revenues for the SNG, and in other cases, generate loses which must ultimately be covered by SNGs. In some cases, SNGs use SOEs to circumvent FRs, in particular balanced budget rules and borrowing limits. It is therefore important to

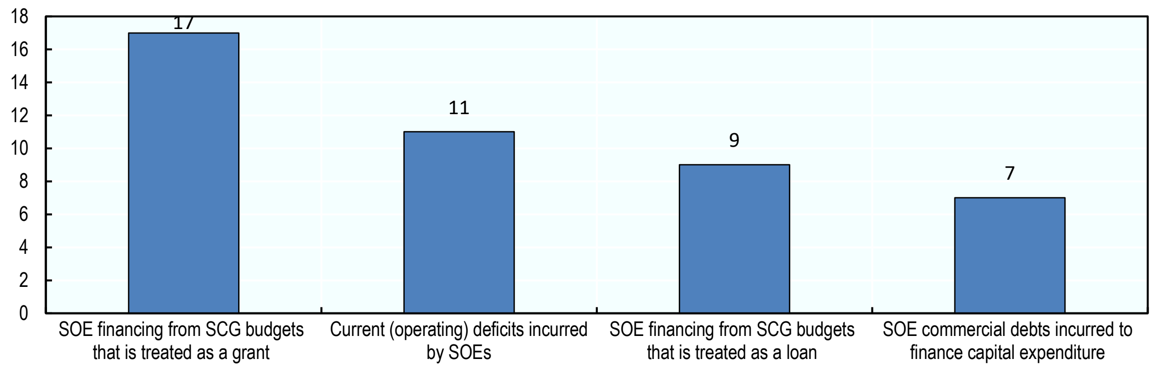
[4] Vammalle and Bambalaite (2021[15]), "Financing and funding municipal public investment: analytical framework and application to five OECD countries", *OECD Working Papers on Fiscal Federalism*, forthcoming.

have a clear framework for integrating SOEs' results in SNGs' budget, and sufficient transparency to assess the risks.

In most countries (17 countries), loans of SOEs affect SNGs' budget balance and are counted in their borrowing limits. In Lithuania for example, borrowing by municipal owned enterprises are computed in the borrowing limit of the municipality. Less than half of the countries (11 countries) consolidate their budget balances with those of the SOEs, and therefore current balances of SOEs affect SNGs' balances. Only seven countries count their SOEs' commercial debts to finance capital expenditure in their budget (Figure 13 and Table A B.11). Only three countries provide explicit SNG guarantees on their SOEs' debts. In Latvia for example, LGs may issue guarantees for their own enterprises, and these are included in the total amount of liabilities that LGs can take. Most SNGs do not guarantee their SOEs' debts (nine countries) or only on in exceptional circumstances (5 countries) or on a case-by-case basis (9 countries) (Figure 14). Other countries require approval by the owner entity for issuing debt (as in South Africa, where provincial entities must approve borrowing by their SOEs), or forbid SNGs from lending to or borrowing from their SOEs (as in Greece).

Figure 13. Results of SOEs affect SNG's budget balance objective

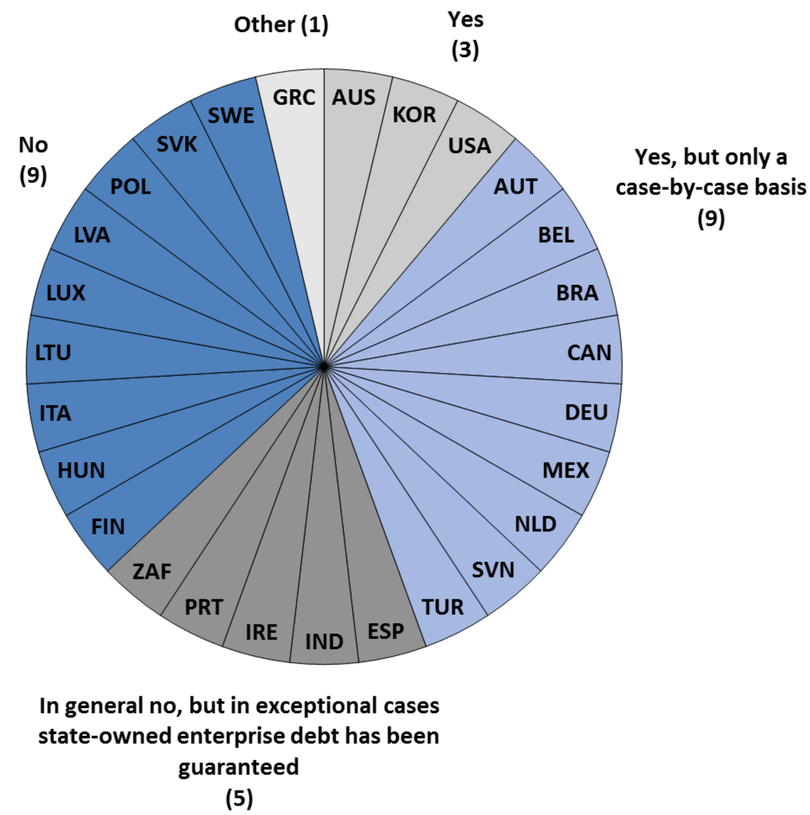
Number of countries



Note: A mix of different elements is possible. Only countries that answered this specific question are shown. Detailed country answers are provided in Table A B.11 in Annex B.
Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 2.6.

Figure 14. SOEs debt guaranteeing by SNGs

Number of countries



Note: Only countries that answered this specific question are shown (27).
Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 4.4.

8 Dealing with the impact of economic cycles and unexpected shocks

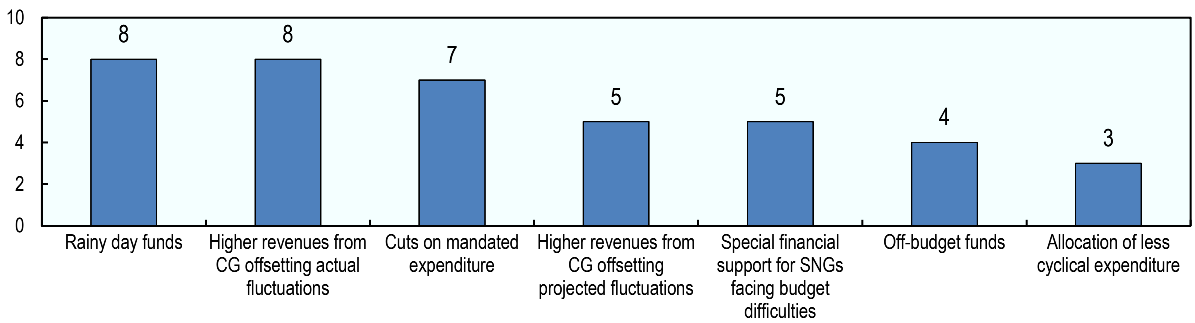
Managing cyclical impacts on SNGs' budgets

Well-designed FRs should minimize pro-cyclical responses from SNGs to the economic cycles. The impact of economic cycles on SNG finances depend on the sources of SNGs' revenues and the nature of their expenditure.

Some countries allocate particularly stable revenue sources to their SNGs and thus do not need a mechanism to deal with normal economic cycles (3 countries) (Figure 15). Property taxes are considered as stable revenues and are widely used to fund SNGs. This is for example the case in New Zealand, where property taxes represent about 50% of SNGs' revenues, and where there is no specific mechanism for dealing with economic cycles on SNG finances.

Figure 15. Elements to manage SNG budget cyclicality

Number of countries



Note: Only countries that answered this specific question are shown (20). Detailed country answers are provided in Table A B.15 in Annex B.
Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 5.1.

CG transfers and equalisation systems can also be calculated so as to ensure that all SNGs have the capacity to provide services at a comparable standard throughout the economic cycle. In South Africa for example, 95% of provincial revenue is made up of grants from national government which are formula-based grants calculated on demographic and developmental factors. The impacts of cyclical fluctuations on revenue are therefore mainly felt by national government, which has protected provinces from the full impact of downturns. On the spending side, impact of cycles is also rather low: provinces are responsible for social functions including school education and public health that have high, but fairly consistent demand, with no significant short-term increase in demand during downturns. In the Netherlands, SNG income also depend heavily on grants from the CG. Each new coalition government sets annual expenditure ceilings for the duration of their term. These include grants for SNGs. This protects SNGs' revenues from fluctuations, both in economic upturns as in economic downturns, which are mainly absorbed by the CG.

Defining FRs on structural terms also helps mitigating the impact of economic cycles. In Lithuania for example, large municipalities are required to have structurally balanced budget, which allows them to have nominal deficit in times of adverse economic circumstances. FRs for small municipalities are calculated in cash terms, but small municipalities are allowed to have a nominal deficit when the national output gap is negative.

Finally, more fiscal autonomy also helps SNGs mitigate cyclical variations. In Belgium for example, regions and communities benefit from large fiscal autonomy, and can take every measure that seems necessary to them. In addition, fiscal objectives are also defined in a structural way, i.e. corrected for cyclical variations and one-offs.

Countries where SNGs have less revenue and expenditure autonomy should therefore pay particular attention to developing mechanisms to mitigate cyclical variations (such as allocating stable revenue sources, or ensuring strong equalisation systems).

Rainy day funds are frequently used to offset cyclical components of SNGs' budgets, and allow them to maintain a stable expenditure level despite fluctuations in the revenues (8 countries).

Some countries do not deal with business cycles in the design of the rules and revenue mix, but by ex-post measures, such as increasing grants in case of difficulties of allowing expenditure cuts. Several countries provide stabilisation through higher CG grants (8 countries compensate actual fluctuations and 5 countries compensate projected fluctuations). In Canada for example, the Fiscal Stabilization Program enables the federal government to provide financial assistance to any province faced with a year-over-year decline in its non-resource revenues greater than 5 per cent. Some countries allow SNGs to cut mandated expenditure in case of economic downturns (7 countries), and others wait for SNGs to face budget difficulties to provide them support (5 countries) (see Figure 15 and Table A B.15).

Addressing economic cycles and unexpected shocks through rainy day funds

Dealing with economic fluctuations

One way of allowing SNGs some room for manoeuvre during economic downturns is for them to set up rainy day funds (RDFs). RDFs, also called reserve funds or contingency reserve fund, are separate funds or budget provisions set aside to meet unforeseen and unavoidable requirements that may arise during the budget year, like natural disasters, armed conflicts or serious economic downturns.

Only eight countries in the survey have RDFs in place.[5] In some countries, it is a national legislation which requires SNGs to have such RDFs. In Mexico for example, the Fiscal Discipline Law (LFDSM) regulates the use of surplus incomes, and consents the creation of a fund whose objectives is to compensate for the drop in freely available income during economic downturns. In other countries, rainy day funds are set up by SNGs themselves. In Canada for example, six of the 13 provinces and territories have RDFs in place.[6] In the USA, every state has a RDF, but the rules for accumulating, keeping or using the funds vary greatly from state to state (Box 13).

[5] Hungary, Latvia, Slovak Republic, Sweden, Korea, Canada, Mexico and USA.

[6] Ontario, British Columbia, Alberta, Quebec, Manitoba and Newfoundland and Labrador.

Box 13. Rainy day funds in the USA

In the USA, every state has a rainy-day fund, also called budget stabilization funds. These allow states to set aside surplus revenues for use during unexpected downturns – as all states must keep a balanced operating budget. Rules for deposit, caps and withdrawal vary considerably across states. Some are narrowly defined, i.e. laws set forth clear or measurable objectives for the circumstances under which the rainy-day fund balance can be used (19 states). Other states have a broad definition, with expansive and nonspecific objectives (PEW, 2016).

Sources of funding

States finance their reserve funds differently. Most allow some or all their year-end surplus to flow to the rainy-day fund. Other states require a flat contribution out of total or special revenue sources. California for example dedicates a portion of its capital gains tax revenue to its budget stabilization account. Similarly, natural resource-rich states like Texas and Louisiana dedicate a portion of oil extraction revenues to various reserve funds, in combination with other deposit mechanisms. A handful of states tie their reserve accounts to either revenue or economic growth (Indiana, Arizona). Other states require specified set-asides until the fund reaches its minimum required balance. A few states replenish their funds with discretionary appropriations as par for the budget process, but regular contributions are not automatic or required in these states.

- Minnesota's Budget Reserve Account may be used when a negative budgetary balance is projected and when objective measures, such as reduced growth in total wages, retail sales, or employment, reflect downturns in the state's economy." These considerations help inform a rigorous two-part process. First, economists perform an annual study evaluating volatility in the parts of the state's economy that are subject to taxation. The calculations allow them to derive a savings target that can provide full coverage against most possible revenue downturns. Since this policy was enacted in 2014, the state has raised its combined savings target for the Budget Reserve and Cash Flow accounts to $2.03 billion.

Use of funds

In most states, the rainy-day fund is dedicated to closing deficit gaps in the current year or maintaining government spending when revenues are projected to decline. However, withdrawal rules vary. Some states include transfers from the rainy-day fund to the general fund in normal appropriations bills, while others require an emergency declaration or a supermajority (e.g., three-fifths or two-thirds) of the legislature to make a transfer. Several states can use the rainy-day fund to cover short-term cash flow gaps. Money is transferred to the general fund and must be paid back by the end of the fiscal year.

In addition to a rainy-day fund that can be used for general purposes during a fiscal crisis, some states have reserve funds available only for specific uses. For example, 37 states and the District of Columbia (DC) have a reserve account dedicated to disaster recovery. Other states have separate reserve funds for education or Medicaid spending, designed to cover shortfalls in these vital programs. Deposit and withdrawal rules for these supplemental reserve accounts may vary considerably from the rules governing the state's primary rainy-day fund.

Caps on fund balances

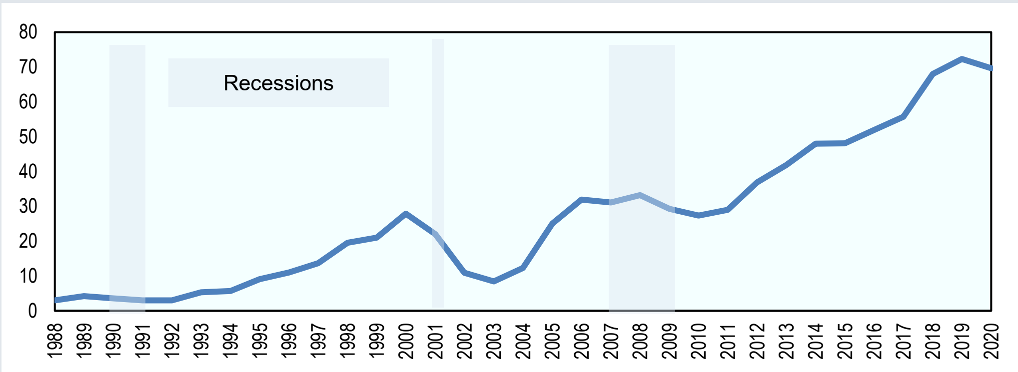
Forty-one states and DC cap the balances of their funds. The cap is typically a percentage of either revenues or expenditures, although some states have more complex formulas for determining maximum fund size. Most states that finance their RDF with operating surpluses stop transfers once the cap has been reached, allowing the surplus to remain in the general fund. A few redirect those operating surpluses to other funds for special projects or taxpayer relief.

- Illinois' rainy day fund for example only represents 0.8% of its state spending (PEW, 2016[22])
- Virginia's Revenue Stabilization Fund can hold a maximum balance of 15 percent of the prior three years' average state tax revenue, an increase from the 10 percent maximum that was in place before 2010. The state raised the limit after concerns arose about the fund's adequacy during the 2008-09 recession compared with the stated objectives. "The only use for the … fund in the constitution is [to fill] a shortfall in an enacted budget," said Virginia Secretary of Finance Ric Brown. "It is appropriately named as a revenue stabilization fund. It is there to stabilize revenue over the business cycle."
- Wyoming and Alaska have the largest rainy day funds, both states allowing their rainy day fund to cover over a year worth of their state's operating costs.

During Economic downturns, rainy-day funds have helped states limit the needed expenditure cuts to deal with revenue declines combined with increases in demand on programs such as unemployment insurance and Medicaid increases. Rainy-day fund balances tend to fall during recessions, but are quickly built up (Figure 16).

Figure 16. US States' rainy-day funds balance (billion USD)

Billion USD



Source: The National Association of State Budget Officers (2019[23]), The Fiscal Survey of States: An Update of State Fiscal Conditions, https://bit.ly/35GqWN8.

Source: Tax Policy Center (2020[24]), Tax Policy Center Briefing Book: The State of State (and Local) Tax Policy. PEW (2016[22]), State Rainy Day Funds: Purpose and Definition.

RDFs usually have rules on how to accumulate reserves (Table 10). Some countries have statutory contributions from SNG general revenues. In Quebec (Canada) for example, the Generations Fund (fund to repay debt) receives sums derived from the exploitation of hydraulic power and several other sources, such as the income generated by the investment of the sums in the Fund, the sale of government assets, a share of the specific tax on alcoholic beverages among others. Other countries make ad-hoc contributions to the RDF. In the Netherlands for example, if a LG is likely to have a surplus the municipal council may either decide to add this money to the reserves for possible hard times or investments in the future, or it may decide to spend it on something more immediate. In Mexico, the Fiscal Discipline Law (LFDSM) states that states must first cover the payment of debts from previous fiscal years, current liabilities and other obligations before they can allocate revenues to their RDF.

Table 10. Sources for rainy-day fund accumulation

Receive statutory contributions from SNG general revenues	Receive statutory contributions from SNG natural resource revenues	Receive statutory contributions from another specified SNG revenue stream	Receive contributions on an ad-hoc basis from the SNG	Receive contributions from central government
FIN	FIN	FIN	FIN	HUN
GRC	GRC	GRC	GRC	
HUN		HUN	HUN	
IRE		IRE	LVA	
4	**2**	**4**	**4**	**1**

Note: Only countries that answered this specific question are shown (9).
Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 7.2.

Many countries/SNGs set maximum amounts which can be held in their RDFs, as well as rules on how and for what purpose funds can be drawn from the rainy day funds (regulations on what can be financed, maximum amounts which can be drawn) (Table 11). In Hungary for example, rainy day funds are only used to cover unexpected expenditures from natural disasters. In Mexico, the Fiscal Discipline Law requires that drawing from RDFs is used in priority to cover the payment of debts and obligations, and to contribute to the funds for natural disasters and pensions. In the USA, most states have caps for drawing on rainy-day funds between 5 and 15% of general funds, but for some it's larger. Hawaii for example only allows 50% or less of its reserve fund to be used each year. Other states do not have any specific rule for drawing on rainy-day funds (Box 9).

The total amount of funds held in RDFs varies greatly across SNGs. In the USA for example, the number of days that states could run on their RDFs vary from 10 in the state of New York to 397 in Wyoming. The median number of days is 28 across states.[7]

Table 11. Limitations to SNG rainy-day funds

SNG rainy day funds are subject to limitations on				SNG rainy day funds may be used for	
The amount which may be withdrawn from the fund (e.g. in a budget cycle) imposed by the SNG itself	What the fund may be spent on imposed by the SNG itself	The amount which may be withdrawn from the fund (e.g. in a budget cycle) imposed by central government	What the fund may be spent on imposed by central government	Current expenditure (operating)	Capital budget
KOR	CAN	LVA	SVK	HUN	CAN
SVK	MEX			LVA	HUN
USA	SVK			POL	SVK
				SWE	SWE
				USA	
3	**3**	**1**	**1**	**5**	**4**

Note: Only countries that answered this specific question are shown (9).
Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 7.3.

Distinguishing between RDFs and SNG reserves is not always easy. Some countries allow SNGs to hold reserves, but do not consider these as rainy day funds. In Brazil for example, the Fiscal Responsibility Law states that the budget must have a contingency reserve, but this is not considered a rainy-day fund.

[7] See: https://www.pewtrusts.org/-/media/assets/2020/03/f50reservesbalances2003v2.pdf

In Switzerland, Seven out of the 26 cantons[8] make provisions for the creation of reserves. However, these are not rule-based and are also not referred to as rainy day funds. The regulations of the canton of Geneva for example explicitly provide for the creation of counter-cyclical reserves. However, the withdrawal of these reserves is only conditionally bound by rules; in particular, it is not bound by economic indicators. In South Africa, provinces do not maintain specific funds that are designated as being for the purposes of having funds available for a rainy day. Some provinces do budget for surpluses in-year, in order to provide for any emergencies that may arise, and some provinces have surpluses that have accumulated over multiple years. But these funds remain part of the provincial revenue fund and are available for general budget spending, they are not earmarked for rainy day purposes only.

Finally, in some countries, it is the CG who has created a special fund for assisting SNGs in financial difficulties. In Portugal for example, the CG created the Municipal Assistance Fund (FAM) in 2014 to financially assist the municipalities in a critical financial situation. This Fund is backed by 50% by the Portuguese Republic and the other half is financed through the compulsory contributions of all 308 municipalities.

Mechanisms for fiscal responses to emergencies

Addressing natural disasters and other emergencies does not only require availability of funds, but as the COVID-19 pandemic has shown, it also requires mechanisms for making these funds available very fast – i.e. not having to go through all the steps of the normal budget process – while still ensuring sufficient transparency and accountability in the allocation and use of funds.

A common mechanism used to address emergencies consists of keeping a share of the budget in an un-allocated appropriation, which can then be allocated to the emergency. This mechanism differs from the RDFs, as it does not have a counter-cyclical effect: there is no inter-temporal transfer of funds from good times to bad times.

Having such a reserve budget line is often mandated by national regulations, with only a discretion on the amount saved (sometimes within a range). For example in In Mexico, the Fiscal Discipline Law (LFDSM) requires all states to have a budget line in their annual budget to attend the affected population and damages caused by natural disasters, as well as to carry out actions to prevent and mitigate their impact on state finances. In Latvia, LGs can put up to 2% of their annual budget under the budget classification “municipal funds for unforeseen events”, which can be allocated during the year by the municipal council. In the budget execution report, these expenditures will appear under the heading to which they were allocated. In Lithuania, municipalities may form the reserve of the director of municipality administration. Each year, when approving the municipal budget, the municipal council determines the specific amount of this reserve, which shall not exceed 1% of the total budgeted expenditure. This reserve can be used to cover emergencies and damages from natural disasters and fires, at the discretion of the director of municipality administration. In Poland, SNGs must include in their budgets a general reserve allocation of 0.1% to 1% of budget expenditures, and an earmarked reserve for dealing with crises and natural disasters of up to 0.5% of budgeted expenditures. In Portugal, the State Budget annually contains an expenditure authorization in the maximum amount equivalent to 1% of the Financial Equilibrium Fund (FEF) of the municipalities of the continent of the year in question, exclusively destined to financial aid to the local administration in case of declaration of calamity.

In addition to these reserve budget allocations, some countries have other mechanisms in place for dealing with unforeseen disasters. In Latvia for example, in case of unforeseen circumstances (natural disasters, fire damage, emergency situations) local governments may request funds from state budget`s contingency funds programme, which covers 70% of expenditure in order to eliminate the

[8] Bern, Basel-Landschaft, St. Gallen, Graubünden, Aargau, Ticino and Geneva.

consequences of disaster. Other 30% should be co-financed by local government own budget, and for this share local government may take borrowing. In Korea, in case of natural disaster, the Association of Local Governments can issue a bond to support a disaster recovery plan. In such cases, it must previously obtain a resolution from local council members of the association.

Escape clauses

Fiscal rules are often criticised for their pro-cyclical effects, in particular amplifying downturns, as SNGs must cut expenditure when revenues decline, i.e., precisely when activity is declining and counter-cyclical government spending would be needed. As seen in the previous section, normal variations in the business cycle can be accommodated using structural fiscal rules or multi-annual fiscal rules. However, these are not sufficient for dealing with exceptional shocks.

This is why many countries have introduced escape clauses in their fiscal rules, in particular regarding their budget balance objectives (13 countries) and borrowing constraints (10 countries) (Table 12). As countries are currently facing an unprecedented health and economic shock due to the COVID-19 pandemic, many countries have triggered these escape clauses, and put in place additional support mechanisms for their SNGs (Box 14).

In some countries, triggering the escape clause requires a formal recognition of a state of emergency, for example by an absolute majority of the Chamber of Deputies in Spain. In other countries, unforeseen supplementary expenditures must be approved by the Ministry of the Interior (Luxembourg). In federal countries such as Austria, Germany, or Switzerland, each regional government (Länder, canton) has different escape clause rules. In Switzerland, about half the cantons foresee escape clauses for their fiscal rules. Some countries allow for funds to be allocated in emergencies without going through the normal budget process (South Africa). Finally, countries where FRs target voted budgets but not realised budgets (Hungary) or where there are no consequences for breaching FRs (New Zealand) do not need escape clauses.

Table 12. Escape clauses to various SNG fiscal rules

Budget balance objectives	Expenditure limitations	Tax limitations	Borrowing constraints
AUT	AUT	IND	AUT
BRA	IND	LVA	BRA
CAN	LVA	PRT	DEU
ESP	MEX	SWE	IND
HUN	PRT		KOR
IND	SVK		LVA
LTU	SVN		MEX
MEX	SWE		PRT
PRT	USA		SWE
SVK			TUR
SWE			
USA			
ZAF			
13	**9**	**4**	**10**

Note: Only countries that answered this specific question are shown (18).
Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 1.7.

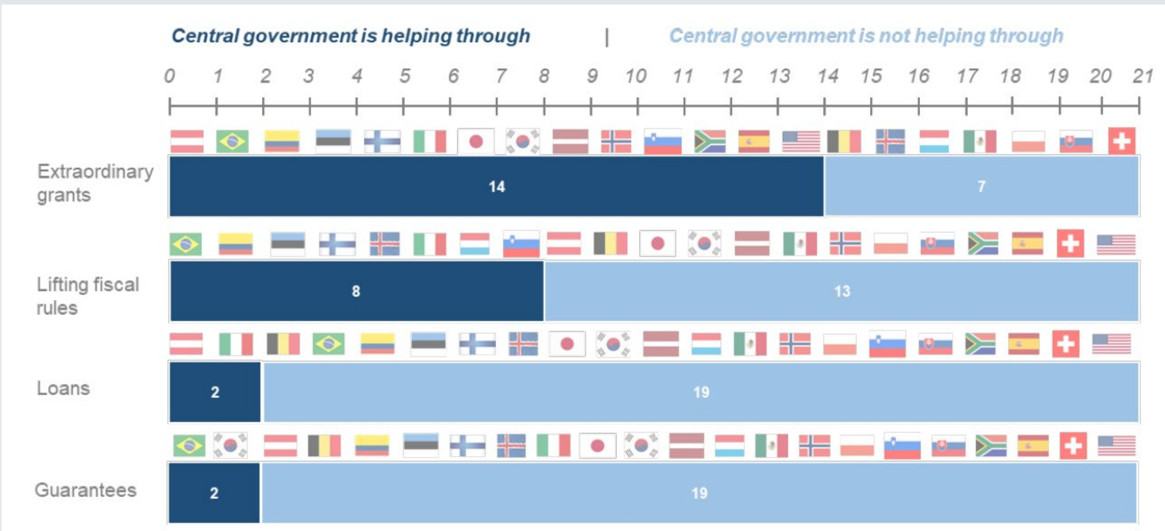
Addressing the COVID-19 crisis

Following the crisis triggered by the COVID-19 pandemic, many countries have triggered the escape clauses to allow SNGs to increase deficits and debts in order to respond to the emergency (Box 14). In Austria for example, each Länder can set its own fiscal rules and escape clauses. The state of Upper Austria, passed a regional debt brake in 2018. However, this debt brake includes an escape clause, which was triggered in 2020, even before the confinement started. Indeed, Austrian Länders have importance compentences in the field of public hospitals.[9] Some governments which did not have a formal escape clause in their FRs also found ways to exceptionally circumvent the rules. For example the federal state of Bavaria in Germany does not have a formal escape clause in its constitutional debt brake. However, it still was able to declare a "disaster situation" and suspend the application of its debt brake rule for at least one year.[10] In Luxembourg, the CG has taken specific measures to take the extraordinary circumstances of the current crisis into account. As such, even if a municipality closes its 2020 accounts with a deficit, it must absorb this shock through next year's budget. Thus, over-indebtedness is obviated. The Government has strongly encouraged that public sector investments must continue and has assessed that the resources available to the municipalities allow them to do so despite the current budgetary challenges.

Box 14. Emergency responses from CG to support SNGs and escape clauses triggered following the COVID-19 pandemic

The most common response from central governments to support SNGs facing financial difficulties following the COVID-19 outbreak was providing extraordinary grants (OECD, 2020[3]). During 2020, in a survey of 21 OECD governments, almost half had temporarily lifted fiscal rules (in particular for EU countries, this was allowed by the "general escape clause" by the European Commission), and in about one-third, the central government provided additional loans and guarantees to SNGs (Figure 17). Overall, about two-thirds of governments either relaxed fiscal rules or plan to do so (OECD, 2020[25]).

Figure 17. Measures employed by central governments to improve subnational liquidity



Source: OECD (2020[3]), Inter-governmental fiscal relations and the Coronavirus (COVID-19) pandemic: emerging responses and preliminary guidance.

[9] Eisl (2020[26]), Fiscal policy-making in the time of coronavirus.

[10] Same as above.

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Annex A. List of respondents to the OECD Survey on Fiscal Rules for Subnational Governments, 2019 update

Table A A.1. List of respondents and country name abbreviations

Level of government	EU/Non-EU	Country	Country 3-letter abbreviation
Local	EU	Finland	FIN
		Greece	GRC
		Hungary	HUN
		Ireland	IRE
		Italy	ITA
		Lithuania	LTU
		Luxembourg	LUX
		Latvia	LVA
		Netherlands	NLD
		Poland	POL
		Portugal	PRT
		Slovakia	SVK
		Slovenia	SVN
		Sweden	SWE
	Non-EU	Brazil	BRA
		Korea	KOR
		New Zealand	NZL
		Turkey	TUR
State	EU	Austria	AUT
		Belgium	BEL
		Germany	DEU
		Spain	ESP
	Non-EU	Australia	AUS
		Canada	CAN
		Switzerland	CHE
		India	IND
		Mexico	MEX
		United States	USA
		South Africa	ZAF

Source: OECD Survey on Fiscal Rules for Subnational Governments 2019.

Annex B. Detailed country answers

Table A B.1. SNGs fiscal rules in OECD countries

Level of government	EU/non-EU	Country	Budget balance rule	Expenditure limits	Borrowing constraints
State	EU	AUT	✓ both surveys	✓ new	
		BEL	✓ both surveys	✓ new	✓ new
		DEU	✓ both surveys		✓
		ESP	✓ both surveys	✓ new	✓ both surveys
	Non-EU	AUS	✓ both surveys	✓ both surveys	✓ both surveys
		CAN	✓ both surveys	✓ new	✓ new
		CHE	✓ both surveys	✓ new	✓ new
		IND	✓	✓	✓
		MEX	✓ new	✓ new	✓ both surveys
		USA	✓	✓	✓
		ZAF	✓	✓	✓
Local	EU	FIN	✓ both surveys	✓ new	✓ new
		GRC	✓		✓
		HUN	✓	✓	✓
		IRE	✓	✓	✓
		ITA	✓ new	✓ both surveys	✓ both surveys
		LTU	✓		✓
		LUX	✓	✓	✓
		LVA			✓
		NLD	✓		✓
		POL	✓ both surveys		✓ both surveys
		PRT	✓	✓	✓
		SVK	✓ both surveys	✓ new	✓ both surveys
		SVN	✓ both surveys	✓ new	✗ existed before
		SWE	✓ both surveys	✓ new	✓ new
	Non-EU	BRA	✓	✓	✓
		KOR	✓ both surveys	✓ new	✓ both surveys
		NZL	✓ both surveys		✓ both surveys
		TUR		✓ both surveys	✓ both surveys
			26	**22**	**27**

Note: Answers in grey – rule existed in previous vintage (2011) but not in current one; Answers in green – rule exists in current vintage (2019) but not in previous vintage (2011); cells in blue – rule exists in current vintage (2019) or in both vintages (2011 and 2019).

BRA, GRC, HUN, IND, IRE, LUX, LTU, LVA, NDL, PRT, SVK, USA, and ZAF did not participate in 2011 survey or did not answer the respective question. Countries, which did not answer the question or do not have any relevant rule are not included in the table.
Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 1.2.

Expenditure limitations

Table A B.2. CG limitations on SNG expenditures (both increases and reductions)

Level of government	EU/Non-EU	Country	Mandatory in nature				Recommended or voluntary			
			Not used	Set for overall expenditure	Set for the current (operating) expenditure only	Set for individual expenditure lines only	Not used	Set for overall expenditure	Set for the current (operating) expenditure only	Set for individual expenditure lines only
Local	EU	FIN	✓					✓	✓	
		GRC	✓				✓			
		HUN	✓				✓			
		IRE		✓						
		ITA		✓						
		LTU	✓				✓			
		LUX				✓				
		LVA						✓	✓	✓
		NLD	✓	✓			✓	✓		
		POL	✓				✓			
		PRT		✓						
		SVK		✓						
		SVN	✓	✓						
		SWE	✓				✓			
	Non-EU	BRA			✓	✓			✓	
		KOR				✓				✓
		NZL	✓				✓			
		TUR				✓				
State	EU	AUT		✓						
		BEL	✓				✓			
		DEU	✓				✓			
		ESP		✓						
	Non-EU	AUS	✓				✓			
		CAN	✓				✓			
		CHE	✓				✓			
		IND						✓		
		MEX			✓			✓	✓	✓
		USA				✓				✓
		ZAF					✓			
			14	**8**	**2**	**5**	**13**	**5**	**4**	**4**

Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 3.1.

Table A B.3. How are expenditure limitations for SNGs adjusted over time?

Level of government	EU/Non EU	Country	Indexation to incomes	Indexation to prices	Linked to an objective needs criteria, such as population growth	Level of government
Local	EU	FIN		✓	✓	
		GRC				
		HUN				
		IRE				✓
		ITA				✓
		LTU				
		LUX				
		LVA				
		NLD				
		POL				
		PRT	✓			
		SVK				✓
		SVN				
		SWE				
	Non-EU	BRA	✓	✓		
		KOR	✓			
		NZL				
		TUR	✓			
State	EU	AUT				✓
		BEL				
		DEU				
		ESP	✓			✓
	Non-EU	AUS				
		CAN				
		CHE				
		IND			✓	
		MEX	✓			
		USA	✓	✓	✓	
		ZAF		✓		
			7	**4**	**3**	**5**

Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 3.2.

Borrowing constraints

Table A B.4. Restrictions on SNG borrowing

Level of government	EU/Non EU	Country	Current								Capital							
			Not used	There are no restrictions	Borrowing is limited to specific lender institutions	Restrictions are limited to specific purposes (e.g. for investment only)	Borrowing abroad is prohibited	Approval from central government on borrowing is required	Borrowing is prohibited	Other	Not used	There are no restrictions	Borrowing is limited to specific lender institutions	Restrictions are limited to specific purposes (e.g. for investment only)	Borrowing abroad is prohibited	Approval from central government on borrowing is required	Borrowing is prohibited	Other
Local	EU	FIN	✓	✓							✓	✓						
		GRC								✓				✓		✓		
		HUN						✓						✓		✓		
		IRE						✓								✓		
		ITA							✓									✓
		LTU												✓				
		LUX							✓					✓		✓		
		LVA						✓					✓	✓		✓		
		NLD	✓								✓							
		POL												✓				
		PRT			✓	✓							✓	✓				
		SVK							✓					✓				
		SVN					✓	✓							✓	✓		
		SWE																✓
	Non-EU	BRA			✓			✓		✓						✓		
		KOR				✓		✓						✓		✓		
		NZL	✓				✓				✓				✓			
		TUR						✓								✓		
State	EU	AUT	✓	✓							✓							✓
		BEL	✓								✓							
		DEU										✓						
		ESP						✓		✓						✓		✓
	Non-EU	AUS	✓	✓							✓	✓						
		CAN	✓								✓							
		CHE		✓								✓						
		IND					✓	✓							✓	✓		
		MEX				✓	✓							✓	✓			
		USA				✓						✓						
		ZAF					✓	✓							✓	✓		
			7	4	2	4	5	10	3	3	7	5	2	10	5	12	0	4

Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 4.1.

Table A B.5. Restrictions on SNG new debt and debt servicing

Level of government	EU/Non EU	Country	On the debt level	On debt service	On the issue of new borrowing (caps)	Other	Not used
Local	EU	FIN					✓
		GRC	✓	✓			
		HUN	✓	✓	✓		
		IRE	✓		✓		
		ITA				✓	
		LTU	✓				
		LUX				✓	
		LVA	✓				
		NLD					✓
		POL		✓			
		PRT	✓				
		SVK	✓	✓			
		SVN	✓				
		SWE					
	Non-EU	BRA	✓	✓	✓		
		KOR	✓	✓	✓		
		NZL					✓
		TUR	✓		✓		
State	EU	AUT					✓
		BEL					✓
		DEU					✓
		ESP	✓	✓	✓		
	Non-EU	AUS					✓
		CAN					✓
		CHE					✓
		IND	✓		✓		
		MEX	✓				
		USA	✓	✓	✓		
		ZAF	✓	✓	✓		
			16	**9**	**9**	**2**	**9**

Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 4.2.

Monitoring and enforcement mechanisms

Origin of SNG FR

Table A B.6. How are different types of SNG fiscal rules created?

Level of government	EU/Non-EU	Country	Budget balance objectives					Expenditure limitations					Borrowing constraints				
			None	**Self-imposed**	**Negotiated between levels of government but not binding**	**Negotiated between levels of government and binding**	**Imposed from above**	**None**	**Self-imposed**	**Negotiated between levels of government but not binding**	**Negotiated between levels of government and binding**	**Imposed from above**	**None**	**Self-imposed**	**Negotiated between levels of government but not binding**	**Negotiated between levels of government and binding**	**Imposed from above**
Local	EU	FIN		✓		✓	✓		✓	✓				✓	✓		
		GRC					✓	✓									✓
		HUN		✓			✓		✓					✓			✓
		IRE					✓					✓					✓
		ITA					✓					✓					✓
		LTU					✓										✓
		LUX					✓					✓					✓
		LVA														✓	✓
		NLD				✓	✓				✓	✓					✓
		POL					✓										✓
		PRT					✓					✓					✓
		SVK					✓					✓					✓
		SVN					✓					✓					
		SWE		✓					✓					✓			
	Non-EU	BRA		✓		✓			✓			✓				✓	✓
		KOR					✓					✓					✓
		NZL					✓	✓						✓			
		TUR	✓									✓					✓
State	EU	AUT				✓					✓						
		BEL		✓		✓			✓					✓			✓
		DEU					✓									✓	
		ESP				✓						✓					✓
	Non-EU	AUS		✓					✓					✓	✓		
		CAN		✓					✓					✓			
		CHE		✓					✓					✓			
		IND				✓				✓							✓
		MEX		✓					✓					✓			✓
		USA		✓					✓					✓			

		ZAF			✓				✓	✓						✓	✓
			1	10	1	7	14	2	11	3	2	11	0	10	2	4	19

Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 1.2.

SNG FR monitoring

Table A B.7. Who monitors compliance with fiscal rules?

Level of government	EU/Non-EU	Country	Budget balance objectives			Expenditure limitations			Borrowing constraints		
			Higher level of government	**SNGs themselves**	**Other**	**Higher level of government**	**SNGs themselves**	**Other**	**Higher level of government**	**SNGs themselves**	**Other**
State	EU	AUT			✓			✓			✓
		BEL		✓	✓		✓			✓	
		DEU								✓	✓
		ESP	✓			✓			✓		
	Non-EU	AUS		✓			✓			✓	
		CAN		✓			✓			✓	
		CHE		✓			✓			✓	
		IND	✓	✓			✓		✓		
		MEX		✓			✓	✓		✓	✓
		USA		✓			✓			✓	
		ZAF	✓	✓		✓	✓		✓		
Local	EU	FIN	✓	✓		✓	✓			✓	
		GRC	✓						✓		
		HUN		✓	✓		✓			✓	✓
		IRE		✓		✓			✓		
		ITA	✓			✓					✓
		LTU			✓						✓
		LUX	✓			✓			✓		
		LVA		✓		✓	✓		✓		
		NLD	✓	✓		✓	✓		✓	✓	
		POL									
		PRT	✓			✓			✓		
		SVK	✓	✓		✓	✓		✓	✓	
		SVN				✓					
		SWE	✓	✓	✓		✓	✓		✓	✓
	Non-EU	BRA	✓	✓	✓	✓	✓	✓	✓	✓	✓
		KOR	✓			✓			✓		
		NZL		✓						✓	
		TUR									
			13	**17**	**6**	**13**	**14**	**4**	**12**	**14**	**8**

Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 1.3.

Table A B.8. To whom it FR monitoring is reported?

Level of govern-ment	EU/ Non-EU	Country	Budget balance objectives				Expenditure limitations				Borrowing constraints			
			Higher level of government	Local legislature	Population, media	Other	Higher level of government	Local legislature	Population, media	Other	Higher level of government	Local legislature	Population, media	Other
Local	**EU**	FIN	✓	✓	✓		✓	✓	✓		✓	✓	✓	
		GRC	✓	✓				✓						
		HUN	✓	✓		✓		✓			✓	✓		
		IRE	✓	✓	✓		✓				✓			
		ITA	✓	✓			✓	✓			✓	✓		
		LTU	✓	✓	✓	✓					✓	✓	✓	✓
		LUX	✓	✓			✓	✓			✓	✓		
		LVA			✓		✓		✓		✓			
		NLD	✓	✓	✓		✓	✓			✓	✓		
		POL		✓	✓							✓	✓	
		PRT	✓				✓				✓			
		SVK	✓	✓			✓	✓			✓	✓		
		SVN					✓	✓						
		SWE	✓	✓	✓	✓		✓	✓	✓		✓	✓	✓
	Non-EU	BRA	✓	✓	✓		✓	✓	✓		✓	✓	✓	
		KOR	✓	✓	✓		✓	✓	✓		✓	✓	✓	
		NZL			✓									
		TUR												
State	**EU**	AUT	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
		BEL			✓									
		DEU										✓		
		ESP	✓		✓		✓		✓		✓			
	Non-EU	AUS		✓	✓			✓	✓			✓	✓	
		CAN		✓	✓			✓	✓			✓	✓	
		CHE		✓	✓			✓	✓			✓	✓	
		IND		✓				✓			✓	✓		
		MEX		✓	✓			✓	✓			✓	✓	
		USA		✓	✓			✓	✓			✓	✓	
		ZAF	✓				✓	✓			✓			
			16	**20**	**18**	**4**	**14**	**19**	**12**	**2**	**16**	**19**	**12**	**3**

Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 1.4.

SNG FR infringement

Table A B.9. In case of infringement CG may impose sanctions

			Budget balance objectives									Expenditure limitations									Borrowing constraints								
Level of government	EU/Non EU	Country	None	Remove, replace, or punish officials	Make recommendations on corrective measures	Impose financial sanctions on a discretionary basis	Impose financial sanctions on an automatic basis	Oblige the SNG to take measures so that the rule is respected in the future	Oblige the SNG to offset (compensate for) the breach of the fiscal rule in future budgets	Impose administrative sanctions that limit the freedom of SNGs	Other	None	Remove, replace, or punish officials	Make recommendations on corrective measures	Impose financial sanctions on a discretionary basis	Impose financial sanctions on an automatic basis	Oblige the SNG to take measures so that the rule is respected in the future	Oblige the SNG to offset (compensate for) the breach of the fiscal rule in future budgets	Impose administrative sanctions that limit the freedom of SNGs	Other	None	Remove, replace, or punish officials	Make recommendations on corrective measures	Impose financial sanctions on a discretionary basis	Impose financial sanctions on an automatic basis	Oblige the SNG to take measures so that the rule is respected in the future	Oblige the SNG to offset (compensate for) the breach of the fiscal rule in future budgets	Impose administrative sanctions that limit the freedom of SNGs	Other
Local	EU	FIN		✓				✓	✓				✓																
		GRC		✓	✓	✓		✓																		✓			
		HUN			✓			✓		✓	✓	✓														✓		✓	✓
		IRE			✓	✓				✓	✓							✓									✓		
		ITA					✓			✓						✓			✓						✓			✓	
		LTU									✓																		
		LUX																											
		LVA												✓	✓				✓				✓	✓				✓	
		NLD			✓			✓	✓	✓				✓	✓		✓	✓	✓							✓			
		POL		✓				✓														✓				✓			
		PRT			✓		✓		✓	✓				✓		✓		✓	✓				✓		✓		✓	✓	
		SVK	✓			✓																			✓				
		SVN										✓			✓												✓		
		SWE																											
	Non-EU	BRA		✓	✓		✓						✓	✓		✓	✓						✓			✓			
		KOR						✓		✓							✓		✓							✓		✓	
		NZL		✓						✓												✓						✓	
		TUR																											
State	EU	AUT	✓			✓					✓				✓					✓				✓					✓
		BEL																											
		DEU																											
		ESP		✓	✓	✓	✓	✓		✓			✓	✓	✓	✓	✓		✓			✓	✓	✓	✓	✓		✓	
	Non-EU	AUS																											
		CAN																											
		CHE																											
		IND			✓			✓						✓			✓						✓			✓			
		MEX																											
		USA																											
		ZAF							✓									✓	✓										

	2	6	8	5	4	8	4	8	4	2	3	6	5	4	5	4	7	1	0	3	5	3	4	8	3	7	2

Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 1.5 and 1.5b.

Table A B.10. In case of infringements SNGs may impose punishments

Level of government	EU/Non EU	Country	Budget balance objectives					Expenditure limitations					Borrowing constraints				
			Remove, replace, or punish officials	Take measures so that the rule is respected in the future	Offset (compensate) the breach of the fiscal rule in future budgets	Other	None	Remove, replace, or punish officials	Take measures so that the rule is respected in the future	Offset (compensate) the breach of the fiscal rule in future budgets	Other	None	Remove, replace, or punish officials	Take measures so that the rule is respected in the future	Offset (compensate) the breach of the fiscal rule in future budgets	Other	None
Local	EU	FIN		✓	✓				✓	✓				✓	✓		
		GRC		✓													
		HUN		✓	✓				✓	✓				✓	✓		
		IRE		✓	✓	✓				✓			✓			✓	
		ITA			✓					✓							✓
		LTU		✓													
		LUX															
		LVA	✓	✓	✓			✓	✓	✓			✓				
		NLD	✓	✓	✓			✓	✓	✓							
		POL		✓										✓			
		PRT		✓					✓					✓			
		SVK	✓	✓	✓			✓	✓	✓			✓	✓	✓		
		SVN										✓					
		SWE		✓	✓				✓	✓				✓	✓		
	Non-EU	BRA	✓	✓				✓	✓				✓	✓			
		KOR		✓					✓					✓			
		NZL					✓					✓					✓
		TUR															
State	EU	AUT	✓	✓	✓			✓	✓	✓			✓	✓	✓		
		BEL		✓	✓				✓	✓							
		DEU		✓	✓	✓				✓	✓	✓					
		ESP		✓	✓				✓	✓				✓	✓		
	Non-EU	AUS	✓	✓	✓			✓	✓	✓							
		CAN	✓		✓												
		CHE			✓					✓					✓		
		IND		✓					✓					✓			
		MEX	✓	✓	✓			✓	✓	✓							

		USA			✓					✓				✓	✓		
		ZAF						✓	✓	✓							
			8	20	17	2	1	8	16	17	1	3	5	12	8	1	2

Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 1.6.

Relations with banks and state-owned enterprises (SOEs)

Table A B.11. Results of SOEs affect SNG's budget balance objective

Level of government	EU/Non-EU	Country	Current (operating) deficits incurred by SOEs	SOE commercial debts incurred to finance capital expenditure	SOE financing from SNG budgets that is treated as a grant	SOE financing from SNG budgets that is treated as a loan
State	EU	AUT	✓	✓	✓	
		BEL				
		ESP	✓		✓	✓
	Non-EU	CAN	✓			
		CHE			✓	✓
		IND			✓	✓
		MEX	✓		✓	✓
		USA	✓		✓	✓
		ZAF			✓	
Local	EU	FIN	✓	✓		
		GRC			✓	
		HUN				
		IRE		✓	✓	
		ITA				
		LTU		✓		
		LUX				
		LVA			✓	
		NLD				
		POL			✓	
		PRT			✓	
		SVK			✓	✓
		SVN	✓	✓	✓	✓
		SWE	✓		✓	
	Non-EU	BRA	✓	✓	✓	✓
		KOR	✓	✓		✓
		NZL	✓		✓	
			11	**7**	**17**	**9**

Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 2.6.

Table A B.12. CG limitations on SNG expenditures (both increases and reductions)

Level of government	EU/Non-EU	Country	Mandatory in nature				Recommended or voluntary			
			Not used	Set for overall expenditure	Set for the current (operating) expenditure only	Set for individual expenditure lines only	Not used	Set for overall expenditure	Set for the current (operating) expenditure only	Set for individual expenditure lines only
Local	EU	FIN	✓					✓	✓	
		GRC	✓				✓			
		HUN	✓				✓			
		IRE		✓						
		ITA		✓						
		LTU	✓				✓			
		LUX				✓				
		LVA						✓	✓	✓
		NLD	✓	✓			✓	✓		
		POL	✓				✓			
		PRT		✓						
		SVK		✓						
		SVN	✓	✓						
		SWE	✓				✓			
	Non-EU	BRA			✓	✓			✓	
		KOR				✓				✓
		NZL	✓				✓			
		TUR				✓				
State	EU	AUT		✓						
		BEL	✓				✓			
		DEU	✓				✓			
		ESP		✓						
	Non-EU	AUS	✓				✓			
		CAN	✓				✓			
		CHE	✓				✓			
		IND						✓		
		MEX			✓			✓	✓	✓
		USA				✓				✓
		ZAF					✓			
			14	**8**	**2**	**5**	**13**	**5**	**4**	**4**

Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 3.1.

Table A B.13. How are expenditure limitations for SNGs adjusted over time?

Level of government	EU/Non EU	Country	Indexation to incomes	Indexation to prices	Linked to an objective needs criteria, such as population growth	Other
Local	EU	FIN		✓	✓	
		GRC				
		HUN				
		IRE				✓
		ITA				✓
		LTU				
		LUX				
		LVA				
		NLD				
		POL				
		PRT	✓			
		SVK				✓
		SVN				
		SWE				
State	Non-EU	BRA	✓	✓		
		KOR	✓			
		NZL				
		TUR	✓			
	EU	AUT				✓
		BEL				
		DEU				
		ESP	✓			✓
	Non-EU	AUS				
		CAN				
		CHE				
		IND			✓	
		MEX	✓			
		USA	✓	✓	✓	
		ZAF		✓		
			7	4	3	5

Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 3.2.

Dealing with cyclical impacts on SNG finances

Escape clauses

Table A B.14. Escape clauses SNG fiscal rules

Level of government	EU/Non EU	Country	Budget balance objectives				Expenditure limitations				Borrowing constraints			
			A deterioration of local economic conditions	A fall in revenue	Impact of a natural or other disaster	Other	A deterioration of local economic conditions	A fall in revenue	Impact of a natural or other disaster	Other	A deterioration of local economic conditions	A fall in revenue	Impact of a natural or other disaster	Other
Local	EU	FIN												
		GRC												
		HUN	✓	✓	✓									
		IRE												
		ITA												
		LTU	✓											
		LUX												
		LVA							✓				✓	
		NLD												
		POL												
		PRT			✓				✓				✓	
		SVK			✓				✓					
		SVN					✓	✓	✓					
		SWE				✓				✓				✓
	Non-EU	BRA	✓	✓	✓						✓		✓	
		KOR									✓	✓	✓	
		NZL												
		TUR												✓
State	EU	AUT	✓		✓	✓	✓		✓	✓	✓		✓	✓
		BEL												
		DEU											✓	✓
		ESP	✓	✓	✓									
	Non-EU	AUS												
		CAN	✓	✓	✓									
		CHE												
		IND	✓	✓	✓		✓	✓	✓		✓	✓	✓	
		MEX		✓					✓				✓	
		USA	✓	✓	✓				✓					
		ZAF			✓									
			8	**7**	**10**	**2**	**3**	**2**	**8**	**2**	**4**	**2**	**8**	**4**

Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 1.7.

Cyclical impacts and rainy-day funds

Table A B.15. Elements to manage SNG budget cyclicality

Level of government	EU/Non-EU	Country	Rainy day funds	Off-budget funds	Higher revenues from CG offsetting projected fluctuations	Higher revenues from CG offsetting actual fluctuations	Special financial support for SNGs facing budget difficulties	Cuts on mandated expenditure	Allocation of less cyclical expenditure
State	EU	AUT		✓ both surveys					✓ both surveys
		DEU	✓ both surveys	✓ both surveys				✓ both surveys	
		ESP				✗ existed before	✓ new		
	Non-EU	AUS				✓ both surveys			
		CAN	✓ both surveys	✗ existed before	✗ existed before		✓ new		
		IND						✓	
		MEX	✓ both surveys			✓ new		✓ both surveys	
		USA	✓	✓		✓		✓	✓
		ZAF				✓			✓
Local	EU	FIN	✗ existed before	✗ existed before	✓ both surveys	✓ new		✓ both surveys	
		HUN	✓		✓				
		IRE			✓ both surveys	✓ new	✓ new		
		LTU			✓	✓			
		NLD			✓	✓		✓	
		PRT					✓		
		SVK	✓	✓					
		SWE	✓ both surveys					✗ existed before	
	Non-EU	BRA					✓		
		KOR	✓ new						
		TUR						✓ new	✗ existed before
			8	**4**	**5**	**8**	**5**	**7**	**3**

Note: Answers in grey – mechanism existed in previous vintage (2011) but not in current one; Answers in green – mechanisms exist in current vintage (2019) but not in previous vintage (2011); cells in blue – mechanism exist in current vintage (2019) or in both vintages (2011 and 2019). BRA, GRC, HUN, IND, IRE, LUX, LTU, LVA, NDL, PRT, SVK, USA, and ZAF did not participate in 2011 survey or did not answer the respective question. Countries, which did not answer the question or do not have any relevant mechanisms are not included in the table.
Source: OECD Survey on Fiscal Rules for Subnational Governments 2019, question 5.1.