The focus of this brief is on the policy responses that governments can and are taking through the channel of inter-governmental relations to tackle the Coronavirus (COVID-19) crisis. Sub-national governments are playing a crucial role in the current crisis, and past experience suggests they will need sufficient support to ensure they can confront the risks. Co-ordinated action across different levels of government is essential to ensuring that responses to the crisis are effective across all regions within countries.

The world is now confronted with a “Black Swan” pandemic outbreak that is challenging policymakers at all levels of government. Nobody imagined the depth and breadth of the crisis that the world is facing today, with COVID-19 severely affecting health, freedom of movement, food security, employment, education, trade, and leisure – there is hardly any aspect of our social and economic system that has not been shackled or halted by the present crisis. In retrospect, the 2008-09 financial crisis now seems like a small-scale rehearsal of these disruptions to our socioeconomic system, with around one-quarter of total GDP directly impacted by the present crisis (OECD, 2020b).


2 See the companion brief on territorial responses to the COVID-19 crisis (OECD, 2020a), www.oecd.org/coronavirus/.
Sub-national governments (SNGs) were at the forefront of the 2008-09 financial crisis, since they were both severely hit by it as well as important actors in overcoming it. Today, SNGs are again at the forefront, as they are important actors in the implementation of the public health measures to prevent the spread of the virus (screening, population monitoring, crisis communications, co-ordinated care for vulnerable/homeless populations, enforcing confinement, curfew, ensuring public order, etc.), and in some countries, in providing the front-line health treatment and services to those infected (see OECD, 2020a). In many countries, SNGs are also a key player in social protection, providing financial support to citizens who cannot work. As with the 2008-09 crisis, this may lead to an acute “scissors effect”, with SNG expenditures surging, while at the same time their revenues collapse (see Box 2).

Having learnt the lessons of the 2008-09 experience, this note aims to: i) show that SNGs are a key player in addressing the present health and economic crisis, and highlight a couple of stylised facts on how they are intervening; ii) identify the main fiscal vulnerabilities of SNGs; iii) highlight some actions that central governments are already taking to financially support SNGs and enhance co-ordination; and finally, iv) look at emerging policy challenges based on past experience to ensure that SNGs can contribute to effectively react to the health crisis and support economic activity.

### SNGs are key players in addressing the COVID-19 crisis

Sub-national governments (SNGs) are at the front lines in addressing the COVID-19 pandemic, in terms of its containment, addressing the health challenges, and supporting populations in need.

**Initial responses to control the virus have relied in part on local policy actions**

While mitigation and confinement responses are increasingly centralised at the central government level, many of the early actions in China, Germany, Italy, UK and US have been at the local or state/region levels. Initial actions to slow the spread of the COVID-19 virus and “flatten the curve” have relied heavily on targeted confinement actions that were in some cases directed at the national level (e.g., in Lombardy, Italy), with bottom-up responses in other cases. Notably, US states and municipalities have been the lead actors in California, New York and Texas, as well as many other regions. In several US regions, adjoining states have even developed “pacts” to ensure co-ordination in the relaxing of social distancing controls, in order to avoid an un-synchronised adjacent relaxation of controls that would undermine efforts to slow the spread of the virus.

**SNGs are responsible for the provision of essential public goods such as health, public order and safety or social protection**

Public services related to health, public order and social protection are potentially going to be more demanded in this stage of virus propagation and lockdowns. Health is directly affected by the outbreak since people who get infected might require treatment in case of severe symptoms. Public order and safety are necessary to enforce the lockdown measures that most OECD countries have taken to suppress the spread of the virus. Social transfers are a natural answer to the income reduction and unemployment that commercial and retail business closure are going to entail throughout the economy. On average, SNGs are responsible for 55% of average country expenditure on public order and safety, 38% of expenditure on health, and 15% of expenditure on social protection (Figure 1). Thus, many of the policies implemented to tackle the virus outbreak are the responsibility of SNGs.

---

3 See Blöchliger et al. (2010) for a discussion of the impact of the financial crisis on SNGs.
Figure 1. SNGs are key players in the provision of health, public order and social protection

Note: Sub-national expenditure by function in 2017 shown as a percentage of general government expenditure. OECD weighted average (weighted by population size of each country) based on available data. Source: OECD National Accounts COFOG database.

Health decentralisation varies from zero to almost 100% among OECD countries (Figure 2, Panel A). SNGs are responsible for more than 40% of health expenditure in ten countries, and above 80% in Switzerland, Denmark, Italy, Sweden, Spain and Finland. It is worth noting that Spain and Italy – both of which have been hit hard by the virus outbreak – are among these countries. Expenditure responsibilities in healthcare are complex in many countries, with decisions on one level of government often affecting expenditures on another, while many decision responsibilities are shared. This necessitates robust intergovernmental co-ordination (Box 1).

The share of public expenditure on public order and safety varies within a range between zero and 90% (Figure 2, Panel B). Federal countries tend to decentralise this function more than unitary ones: Switzerland, Germany, the United States and Belgium are federal countries and are among the countries where SNGs have the highest share on this expenditure function. As a result, SNGs from these countries may face a higher financial pressure from this expenditure.

Expenditures on social protection are not as decentralised as those on health and public order and safety. Half of the countries analysed decentralised less than 10% of this type of expenditure (Figure 2, Panel C). This follows the common practice of social security and protection more often managed at the central level.
Figure 2. Decentralisation of health, public order and safety, and social protection expenditure

a. SNGs' health share as a % of general government, 2017

b. SNGs' public order and safety share as a percentage of general government

c. SNGs' social protection share as a percentage of general government

Note: In Panel c, Denmark appears as an outlier, partly because social security is included with the SNG expenditure.
Source: OECD National Accounts COFOG database.
Box 1. Decision-making in health care is shared across levels of government

Decision-making in health care tends to rest largely with the central government, which has considerable power across many aspects of the delivery of health services. More specifically, central governments are more likely to be responsible for decisions regarding the policy aspects of health care, but have less control over decisions regarding the inputs, outputs and monitoring of health care services. In most countries, sub-national governments have large responsibility for input-related matters, such as determining the outsourcing of services and deciding on the contractual status of staff. On average, local governments have little decision-making power in the health sector, but have the most responsibility with regard to decisions about health care inputs.

Figure 3 shows the allocation of responsibility for decisions in health care across respondent countries. It is calculated as the number of times a country responded that a level of government was responsible for a health decision, and then shows these sub-totals as a proportion of the total ‘yes’ responses, for each country. In certain cases, decisions are shared across more than one level of government.

Figure 3. Health sector spending authority varies widely across levels of government


Due to this decentralised structure in which different levels of government contribute to the decision-making process, collaboration between different levels of government is a good practice to improve the quality and the efficiency of the service provided through a better allocation of resources. Although sub-national governments are mostly in charge of health inputs, in critical situations the inputs have an important role since health system capacity can become overwhelmed and inputs scarce. Thus, coordination is ever more crucial to attain a better allocation of resources that makes scarce inputs available to the people in need.

Many SNGs have already taken actions to expand their health budgets, support local economic activity, or provide direct financial support to vulnerable populations

In many countries where SNGs have large responsibilities in health, these have already allocated additional appropriations to their health budgets. This is notably the case in the United States, where most US states have increased their appropriations for health and/or created special appropriations to respond to the COVID-19 crisis. In some countries, the cost of fighting the COVID-19 outbreak is shared between the central government and SNGs (as in Australia).

SNGs are at the forefront of ensuring the continuity of essential public services, and many are taking actions to this end. In Switzerland for example, several cantons are organising childcare for parents in health professions.

SNGs also participate in the national efforts to support small businesses and vulnerable populations. They are sometimes used to channel central government funds to the target populations/firms (as in Chile), or provide themselves the funds (Netherlands).

SNGs are taking tax relief measures or are affected by national measures

In a number of countries (e.g., Argentina, Australia, Belgium, Canada, France, Greece, Italy, the Netherlands, Norway and others), central governments are delaying the payment of taxes or reducing tax bases or rates to support businesses and vulnerable citizens. Some of these taxes are SNG taxes. Deferral of shared personal income taxes and predominantly local property taxes directly impacts local governments. Deferring payments on taxes which constitute SNG revenues is sometimes decided by the central government, or the centre is recommending SNGs to do so (Lithuania), or is decided by SNGs themselves (Australia, Canada). While in some countries the tax authorities have clearly stated they will compensate SNGs for the transitory reduction in revenues (Chile), this is not always so.

SNGs are also a large employer and could therefore play a stabilising role

Public employment may work as a buffer for reducing the negative economic effect generated by the fall in economic activity. In most OECD countries, SNGs are large employers and employ more people than the central government (Figure 4, Panel A). In some countries (usually federal ones), such as Switzerland, Belgium, US and Germany, SNGs are responsible for up to 80% of government employment.

Considering the whole labour market, SNGs also have a prominent role. On average, 10% of OECD countries’ workforce is employed by SNGs (Figure 4, Panel B). This share increases to around 20% in Nordic countries. It is thus important for SNGs to be able to maintain their personnel to reduce the negative economic impact from a potential acute recession.
Figure 4. In many OECD countries, SNGs employ a large share of civil servants and are responsible for a large share of total employment

a. SNG’s civil servants as a share of general government employment

b. SNG’s civil servants as a share of total employment


SNGs are vulnerable to shocks, which may hinder a proper response

The COVID-19 outbreak may affect sub-national governments’ fiscal position from both the expenditure and revenue side. On the expenditure side, SNGs may suffer severe consequences from this initial phase of virus propagation that pushes up health service demand and public order spending due to lockdowns. Social protection spending, on the other hand, may be affected for much longer, depending on the persistence of the economic crisis. On the revenue side, SNGs may experience a fall in revenues due to the weakening of economic activity and tax policy changes. As a result, SNGs may suffer from a “scissors effect” of higher spending and lower tax revenue, which has the potential to undermine their fiscal balance (this situation happened during the Great Recession – Box 2 explores this topic in more detail). Not all SNGs are exposed to the same risks – those SNGs reliant on volatile tax bases and charged with large health, public safety and social welfare responsibilities are more vulnerable.
Box 2. The 2008-09 Financial Crisis generated a strong “scissors effect’’ on SNGs’ budgets

While the impact of the crisis on sub-national government finances varied across countries, most sub-central governments struggled with a “scissors effect” of decreasing tax revenues and rising expenditure (Blöchliger et al., 2010). Tax revenues fell sharply due to declining economic activity. In some cases, this was compounded by additional tax cuts included in national recovery packages. Sub-national governments that rely the most on taxes faced the greatest deficit in 2009 (i.e., Canada, Iceland, New Zealand, Norway, Poland and Spain). The effect was even sharper in countries in which sub-national governments primarily rely on a pro-cyclical tax base, such as corporate or personal income taxes (e.g., Spain and Canada).

At the same time, the crisis led to higher spending on unemployment, social protection and social welfare more generally. In many OECD Member countries, sub-central governments are predominantly responsible for welfare services and social transfers. In EU countries, social protection spending by sub-central governments increased by 6.4% in 2009 and by 3.5% in 2010, as employment lagged behind economic activity (Dexia, 2011).

As a result, sub-national government budget deficits rose in countries where these were allowed, while spending cuts or tax increases were required in countries where sub-central governments had to follow balanced-budget rules (e.g., US). In Spain, for example, sub-national governments were severely hit by the recession, facing both a collapse of their revenues (-7.7%) and a surge in their expenditures (+15.5%) (OECD, 2010). The unemployment rate, which soared from 8.7% in 2007 to 18% in 2009 and 20.7% in March 2011, prevented raising taxes and constrained sub-central governments to increase social protection spending (+34.1% between 2006 and 2009).

As sub-central governments’ revenues are often based on the previous year’s activity (e.g., for shared taxes, equalisation transfers, etc.), most sub-national governments saw the situation worsen in 2010 and 2011, despite some recovery at the national level. For US states, the fiscal year 2011 was one of the most difficult in modern times, with little improvement in 2012. According to the United States Centre on Budget and Policy Priorities (CBPP), 44 states projected budget deficits totalling USD 112 billion for Fiscal Year 2012 (Johnson et al., 2011).


Key expenditures in time of crisis represent a significant portion of SNGs’ budgets, leaving them vulnerable to spending hikes

Not only are SNGs key players in the provision of health, public order and social protection services (the latter to a lesser extent), but also these services represent a significant portion of SNG’s budgets (Figure 5). On average, 34% of their expenditures are on these three functions. Despite central governments’ having main responsibility for social protection, this expenditure item still consumes a large portion of SNG’s budgets, due to its size. Health expenditures are also very prominent – in Italy, they represent 48% of SNGs’ total expenditure and in countries such as Sweden, Denmark, Finland, Austria, Spain and Colombia its budget share is above 20%. Hence, health and social protection expenditure hikes may disproportionally hurt the fiscal balance of SNGs.
At present, SNGs draw their own-source tax revenues from a range of revenue streams with income, property and consumption taxes being the primary sources (Figure 6). Other taxes play a comparatively minor role. The tax mix itself appears strongly related to the extent of decentralisation. In the countries where payments of SNG taxes are being delayed, SNGs will suffer from revenue losses. The impact of tax deferrals on SNGs will vary in accordance with the relative importance of the deferred tax to the SNG tax base. Similarly, the impact of the crisis on overall SNG revenues will vary in accordance with the income elasticity of the tax base. For example, greater SNG reliance on income tax relative to property tax is characteristic of countries with higher levels of sub-central fiscal autonomy (Figure 6). Among these countries, there is an inverse correlation between the income elasticity of taxation and property tax contribution to the SNG tax base, consistent with related work by Colin and Brys (2019). This suggests that SNGs that are more dependent on income taxation will face particular risks. In countries where SNGs mostly rely on tax sharing, the effect of the crisis may come with a lag, as tax sharing is usually calculated on the previous year’s revenues.
The extent to which SNGs are dependent on intergovernmental grants also varies greatly across countries (Figure 7). These grants range from 84% of SCG revenue in Lithuania to less than 10% in Iceland. The ability of such grants to shield SNGs from the fiscal impact of the crisis depends on whether they have pro-cyclical or counter-cyclical tendencies, with the latter being more protective during an economic downturn.

**Figure 6. Sub-national tax base composition, 2018**

Note: Countries are grouped into quartiles by SNG share of total government revenue, decreasing left to right. Within each quartile, countries are sorted by income tax % SNG tax revenue for the top two quartiles and property tax % SNG tax revenue for the bottom two quartiles. Where data for 2018 was not available, the most recent available data were used.

Source: OECD Revenue Statistics database

**Figure 7. SNG own-source revenues vs inter-governmental transfers, 2017**

Note: This figure depicts SNG own-source revenues as a percentage of the sum of own-source revenues and inter-governmental transfers.

Source: OECD Fiscal Decentralisation database.
In addition to tax policies, the weakening of economic activity may also negatively affect sub-national revenues. The elasticity of SNG revenues to economic activity (GDP) is higher than 0.5 for all countries analysed and can be as high as 1.2 (Figure 8). It is influenced by the extent to which the revenue sources rely on a volatile tax base such as corporate or personal income. Other tax bases such as property and consumption taxes tend to be less prone to suffer from an economic downturn. Nevertheless, the present crisis could change these estimated overall elasticities. During the pandemic-related lockdown periods that entail the closure of commercial and retail business, consumption and property taxes that are regarded as stable tax bases may behave more unpredictably. As a result, even SNGs more reliant on these “stable” income sources may still suffer a substantial revenue loss. A comparison with the 2008-09 Financial Crisis may provide valuable insights – the decrease in tax revenues during that period exceed the GDP contraction in most countries. More specifically, the average tax-to-GDP ratio in OECD countries fell by 1.4 percent and varied depending on the tax mix of the countries (for a more detailed analysis comparing different tax bases see OECD, 2020c).

**Figure 8. Sub-national revenue sensitivity to changes in GDP**

![Sub-national revenue sensitivity to changes in GDP](image)

*Note*: The responsiveness elasticity is calculated as the coefficient of a log-log regression that regresses overall SNG revenue on GDP (including different types of own-source taxes and intergovernmental transfers). Years considered: from 1995 to latest available year (varies among countries). Only countries with regression R² higher than 75% are presented.

*Source*: Calculations based on OECD Fiscal Decentralisation database

**Putting pressure on sub-national budget balances may lead to pro-cyclical reductions in public investment**

The fiscal balances of SNGs are negative for eight of the countries analysed and in those with fiscal surpluses, for five countries (Portugal, Germany, Czech Republic, Luxembourg and Greece) the surplus exceeds 5% of their revenues (Figure 9). Sub-national expenditures are not always discretionary and spending hikes combined with negative shocks on revenues may aggravate imbalances. As a result, in the present highly unpredictable economic environment, banks may be reluctant to provide adequate liquidity to SNGs.
Sub-national fiscal balances tend to fluctuate less than central governments’, which implies a smaller counter-cyclical effect than at the central government level (Figure 10). Indeed, central governments tend to have more room for manoeuvre and have better access to financial markets, while in some countries – particularly unitary countries – SNGs may follow strict fiscal rules and have limited revenue and expenditure power. As a result, in time of crisis, SNGs may be forced to reduce expenditure (often public investment) to comply with fiscal rules, thus creating a pro-cyclical effect (OECD, 2011).4

Figure 10. SNG fiscal balances usually fluctuate less than central governments

Average central and sub-national fiscal balance as a percentage of their revenues

---

4 This was for example the case in some countries during the 2008-09 crisis (Vammalle, 2010).
SNGs tend to invest more than central governments as a proportion of their revenues. The investment share as percentage of total revenue is around 15% at the sub-national level and 5% at the central level (Figure 11). Economic downturns that create fiscal imbalances are corrected to some extent at the sub-national level through a significant reduction in investment. This situation is not ideal since SNGs are responsible for nearly half of public investment which aggravates the crisis due to a pro-cyclical effect.

**Figure 11. SNG investment usually fluctuate more than central governments**

Average central and sub-national investment as a percentage of their revenues

![Graph showing investment fluctuations](image-url)

*Note: Gross capital formation is used as a proxy for investment (GPSP) and is presented as a percent of Total Revenue (GTR) of the respective level of government.*

*Source: Calculations based on OECD Fiscal Decentralisation database.*

**There is also an institutional risk that fiscal rules may prevent SNGs from taking the necessary measures**

Fiscal rules are institutional arrangements whose purpose is to mitigate sub-national fiscal risks through the imposition of constraints on fiscal policy, usually operationalized by limits on certain aggregates. Their main goal is to ensure fiscal sustainability at the sub-national level. Fiscal rules that constrain SNG budgeting are very common across the OECD (Table 1), and in many countries, these were further strengthened after the 2008-09 crisis. In particular, most OECD countries require SNGs to balance their budgets, and many countries only allow SNG borrowing for financing public investment.

The restrictive nature of fiscal rules in general, and balanced budget rules in particular, necessarily triggers concerns about pro-cyclicality (OECD, 2013). More rigid rules and rules that apply to shorter timeframes are even more susceptible to pro-cyclical tendencies. During a time of crisis, it may be possible to relax such rules with a reduced risk of moral hazard problems emerging later. Relaxation may take the form of both formal escape clauses that can be triggered by prescribed circumstances and/or effective suspension of the rules in practice when it is unreasonable to expect SNGs to comply. The latter case may be particularly pertinent where SNGs self-impose their own fiscal rules, implying that they are equally in a position to lift or adjust them.

---

5 Allain-Dupré, Hulbert and Vammalle (2012).
### Table 1. SNG fiscal rule practices

<table>
<thead>
<tr>
<th>Sub-national government</th>
<th>Budget balance rule</th>
<th>Expenditure limit</th>
<th>Taxation limit</th>
<th>Borrowing restraint</th>
<th>Sub-national government</th>
<th>Budget balance rule</th>
<th>Expenditure limit</th>
<th>Taxation limit</th>
<th>Borrowing restraint</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia- States</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>Latvia-Districts and Municipalities</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Austria- Lander</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td>✓</td>
<td>Lithuania- Municipalities</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Belgium-Regions and Communities</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>The Netherlands – Municipalities</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Brazil-States and Municipalities</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>New Zealand- Local authority</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Canada- Provinces</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>Poland- Municipalities</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Estonia- Municipalities</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>Portugal- Municipalities</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Germany- Lander</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
<td>Slovenia- Municipalities</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Iceland- Municipalities</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>South Africa- Provinces</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Ireland-Local governments</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>Spain-Regions and Municipalities</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Italy-Provinces, Regions and Municipalities</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>Switzerland- Cantons</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Korea- Municipalities</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>United States of America – States</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

Note: This table is based on a preliminary assessment of the 2019 Fiscal Network Survey of Sub-central Fiscal Rules. It is subject to change based on further analysis. ✓* indicates that the fiscal rule is self-imposed by the SNG, without the intervention of a higher level of government.
1. Such restraints have not been imposed in practise by the federal government on regions and communities.

The use of escape clauses and flexibility can help to mitigate the pro-cyclicality of fiscal rules and ensure an adequate fiscal policy during times of crisis. A large portion of countries that have adopted sub-national fiscal rules have similarly implemented escape clauses (Table 2). In some cases where formal exemptions to fiscal rules are not specified in legislation, mechanisms exist whereby central governments take a holistic view of circumstances in assessing fiscal rule compliance.

Most countries that have adopted fiscal rules at the sub-national level do so to prevent SNG debt crises that might pose systemic macroeconomic risks and require central bailouts (OECD, 2013; Herold, 2018). Despite their fundamental role in ensuring fiscal sustainability, during times of crisis compliance with such rules might not be attainable or even desirable. Moreover, SNGs are usually more vulnerable to shocks than the central government. They have less room for manoeuvre since they may not borrow freely and
may have less discretion over spending and taxes. As a result, exemptions to fiscal rules may be necessary during a crisis.

Similar to escape clauses in fiscal rules that allow for exceptional borrowing, withdrawals from rainy day funds may serve as a counter-cyclical fiscal instrument. By enabling jurisdictions to save funds in a reserve when revenues allow, they create some fiscal space to react during emergencies. While rainy day funds are uncommon at the sub-national level, there are some notable examples, such as the US and Canada where 48 of 50 states and 6 out of 10 provinces possess them, respectively.

Table 2. Existence of SNG escape clauses in fiscal rules

<table>
<thead>
<tr>
<th>Country</th>
<th>Escape clauses</th>
<th>Rainy day funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia-State level</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Austria-State level</td>
<td>Exemptions possible when finances are adversely affected by local economic conditions, disasters, supreme court rulings, or EC decisions.</td>
<td>None</td>
</tr>
<tr>
<td>Belgium-Regions and Communities</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Brazil</td>
<td>Exemptions possible for budget balance objectives and borrowing constraints in case of low economic growth or public calamity.</td>
<td>None</td>
</tr>
<tr>
<td>Canada-Provinces</td>
<td>Exemptions possible when finances are adversely affected by falls in revenue, local economic conditions, or disasters.</td>
<td>Yes, 6 of 10 provinces</td>
</tr>
<tr>
<td>Estonia-Municipalities</td>
<td>Sanctions only take effect when SNG violates limits two-years in a row</td>
<td>None</td>
</tr>
<tr>
<td>Germany -Landers</td>
<td>Exemptions possible for borrowing constraints in case of exceptional emergency conditions.</td>
<td>Yes</td>
</tr>
<tr>
<td>Iceland-Municipalities</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Ireland-Local governments</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Italy- Regions and Municipalities</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Korea-Municipalities</td>
<td>Exemptions possible for borrowing constraints when finances are adversely affected by falls in revenue, local economic conditions, or disasters.</td>
<td>Yes</td>
</tr>
<tr>
<td>Latvia-Districts and Municipalities</td>
<td>Exemptions possible when finances are adversely affected by natural or other disasters</td>
<td>Yes</td>
</tr>
<tr>
<td>Lithuania-Municipalities</td>
<td>Exemptions possible to balanced budget when finances are adversely affected by a deterioration of local economic conditions.</td>
<td>None</td>
</tr>
<tr>
<td>The Netherlands-Municipalities</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>New Zealand-Local authorities</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Poland- Municipalities</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Portugal-Municipalities</td>
<td>Exemptions possible when finances are adversely affected by natural or other disasters</td>
<td>None</td>
</tr>
<tr>
<td>Slovenia-Municipalities</td>
<td>Exemptions possible for expenditure limitations when finances are adversely affected by falls in revenue, local economic conditions, or disasters.</td>
<td>None</td>
</tr>
<tr>
<td>South Africa-Provinces</td>
<td>In the case of an emergency, provinces are allowed to spend without following all the normal budgeting process, but are only allowed to spend up to 2% of the total provincial budget.</td>
<td>None</td>
</tr>
<tr>
<td>Spain–Regions and Municipalities</td>
<td>Exemptions possible for balanced budget objectives when finances are adversely affected by falls in revenue, local economic conditions, or disasters.</td>
<td>None</td>
</tr>
<tr>
<td>Switzerland- Cantons</td>
<td>About half of the cantonal fiscal rules foresee exemptions for special circumstances, but the rules vary by the type/design of the fiscal rule. The rules of the Canton of Bern foresee no exemptions.</td>
<td>None, however some Cantons maintain some reserve on their balance sheets which are not referred to as rainy day funds.</td>
</tr>
<tr>
<td>United States of America</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

And may lead to increasing SNG debt levels

The negative impact of the crisis on sub-national fiscal balances may be covered by an increase either in intergovernmental transfers or in SNG debts. While, on average, SNG debts only represent about 15% of total public debt and 15% of GDP (Figure 12), these may represent a high burden on SNGs’ budgets. Indeed, in some countries, average levels of SNG debts (measured as their debt to revenue ratio) are already high (Figure 13). In eight countries, SNG debts represent more than one year of revenues, and in more than half the countries, they are above 50% of annual revenues.

Figure 12. Composition of public debt as a share of GDP

![Figure 12. Composition of public debt as a share of GDP](image)

Notes: This figure shows the respective contributions of SNG and central government plus social security (CGSS) to overall public debt as a percentage of GDP.
Source: Calculations based on OECD Fiscal Decentralisation database and OECD National Accounts database.

Figure 13. Sub-national debt to revenue ratio by country, 2016

![Figure 13. Sub-national debt to revenue ratio by country, 2016](image)

Source: Calculations based on OECD Fiscal Decentralisation database.
In addition, SNGs usually pay higher interest rates than central governments. Indeed, SNGs have usually limited power to change their tax policy, are dependent on intergovernmental transfers, have little discretion over spending, and are in charge of key public services that cannot be adjusted abruptly (e.g., education, health, public safety). They therefore have little capacity to control their primary balance.

Still, in most countries, SNG interest payments as a share of their revenues is lower than 2% (Figure 14). Only a handful of countries (Turkey, Canada, New Zealand and the United States) have interest payments to revenue ratios above 4%, with the highest being the USA, where interest payments represent about 8% of SNG revenues. The interest payments share of SNG budgets tends to be far smaller than the share of central government budgets. The average spent on interest payments as a percentage of their respective budget is 1.5% for SNGs in comparison to 5% for central governments (Figure 15).

**Figure 14. Sub-national interest paid to revenue ratio by country, 2016**

![Graph showing sub-national interest paid to revenue ratio](image)

Source: Calculations based on OECD Fiscal Decentralisation database and OECD National Accounts database.

**Figure 15. SNGs and Central Government interest paid to revenue ratio by country, 2016**

Ordered by the difference between the interest paid to revenue ratio by SNG and CG

![Graph showing SNG and central government interest paid to revenue ratio](image)

Source: Calculations based on OECD Fiscal Decentralisation database and OECD National Accounts database.
Central governments and central banks are already taking some actions to support SNGs

How to finance SNG deficits and ensure the sustainability of their debts will be a key issue that countries will need to address when the health emergency will be over.

Fiscal rules for SNGs are being relaxed, with measures taken to increase their liquidity

At the European level, the European Commission proposed on the 27 March to activate the general escape clause of the Stability and Growth Pact as part of its strategy to respond quickly, forcefully and in a coordinated manner to the COVID-19 pandemic (http://ec.europa.eu). This should allow many EU countries to also relax their internal fiscal rules for SNGs. For example, Spain has relaxed its fiscal rules for SNGs and will allow municipalities to go into deficit. In the US, a Senate bill introduced on the 20 March would allow the Federal Reserve to purchase municipal debt, in an effort to ease the economic strain of the coronavirus pandemic on state and local governments. In Germany, at least three states have indicated that they intend to circumvent their balanced budget rule and have drawn attention to the fact that their rules permit them to do so during times of emergency. Finally, in Canada, Alberta’s provincial government has cast doubt on an election promise to achieve a balanced budget by 2023—analogous to lifting a self-imposed fiscal rule.

Some governments and central banks are already taking measures to support SNGs

Many countries are discussing or have already voted on additional budgetary measures to support SNGs that will face large additional spending due to COVID-19, including US, Finland, Italy, Norway, and Spain. In Australia and Brazil, central governments have offered additional support for health spending to SNGs. In Sweden, a package of SEK 22 billion has been proposed to boost both general grants to municipalities and grants specifically tied to health and social services.

Central Banks have also become involved in providing liquidity to SNGs. The Bank of Canada’s Provincial Money Market Purchase program allows it to directly purchase provincial money-market securities. In the US, a Senate bill introduced on 20 March would allow the Federal Reserve to purchase municipal debt, in an effort to ease the economic strain of the pandemic.

New institutions are being created to ensure coordination across levels of government

The need for coordination has been a dominant force behind the multi-level responses to the pandemic that have been observed (OECD, 2020a). Australia, Canada and Chile have all activated or created agencies dedicated to inter-governmental crisis coordination. As an aspect of coordination, digitalisation is also playing a promising role, with countries such as Korea employing digitalised monitoring and reporting systems to track the spread of the virus. At the EU level, the European Committee of the Regions (CoR) has defined an action plan to support and assist local and regional authorities on the forefront of the fight against the Coronavirus pandemic. On 24 March, the CoR released an action plan which includes the launch of an exchange platform to help local and regional leaders sharing their needs and solutions and to enhance mutual support between local communities across Europe. Coordination mechanisms have also been developed in countries. Spain, for example, has created an inter-ministerial commission to

---

ensure co-ordination within the federal government as well as an inter-territorial commission for co-operation across levels of government.

A three-phase reaction to the Covid-19 crisis

Today, all players (CGs, SNGs, private companies) are taking emergency measures to save lives and protect employment and citizens. Coordination mechanisms are essential, as is ensuring sufficient liquidity to avoid bankruptcies and pro-cyclical policies (Box 3). As the pandemic gets under control, the key priority will shift to addressing the economic impact of the crisis (Figure 16). Current OECD projections show that the initial impact of containment measures may be up to 30% of GDP losses. To address this, the OECD is calling for a “Global Marshall Plan”, supporting workers and individuals, and keeping businesses afloat. The experience from the 2008-09 crisis shows that it is essential to ensure that SNGs are not forced to carry out pro-cyclical policies, which could worsen the economic crisis. SNGs are key actors for public investment, and a large employer. They should therefore be key actors in the medium-term, to help rebuild our economies. In the longer-term, as economies recover, SNGs will need to participate in national consolidation policies. Escape clauses which are justified in present circumstances will need to be replaced by post-pandemic rules, when economic conditions allow, with a necessary correction within an adequately lengthy period.

Figure 16. The role of SNGs now, in the short and in the medium-term to address the Covid-19 crisis
Box 3. Tackling the policy challenges

In times of crisis, it is necessary to act fast. It is therefore essential to build on the good practices and recommendations previously identified in OECD work (see, e.g., Forman et al., 2020). For example:

- Coordination across levels of government is even more crucial, to control the spread of the pandemic, allocate scarce resources better and provide support to businesses and individuals.
- Strict compliance with sub-national fiscal rules would trigger damaging pro-cyclical policies – escape clauses or relaxation of fiscal rules may be necessary.
- Delaying tax payments for firms and households is a necessary measure to support the economy; however, SNGs still need sufficient revenues to carry out their tasks. This could be achieved by providing SNGs with emergency transfers and/or provide state guarantees for exceptional bank loans.

References

Contact

Sean DOUGHERTY (✉ sean.dougherty@oecd.org)
Camila VAMMALLE (✉ camila.vammalle@oecd.org)
Pietrangelo DE BIASE (✉ pietangelo.debiase@oecd.org)
Kass FORMAN (✉ kass.forman@oecd.org)

This paper is published under the responsibility of the Secretary-General of the OECD. The opinions expressed and arguments employed herein do not necessarily reflect the official views of OECD member countries.

This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

The use of this work, whether digital or print, is governed by the Terms and Conditions to be found at http://www.oecd.org/termsandconditions