OESTERREICHISCHE NATIONALBANK
EUROSYSTEM

Subnational Public Debt in Europe

Subnational Public Debt in a Fiscally Sustainable Europe
September 24 to 26, 2014, Eisenstadt

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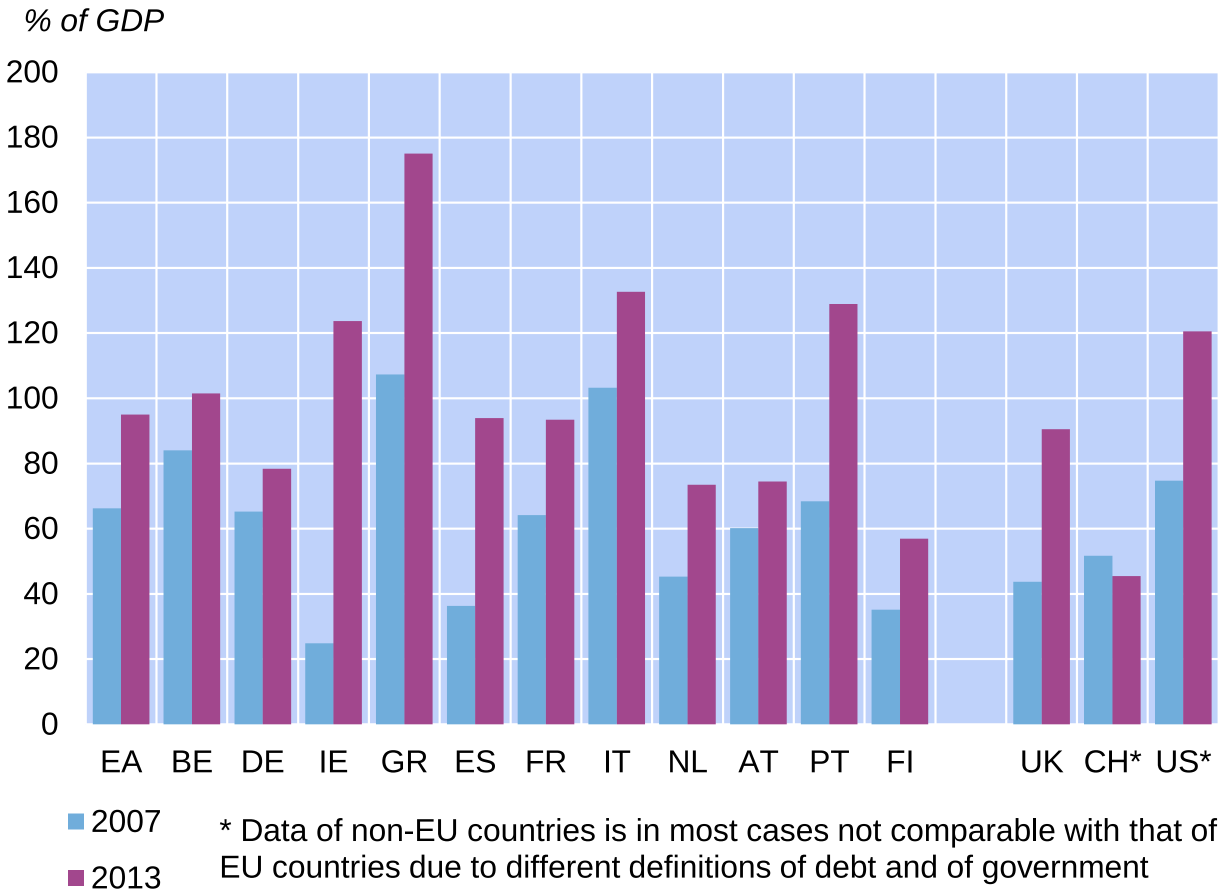
Oesterreichische Nationalbank

Strong Increase in General Government Debt in Euro Area

Public debt in selected EU countries, CH and the US



* Data of non-EU countries is in most cases not comparable with that of EU countries due to different definitions of debt and of government

Source: European Commission (EA, UK), OECD quarterly public sector debt (CH, US).

2007: 66% of GDP

2013: 95% of GDP

Due to:

- Working of automatic stabilizers => increase in public deficits
- Financial aid to the banking sector (particularly in IE, ES, SI)
- EU crisis management (EFSF, ESM ...)

EU Reaction to (Unsustainable) High Debt Levels: Reform of SGP and Fiscal Compact

Reform of Stability and Growth Pact (implemented in late 2011):

- Strengthening of preventive arm:
  - Significant increase in automaticity (strengthening of European Commission)
  - Improvement in measurement of progress toward MTO by defining an expenditure rule
- Strengthening of corrective arm:
  - **Operationalization of debt criterion**: If debt is above 60%, it has to be reduced by 1/20 of the difference between 60% and the actual debt level p.a.

Fiscal Compact (2012):

- Countries have to implement rules on structural balance into national legislation
  - including an automatic correction mechanism in case of deviations **("debt brake")**
- Further increase in automaticity of corrective arm of SGP: countries commit to following the European Commission's recommendations (breaches of the deficit criterion only)

EU Fiscal Rules

EU fiscal rules refer to general government

- i.e. central government + social security funds + provinces + municipalities + extra-budgetary units
- rough idea: cover everything which is (in the end) mainly financed by taxes

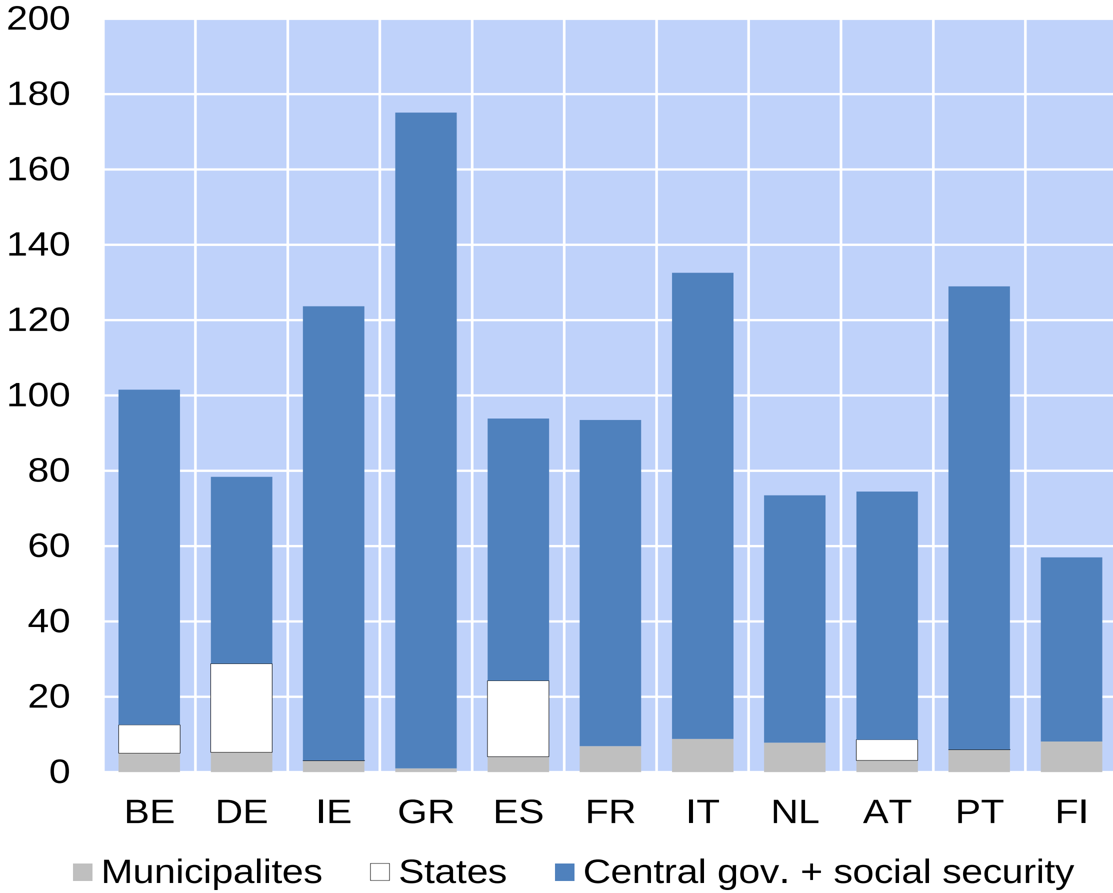
EU communicates with central government but wants (almost) all information on general government

- real time information on subcentral government levels usually not available
- difficult to project, in particular expenditure developments

(Offical) Government Debt Mostly at Central Government Level

Government debt in selected EA countries

2013 values in % of GDP



Quelle: Source: ECB (SDW).

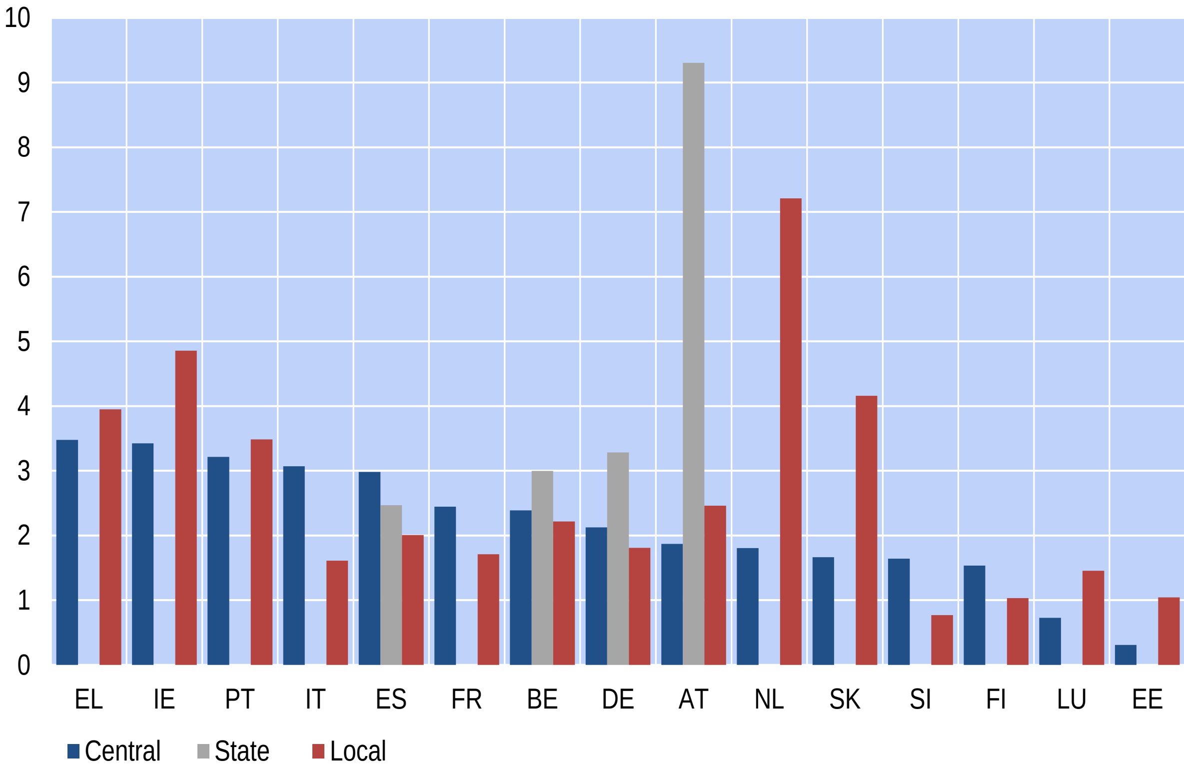
- Statistically only 4 EU countries are counted as federal states (BE, DE, ES, AT)
- Subcentral debt looks relatively "small" compared to central government debt
  - only in DE and ES > 20% of GDP
  - AT 9% of GDP

=> No problem at all?

SCG Financial Liabilities and Debt-Bearing Capacities

Gross financial liabilities

Ratio of debt to own tax revenue, by level of government, 2011



Source: extract from OECD (2014).

- Debt-bearing capacities are lower in subcentral governments
- OECD indicator: particularly high in AT provinces and NL local governments due to low tax revenues
- Masks variation within SCG; in DE, for example, ratio in the most indebted land is about 4.5 times higher than in the least indebted land.

National Fiscal Rules to Increase Debt Sustainability – the Internal Stability Pact in Austria I

- first informal arrangement in 1996
- law since 1999, negotiated between all levels of government
- sets deficit limits for all levels of government
- 2012 Austrian Stability Pact sets nominal targets up to 2016:

ÖStP 2012: Required budget balance in % of GDP

	2012	2013	2014	2015	2016
Central government	−2.45	−1.75	−1.29	−0.58	−0.19
States	−0.54	−0.44	−0.29	−0.14	0.01
Local governments	balanced budget per state				

Source: ÖStP 2012.

- from 2017 onward: structural balance targets
    - central government: -0.35% of GDP
    - provinces and local governments: -0.1% of GDP
- in case of noncompliance: sanctions are possible

National Fiscal Rules to Increase Debt Sustainability – the Internal Stability Pact in Austria II

Public debt in Austria by subsector in % of GDP

	1995	2000	2005	2007	2008	2009	2010	2011	2012	2013
Central gov + social security	68.2	66.2	64.2	60.2	63.8	69.2	72.5	73.1	74.4	74.5
State government	3.1	2.3	3.0	3.4	3.8	4.8	6.1	6.3	6.1	5.5
Local government	6.6	2.7	2.0	1.8	1.9	2.2	2.8	3.0	3.0	3.1

Source: ECB.

- Strong decrease of local government debt since 1995
  - significantly due to outsourcing
- Subcentral governments also hit by crisis (2009-2010)

In 2009-2010 suspension of the targets of the pact due to exceptional economic circumstances.

Conclusions – Remaining Challenges

National fiscal rules can help increase subcentral government debt sustainability, but challenges remain:

- enforceability of rules – credible limitations
- room for maneuver for subcentral governments
  - while central (and provincial) governments typically provide public goods and redistribute income, municipalities typically provide all kinds of services to citizens, which cannot be changed in the short term
- problem with ESA-based debt data as the separation between public and private sector debt is not always clear-cut.
- Implicit liabilities – like provincial guarantees – might exceed debt-bearing capacities of subcentral governments
  - Costly bail-out by central government

Workshops and further research are needed to explore avenues for making subcentral government debt more sustainable.