EUROPEAN
COMMISSION

Brussels, 24.11.2026
SWD(2026) 977 final

PART 10/15

COMMISSION STAFF WORKING DOCUMENT

Accompanying the document

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS

On the Tenth Report on economic, social and territorial cohesion

Chapter 3.2 Sub-national government finance

{COM(2026) 966 final}

Chapter 3.2
Sub-national government finance

3.2.1. Subnational government structures and competences in the EU

3.2.1.1. Subnational governments play a role in public sector performance and competitiveness

Subnational governments (SNGs) ([169]) play a central role in exercising key public competences, delivering key public goods and services and shaping territorial economic and social outcomes. This section examines the differences in subnational governance structures across the EU, as well as the attribution of competences and decision-making authority.

The composition of subnational government structures varies considerably across the EU. Nine Member States operate a single municipal tier with no other directly elected level (Bulgaria, Cyprus, Estonia, Ireland, Latvia, Lithuania, Luxembourg, Malta and Slovenia). Thirteen Member States have two subnational tiers (typically municipalities and regions). Finally, five Member States have a three-tier structure that includes an intermediary level such as provinces, departments or districts (Belgium - *provinces*/*provincies*, Spain – *provincias*, France - *départements*, Germany – *Landkreise* and Poland - *powiats*).

Over the past two decades, **the overall trend has been toward the strengthening or creating regional tiers** in Member States (OECD/UCLG, 2026). The rationale differs between countries but commonly includes the need to co-ordinate sectoral policies across municipalities, manage EU structural funds at an appropriate territorial scale, and exploit economies of scale in the delivery of services.

In the EU, there is a broad spectrum of subnational functions, from highly centralised unitary states where SNGs act primarily as administrative implementers, to highly decentralised countries, typically where states, regions and municipalities wield extensive legislative and executive powers (Table 3.2.1). In several Member States, subnational entities – particularly regions – exercise legislative powers. Besides the federal and quasi-federal states of Belgium, Germany, Spain and Austria, this is the case in regions in unitary countries such as Italy and autonomous regions in Portugal or Finland. In such contexts, the implementation of reforms is contingent on alignment with subnational legal frameworks and political processes. While, beyond these countries, subnational entities in the EU generally do not have primary legislative power, they often exercise substantial regulatory or executive authority. In practice, the latter usually includes adopting and implementing rules, ordinances or by-laws within national legal frameworks, and authority in planning and permitting.

([169]) SNGs encompass all tiers of general government below the central government, excluding social security funds. This includes state and regional governments, intermediate tiers such as provinces and departments, and municipal governments, as well as other entities classified within the subnational government sector, such as intermunicipal cooperation bodies and subnational public agencies, provided they meet the criteria for general government units under national accounts frameworks. A defining feature of SNGs is that they possess their own legal personality and exercise some degree of independent fiscal authority, which distinguishes them from deconcentrated units such as territorial offices of the central government.

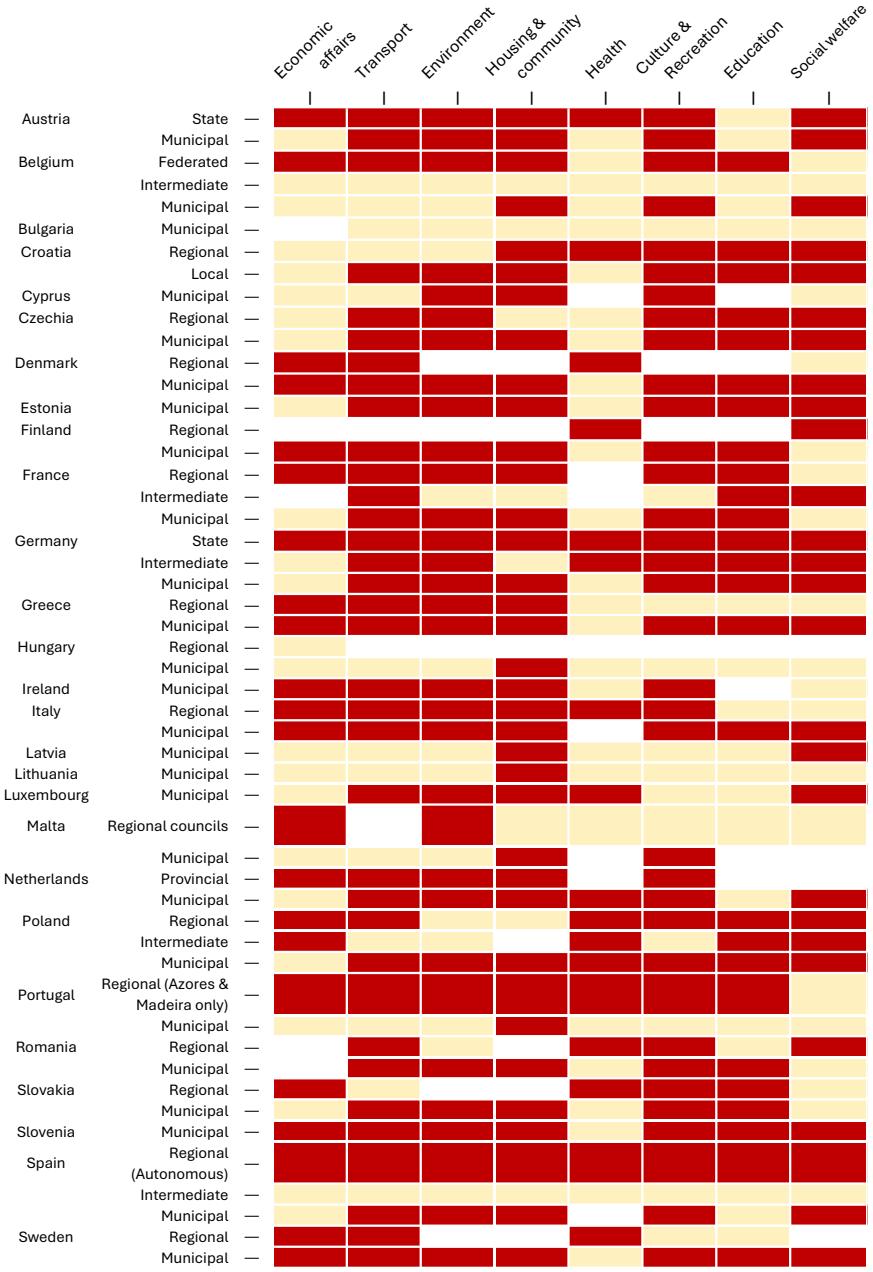
Table 3.2.1: Legislative and regulatory powers of subnational governments in the EU

Country	Regional / state tier	Intermediate tier	Municipal tier
Austria	Legislative Länder	No tier	Regulatory
Belgium	Legislative Regions + Communities	Regulatory	Regulatory
Germany	Legislative Länder	Regulatory	Regulatory
Spain	Legislative Auton. Communities	Limited reg.	Regulatory
Italy	Legislative Regions	No tier	Regulatory
Finland	Legislative* Åland only; counties = reg.	No tier	Regulatory
Portugal	Legislative* Azores & Madeira only	No tier	Regulatory
Sweden	Regulatory	No tier	Regulatory
Denmark	Limited reg.	No tier	Regulatory
France	Regulatory	Regulatory	Regulatory
Netherlands	Regulatory	No tier	Regulatory
Poland	Regulatory	Regulatory	Regulatory
Czechia	Regulatory	No tier	Regulatory
Croatia	Regulatory	No tier	Regulatory
Slovakia	Regulatory	No tier	Regulatory
Romania	Limited reg.	No tier	Regulatory
Slovenia	No tier	No tier	Regulatory
Latvia	No tier	No tier	Regulatory
Lithuania	No tier	No tier	Regulatory
Hungary	Limited reg.	No tier	Limited reg.
Greece	Limited reg.	No tier	Limited reg.
Bulgaria	No tier	No tier	Limited reg.
Estonia	No tier	No tier	Limited reg.
Luxembourg	No tier	No tier	Limited reg.
Malta	Limited reg.	No tier	Limited reg.
Cyprus	No tier	No tier	Limited reg.
Ireland	Limited reg.	No tier	Limited reg.

Legislative = subnational tier can adopt primary legislation (statutes/acts). Legislative (asymmetric) = legislative power limited to specific regions (e.g. FI: Åland; PT: Azores and Madeira). Regulatory = power to adopt bylaws, ordinances and implementing regulations. Limited regulatory = narrow bylaw powers under strong central supervision. "No tier" = tier does not exist or is deconcentrated state administration.

Source: European Commission

Table 3.2.2: Level of competence by subnational tier and sector in the EU



White = no SNG responsibility in that sector; yellow = Limited / shared / delegated responsibility: narrow competence, mostly executed on behalf of central government, or restricted to a few sub-functions; red = substantial or lead role.

Source: European Commission and SNG-WOFI Observatory (OECD/UCLG, 2026)

Depending on the institutional set-up of Member States, subnational governments can have a role in deciding on and implementing reforms addressing structural issues supporting the EU's competitiveness drive. Even in the most centralised systems, subnational responsibilities – such as spatial planning, business and construction permitting, transport, health and other key public and environmental services such as waste management and water provision – have a direct bearing on how fast infrastructure is put in place and the quality of the local business environment. In moderately decentralised countries such as Czechia, France, Italy and Poland, shared responsibilities for education infrastructure, vocational training and primary healthcare are closely aligned with the EU's skills and workforce objectives. This is because the quality and accessibility of locally delivered services directly affect labour market participation and human capital formation. In federal and highly decentralised states, subnational governments

Box 3.2.1: Federal or quasi-federal countries in the EU27

Subnational governments operate within different constitutional architectures. In **unitary states**, sovereignty rests with the central government and applies uniformly across the territory; subnational tiers exist and exercise powers only insofar as the centre devolves them, and those powers can in principle be modified by ordinary legislation. In **federal (and quasi-federal) states**, sovereignty is shared between the federal level and self-governing federated entities, which typically have their own constitution, parliament and government, and whose status cannot be unilaterally altered by the federal level. The distinction is not always clear-cut: some unitary states have devolved such extensive autonomy to certain regions that they function in many respects like federated entities, while the practical weight of subnational government in some unitary states exceeds that of formally federal ones.

Four EU member countries operate federal or quasi-federal systems (Austria, Belgium, Germany and Spain). Municipalities perform functions similar to those in more centralised countries such as France and Portugal, while states or regions assume responsibilities often managed by the central government in those systems, particularly in education, healthcare and economic affairs.

manage and/or control several policy levers that are relevant for competitiveness. These include full education, health and university systems critical for closing the innovation gap, regional transport and energy networks central to decarbonisation, and active labour market policies essential for workforce adaptation. The administrative and fiscal capacity of subnational governments to fulfil these functions is therefore a relevant factor in addressing structural issues.

Some regions and cities have unique responsibilities due to asymmetric decentralisation, i.e. arrangements that provide specific territories with powers beyond the standard national framework (Allain-Dupré, 2020). For instance, in Spain, the Basque Country and Navarre operate a special 'foral' system granting full autonomy to design, manage and collect all direct taxes. In Italy, the constitution grants five regions and two autonomous provinces ([170]) a special statute that gives them significant autonomy for instance in taxation (Gianelle, Sacchi and Salotti, 2026). Portugal's Azores and Madeira are autonomous regions with their own legislative assemblies and wide policy responsibilities in public health, educational curricula and tourism, alongside special fiscal autonomy. Finland's Åland Islands operate as an autonomous region with extensive responsibilities. France applies asymmetric arrangements in territories such as Corsica and the outermost regions. Finally, capital and metropolitan cities in several EU Member States can also hold asymmetric powers, often combining municipal and regional competences, as in Berlin, Bucharest, Paris and Vienna.

3.2.2. Subnational government finance

3.2.2.1. The gap between SNGs' own revenue and expenditure has led to more intergovernmental transfers

Subnational governments obtain revenue from two main sources: own (non-grant) revenues (taxes, charges and fees that they raise themselves) ([171]) and grants and transfers from higher levels of government. The focus here is on non-grant revenues because these can indicate (although with some degree of approximation) the fiscal autonomy of a subnational government, i.e. how much it can raise independently of the central government ([172]). While subnational expenditure has remained stable as a proportion

([170]) Sicilia, Sardegna, Valle d'Aosta, Friuli-Venezia Giulia, Trentino-Alto Adige and the autonomous provinces of Bolzano/Bozen and Trento.

([171]) For the revenue structure by level of government in EU27 Member States, see Section 2.2.2 'Tax revenues by tax category and level of government' in the Annual Report on Taxation 2026 (European Commission, 2026).

([172]) A complementary indicator is the 'realised revenue retention rate' (Preyer et al., 2025), which measures the share of locally generated revenues that remain in the originating jurisdiction, net of intergovernmental transfers made for horizontal or vertical equalisation purposes, thereby capturing the degree of fiscal autonomy actually retained by municipalities, see Box 2 in the Annual Report on Taxation 2026 (European Commission, 2026).

Table 3.2.3: SNGs' expenditure as a share of total public expenditure, by function (2024)

	Housing and community amenities	Environmental protection	Recreation, culture and religion	Education	Economic affairs	General public services	Health	Public order and safety	Social protection	Defence
ES	97%	87%	82%	96%	54%	88%	95%	48%	10%	0%
BE	99%	85%	94%	100%	62%	50%	16%	52%	30%	0%
DE	81%	69%	84%	85%	41%	44%	5%	89%	25%	0%
SE	86%	75%	73%	81%	45%	19%	97%	12%	37%	1%
BG	94%	87%	54%	69%	12%	24%	13%	1%	8%	4%
PL	93%	76%	72%	74%	35%	28%	45%	12%	9%	0%
AT	87%	26%	56%	60%	33%	38%	51%	15%	17%	0%
CZ	86%	80%	64%	79%	37%	28%	19%	12%	7%	0%
EU27 median	**79%**	**69%**	**56%**	**63%**	**31%**	**24%**	**16%**	**8%**	**8%**	**0%**
EU27 average	**81%**	**80%**	**71%**	**68%**	**43%**	**49%**	**33%**	**35%**	**18%**	**0%**
NL	80%	86%	74%	79%	37%	16%	3%	18%	21%	0%
LT	73%	70%	53%	68%	31%	18%	28%	5%	8%	0%
FI	53%	27%	67%	68%	39%	36%	82%	18%	25%	0%
EE	92%	50%	45%	66%	33%	14%	25%	1%	7%	0%
PT	93%	57%	57%	23%	23%	32%	7%	8%	5%	0%
DK	31%	57%	43%	41%	34%	23%	98%	6%	83%	1%
FR	86%	84%	69%	30%	33%	33%	1%	20%	9%	0%
SI	79%	29%	56%	57%	23%	16%	15%	9%	5%	0%
RO	69%	70%	66%	19%	30%	20%	34%	4%	9%	0%
EL	53%	85%	52%	6%	23%	9%	0%	1%	0%	0%
IT	53%	91%	36%	27%	36%	25%	98%	12%	3%	0%
LV	94%	24%	48%	70%	27%	14%	23%	5%	9%	0%
SK	76%	50%	40%	63%	20%	24%	4%	5%	4%	0%
LU	47%	55%	62%	13%	13%	25%	1%	2%	4%	0%
HR	39%	49%	40%	70%	20%	35%	28%	7%	4%	0%
HU	69%	25%	21%	17%	12%	10%	5%	2%	6%	0%
IE	49%	12%	37%	1%	27%	9%	0%	11%	13%	0%
CY	32%	74%	13%	0%	0%	6%	0%	0%	0%	0%
MT	0%	7%	1%	0%	1%	5%	0%	1%	0%	0%

Values are consolidated from the perspective of the spender (i.e. transfers between levels of government are excluded from the expenditure of the level providing the transfer).

Source: Eurostat (Eurostat, 2026b)

of total public spending over the past two decades, the share of non-grant revenue in general government revenue has declined in many EU Member States.

The wide range of subnational government functions is also partially reflected in the distribution of expenditure across different levels of government. Higher shares of subnational expenditure often correspond to a higher level of responsibility in the regional or local authorities. Across the 27 EU Member States, expenditure on housing and community amenities, environmental protection and education are in general the most consistently decentralised. Recreation, economic affairs and general public services sit at an intermediate level, while health, public order and safety, social protection and defence are predominantly or entirely centralised (Table 3.2.3). There are, however, significant differences between countries. Cyprus and Malta show near-zero subnational shares, whereas SNGs account for more than half of general government expenditure in half or more of the main expenditure categories in Spain, Belgium, Sweden and Germany ([173]). SNGs in Denmark, Italy, Sweden, Spain and Finland account for 82–98% of health spending, far above the EU27 median (16%). In social protection, SNGs in Belgium, Sweden, and Denmark (30–83%) exceed the 8% median.

([173]) Ordered by total expenditure decentralisation share.

Box 3.2.2: Revenue decentralisation and national tax sharing schemes

It is important to remark, **revenue decentralisation indicators based on national accounts data should be interpreted with caution in countries with significant tax sharing arrangements**. Under the European System of Accounts 2010 and the Government Finance Statistics Manual 2014, tax revenue must be attributed to the government level that exercises substantive control over the tax (i.e. the unit with effective authority to set the rate, define the base, or grant exemptions) irrespective of which level physically collects or receives the proceeds. Where the central government legislates a tax and unilaterally determines the share allocated to subnational governments with no statutory or constitutional entitlement on the part of SNGs, the appropriate treatment under ESA 2010 is to record the full amount as central government revenue and the subnational allocation as an intergovernmental grant. In practice, however, the boundary is not always clear-cut: in countries such as Germany, constitutionally mandated tax-sharing is recorded as tax revenue at each level, which Eurostat considers consistent with ESA 2010. Following the transition to the 2008 System of National Accounts/ESA 2010 framework, a number of countries reclassified arrangements previously reported as tax sharing into intergovernmental grants, implying that measured tax decentralisation had been overstated (Blöchliger and Petzold, 2009) (Blöchliger and Nettley, 2011). Harmonisation remains incomplete across EU Member States, and subnational revenue shares derived from Eurostat government finance statistics may therefore still overestimate genuine subnational fiscal autonomy in countries with non-discretionary revenue-sharing arrangements.

The finances of subnational governments are characterised across the EU by substantial vertical fiscal gaps, i.e. a mismatch between what subnational governments spend and what they raise on their own (see Box 3.2.3) To varying degrees, all 27 Member States exhibit a gap between non-grant revenue and expenditure at the subnational level (Figure 3.2.1, Panels A and B). On a weighted average basis, SNGs were responsible for 35% of the general government (GG) expenditure in the EU in 2024 but collected only about 20% of GG revenue (the median values are 24% and 8%, respectively). Rather than the level of revenue or expenditure in isolation, the key metric to focus on is the gap between these two, because it determines how much subnational governments depend on central transfers to fulfil their spending responsibilities (see Box 3.2.3). A wide and growing gap can indicate diminishing fiscal autonomy, as local authorities may have less flexibility to adapt to local needs or respond to shocks without requesting additional central support, although the actual room for manoeuvre also depends on the overall size and design of transfers relative to spending needs. Therefore, the trend over time is more important than a single measurement of either variable.

The gap between SNG expenditure and non-grant revenue has widened since the 2000s. While the SNG shares of GG expenditure have remained relatively stable in this period, the median SNG share of GG revenue has fallen from around 10% to 8%. This reflects the re-centralisation of revenue in smaller, less decentralised EU countries over the past 25 years (meaning that a growing share of tax revenue is collected and controlled by central, rather than local, governments), with expenditure shares remaining stable.

The growing divergence between SNG non-grant revenue and expenditure is further emphasised in individual Member States over the same period (Figure 3.2.1, Panels C and D). SNG revenue shares increased by more than 0.5 percentage points in only five Member States, while declining by more than that margin in 15 Member States. Conversely, SNG expenditure shares increased by more than 0.5 percentage points in 12 Member States but decreased by more than that amount in only eight. These aggregate trends mask significant differences between groups of countries. Among federal and quasi-federal Member States (Belgium, Germany, Spain and Austria), non-grant revenue shares have remained stable or increased, reflecting constitutionally embedded decentralisation arrangements and greater SNG fiscal autonomy. By contrast, in the remaining, more centralised Member States, expenditure shares have tended to remain stable or have grown, while non-grant revenue shares have shrunk, driving the widening gap observed at the EU level.

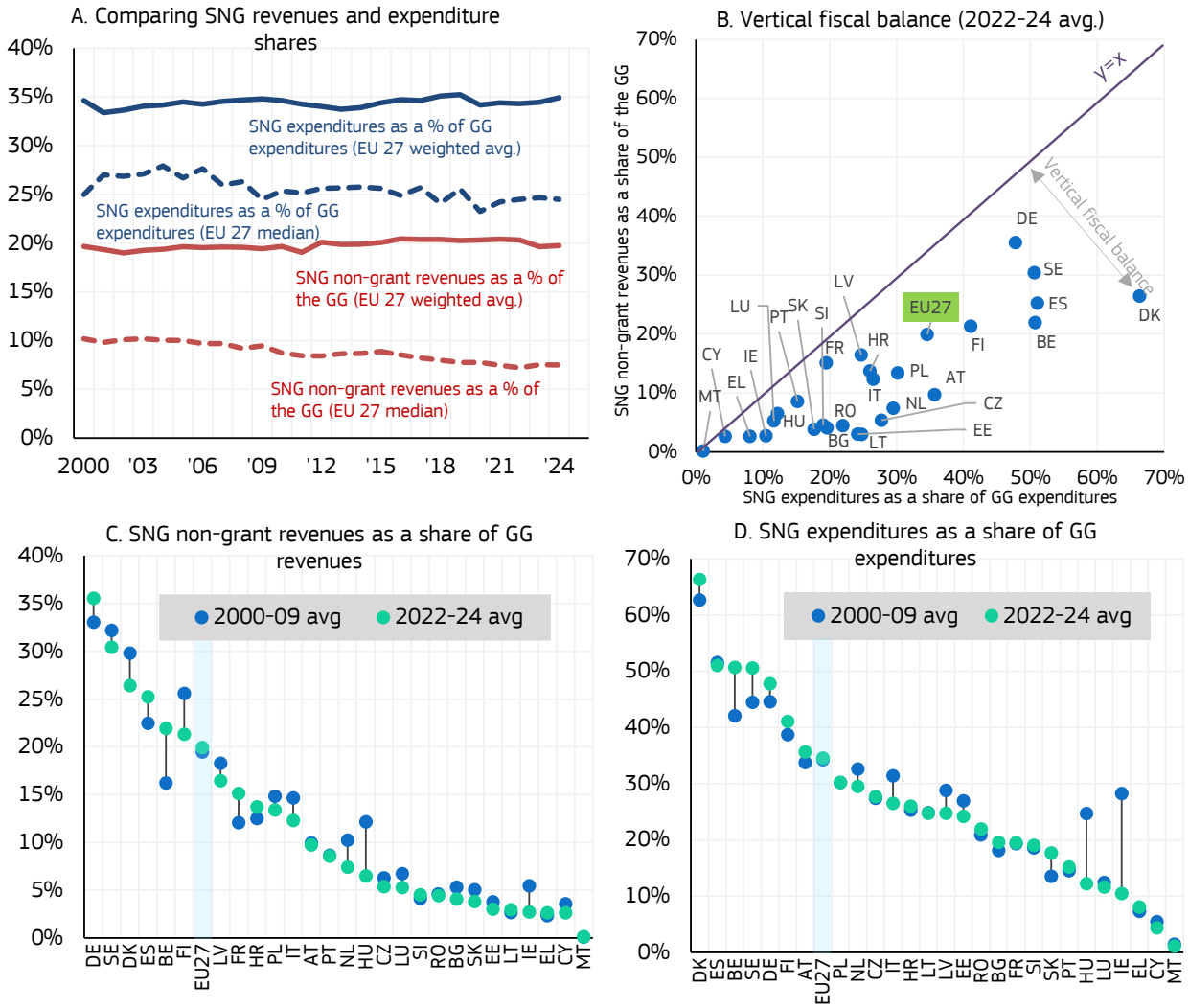
Box 3.2.3: Vertical fiscal gap and inter-governmental transfers in subnational government finance

Decentralising expenditure responsibilities to SNGs can offer substantial economic and democratic advantages (Oates, 1972). Because local governments are closer to the citizens they serve, they possess better information to tailor the mix and level of public goods to match heterogeneous local preferences, leading to greater allocative efficiency (principle of subsidiarity). This proximity also enhances political accountability, as voters can more easily monitor and evaluate the performance of local officials and can "vote with their feet" by migrating to jurisdictions that offer a public service bundle that best suits their needs, creating a competitive environment that drives public sector efficiency (Tiebout, 1956). These benefits of decentralisation have been corroborated by a growing body of empirical evidence (Martínez-Vázquez, Lago-Peñas and Sacchi, 2017). Allocating taxes to local governments on an origin basis may also foster tax compliance and local income growth (European Commission, 2026). Decentralisation may, however, also entail risks, such as wider regional disparities, insufficient administrative capacity in smaller jurisdictions and fiscal coordination failures (Ter-Minassian and Fedelino, 2010); (OECD, 2019).

Despite the advantages, **the potential for decentralising revenue is much more limited than for expenditure** (Ter-Minassian, 1997); (OECD, 2019). Decentralising revenue, especially those based on mobile factors such as the corporate income tax (CIT) and the personal income tax (PIT), risks promoting harmful tax competition, revenue erosion and economic distortions (Wilson, 1999). Furthermore, central governments tend to retain broad-based taxes such as the value-added tax (VAT) and CIT, both because they are essential for macroeconomic stabilisation and redistribution, and because they benefit from economies of scale in administration (Oates, 1972); (Bird, 1999). Consequently, SNGs' own revenues are typically confined to taxing immobile bases, most notably property, user charges, fees, revenue from assets, and surcharges on centrally administered taxes (Bird, 2004).

The asymmetry between (broad) expenditure responsibilities and limited taxing capacity generates structural vertical fiscal gaps that are inherent to decentralised systems (Boadway and Shah, 2009). Consequently, central governments must establish robust systems of tax-sharing arrangements and intergovernmental transfers to close the fiscal gap. As well as financing SNG service delivery mandates, intergovernmental transfers serve multiple purposes, including equalisation, internalising spillovers and maintaining national standards in health, education and regional development (Oates, 1999); (Boadway and Shah, 2009). In other words, **asymmetry exists by design: transfers and tax sharing are not a matter of fiscal generosity, but a necessary mechanism to ensure lower levels of government have the revenue capacity to provide public services and realise the benefits of fiscal decentralisation, without unfunded mandates**. Therefore, for incoming transfers to result in efficient expenditure, they must themselves be managed effectively and efficiently; in other words, **the administrations receiving these financial flows must have the necessary expertise and appropriate bodies in place to ensure sound management of the transfers**.

Figure 3.2.1: The vertical gap in SNG finance



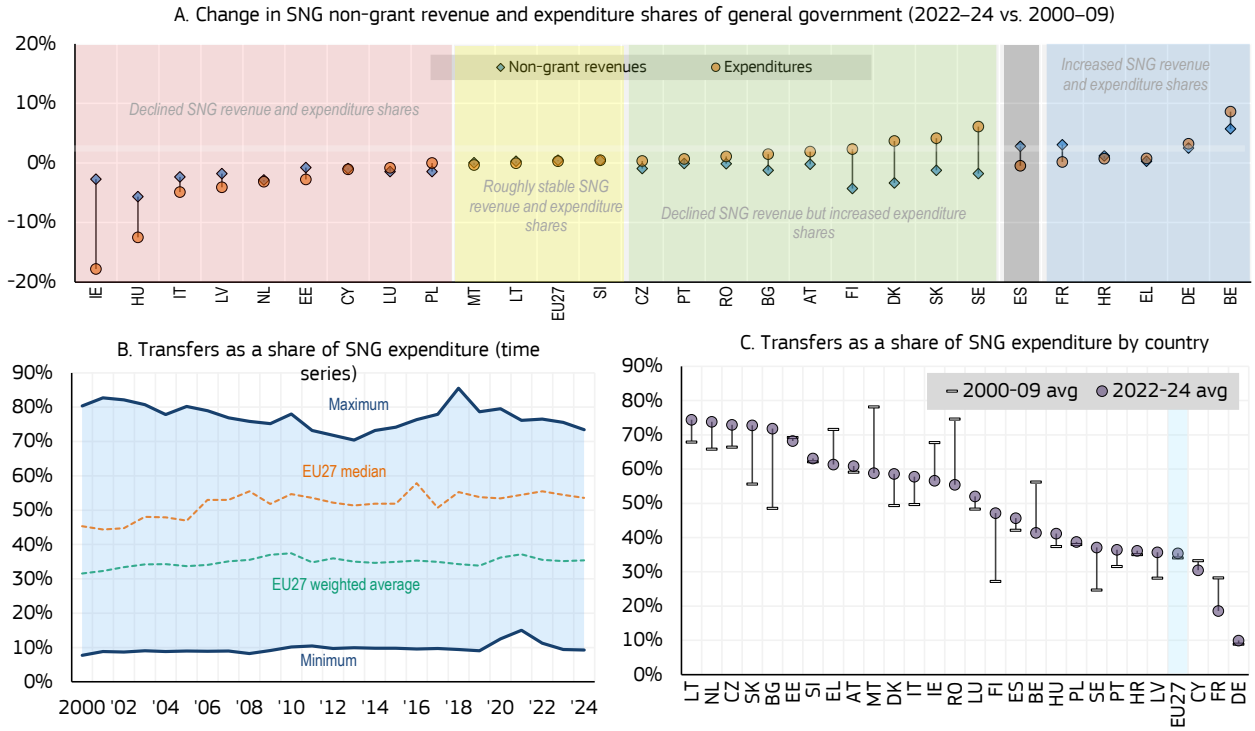
SNG revenues as a share of general government (GG) revenue are adjusted by excluding transfers from the revenues of each level of government, thereby capturing the share of revenues raised by that level. This includes own-source tax revenues, shared tax revenues allocated to SNGs, and non-tax revenues such as user charges and fees, property income, and revenues from the sale of goods and services. SNG expenditure shares, by contrast, exclude transfer expenditures from the level providing the transfer and attribute them to the level that ultimately spends the funds on government functions. This way of computing these aggregates highlights the vertical fiscal balance. However, there are other possible ways to compute revenue and expenditure decentralisation.

Source: DG REGIO calculations based on Eurostat (2026) and (OECD, 2027) data

The widening gap was particularly evident in five Member States: Sweden, Slovakia, Denmark, Finland and Bulgaria (listed in descending order of the gap and shown in green in Figure 3.2.2, Panel A). In these countries, the revenue share held by SNGs declined, while their expenditure share increased, on average, in 2022-2024 compared to 2000-2009. Smaller shifts in the same direction occurred in Austria, Czechia, Portugal and Romania. Conversely, Spain was the only EU Member State where the levels of these shares moved markedly in opposite directions, with its non-grant revenue share rising by around 2.8 percentage points and its expenditure share falling by around 0.5 percentage points.

Panel B of Figure 3.2.2 shows how dependency on central transfers in the EU as a whole has evolved from 2000 to 2024. It reveals that the combination of shrinking own revenue bases and increasing expenditure responsibilities at the subnational level has been accompanied by an increased reliance of SNGs on central government transfers (which may include tax sharing). The median ratio of these transfers to subnational expenditure rose from around 46% in the early 2000s to 55% in 2022–24. While some Member States relied on transfers for over 70% of subnational spending throughout the period, others have maintained considerably lower ratios. Panel C of Figure 3.2.2 presents averages for

Figure 3.2.2: SNG non-grant revenue and expenditure shares and their impact on central transfers



In Panels B and C, only transfers from the central government and social security funds are included; hence, transfers between subnational governments (e.g. region/state-to-local or local-to-region/state) are excluded from both the numerator and denominator of the ratios.

Source: DG REGIO calculations based on Eurostat (2026) and (OECD, 2027) data

both periods (2000–09 and 2022–24) for each Member State, enabling comparison of both the level of transfer dependency and its shift over time. Reliance on transfers ranges from 10% in Germany to over 70% in Bulgaria, Czechia, Lithuania, the Netherlands and Slovakia. Among the federal and quasi-federal Member States, Germany is a clear outlier with a consistently low share of transfers. This occurs because constitutionally mandated tax sharing substitutes for grants. Belgium and Spain, on the other hand, show moderate ratios (around 41% and 46%, respectively), and Austria a higher one (around 61%), reflecting their own constitutional arrangements.

Several notable patterns also emerge when comparing the two periods. Bulgaria recorded the largest overall increase in the transfer dependency ratio (around 23 percentage points), Finland and Slovakia saw substantial rises of around 20 and 17 percentage points, respectively, and Sweden a significant increase of around 12 percentage points. In all four countries, this was driven by growing shares of SNG expenditure without a commensurate expansion of own revenue. This trend is particularly notable in Sweden, given its traditionally high degree of local fiscal autonomy. In Finland, the increase largely reflects the 2023 health and social services reform, which transferred these functions from municipalities to the newly created, centrally funded wellbeing services counties, with a corresponding reduction in municipal income tax rates and an increase in state taxation. Italy also saw a marked increase (around eight percentage points), with own-source revenue shares declining, although SNG expenditure shares also fell. By contrast, Romania, Ireland, Greece and Malta registered the largest declines. In Ireland, this was driven by falling shares of SNG expenditure, while in Greece it reflected fiscal consolidation following the sovereign debt crisis. Among the federal and quasi-federal Member States, Germany, Spain and Austria have shown stable ratios throughout. Belgium stands out with a notable decline of around 15 percentage points, which is attributable to successive state reforms that have progressively broadened regional tax bases and reduced reliance on federal transfers.

Box 3.2.4: Subnational own source non-tax revenues (OSNTR)

Regional and local governments can raise their own revenues without relying on taxes or transfers from the central government. Such **'own-source non-tax revenues' (OSNTR) strengthen local financial independence**, give local authorities more flexibility and control over spending, and make them less vulnerable to political changes or fluctuations in national transfers.

In the EU, in 2024, such revenues made up only about 12% of regional and local government income (and 2% of GDP), showing the limited ability of subnational governments to raise money independently. This share has remained broadly unchanged across the EU since 2007, but the picture varies widely across countries, from 2% in Spain to 38% in Cyprus.

OSNTR can be separated in three main categories:

A) **Cost recovery revenues** (e.g. fees, tolls, product sales, parking),

B) **Asset-based revenues** (e.g. rental from public property, concessions, royalties)

C) **Financial revenues** (e.g. interest from loans and financing, dividends).

Cost-recovery revenues are by far the most significant OSNTR source, constituting a median of 88% in 2024. This is followed by financial revenues (9%) and asset-based revenues (3%).**Substantial within-country variation in each category of OSNTR suggests significant room for catch-up potential**: **in many places, these revenue sources are underused and could be better mobilised.** The potential is largest for asset-based revenues, where local governments hold considerable autonomy, particularly over rental income from public properties. Cost-recovery revenues offer moderate potential, as utility fees are tightly regulated, but charges for the use of public spaces and street furniture remain underexploited. Financial revenues offer the least room, given stricter regulation including requirements for savings and tight oversight of municipal finances.

Source: (OECD, 2026)

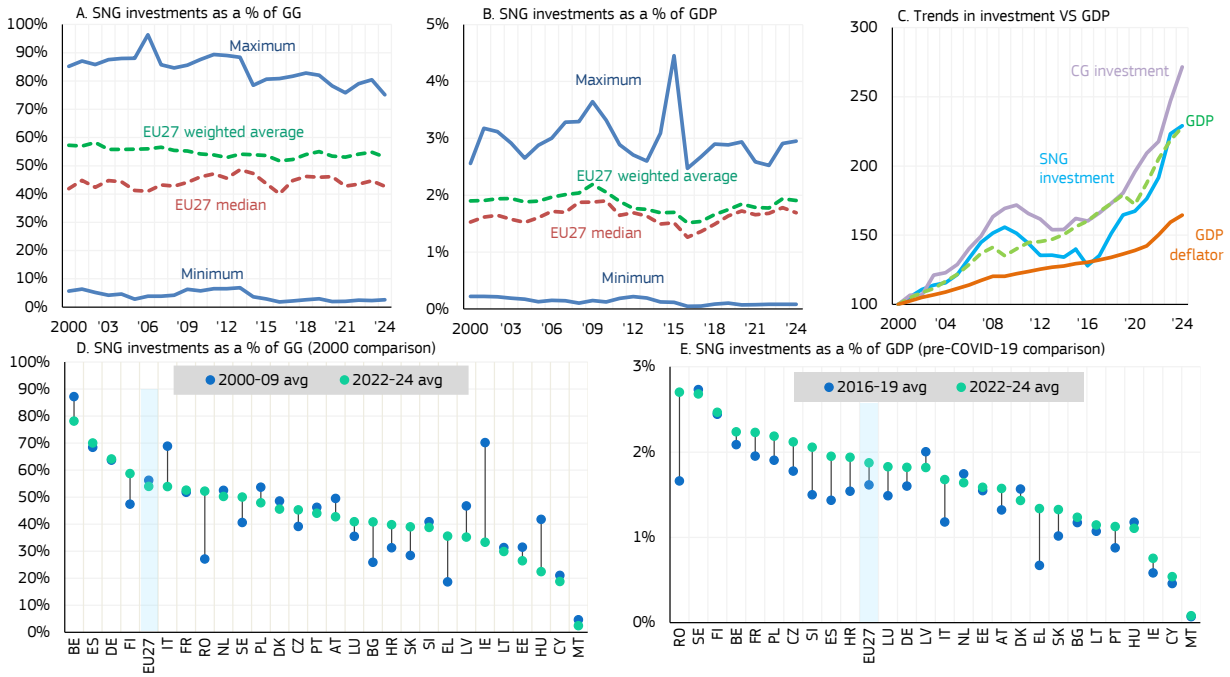
3.2.2.2. SNGs have significant investment responsibilities and limited borrowing capacity

Subnational governments account for more than half of all public investment in the EU, though their weighted average share has fallen from 57% in 2000 to 53% in 2024, while the median share has remained largely unchanged ([174]) (see Figure 3.2.3, Panel A). The SNG investment share has increased in 12 Member States and declined in the remaining 15; in the former group, the average increase was nine percentage points, compared with the average decline of eight percentage points in the latter (see Figure 3.2.3, Panel D).

Panel B of Figure 3.2.3 shows SNG investment as a share of GDP over time in absolute terms for both the EU median and the weighted average. The weighted average peaked at around 2.2% of GDP in 2009, driven by the pre-crisis investment boom and counter-cyclical fiscal policies, before falling to a trough of around 1.5% in 2016 amid post-crisis consolidation. The post-2016 recovery brought the weighted average back to around 1.9% of GDP by 2024, broadly in line with pre-crisis levels. The median SNG investment-to-GDP ratio rose from around 1.3% in 2016 to 1.7% in 2024.

([174]) The gap between the weighted average and the median throughout the period reflects the outsized weight of larger, more decentralised Member States (particularly Germany and Spain) in the EU aggregate.

Figure 3.2.3: Trends in SNG investment



'Investment' refers to gross fixed capital formation.

Source: DG REGIO calculations based on Eurostat (2026) and (OECD, 2027) data

Panel E of Figure 3.2.3 shows SNG investment as a share of GDP by country for two periods (2016–2019 and 2022–2024). It reveals that the post-2019 increase was widespread, with 22 Member States recording higher SNG investment-to-GDP ratios in 2022–2024 compared to 2016–2019. The COVID-19 pandemic did not disrupt this upward trend significantly, largely owing to substantial central government fiscal support and the relative stability of recurrent property tax revenue (OECD, 2021b). The post-2019 increase exceeded 0.4 percentage points of GDP in five Member States: Romania, Greece, Slovenia, Spain and Italy (in descending order). SNG investment relative to GDP declined only in Latvia, Denmark, the Netherlands, Hungary and Sweden (in descending order of magnitude).

Figure 3.2.3, Panel C presents SNG and central government (CG) investment in nominal terms (indexed at 100 in 2000), alongside nominal GDP and the GDP deflator. This puts the recovery in SNG investment in context by distinguishing real growth from price effects. SNG investment in nominal terms more than doubled between 2000 and 2024 (index around 229), a substantially lower increase than CG investment (with an index around 272). The rise in CG investment (especially post-2020) may reflect the concentration of emergency and recovery spending at the central level during the COVID-19 crisis and the energy shock. Importantly, this nominal growth has significantly outpaced inflation over the same period: the GDP deflator rose to an index of around 165 by 2024, meaning that real SNG investment in 2024 was 40% above its 2000 level. The post-2016 recovery in SNG investment is therefore not merely a nominal phenomenon driven by higher prices but reflects a genuine expansion in investment volumes. However, the post-2021 inflation surge (the deflator rose by over 25 points between 2020 and 2024) has eroded some of the real value of SNG investment budgets, particularly where investment programmes were agreed in nominal terms before the inflationary episode. Compared with GDP (with an index around 228), SNG investment broadly kept pace in nominal terms, although the trough in 2015–16 represented a period of real contraction relative to economic activity.

Despite their role in driving public investment in many Member States, SNGs accounted for only about 14% of total general government debt in 2024. This share has been declining over time, with the EU median share even lower, at just 6%. In all Member States, SNGs account for a substantially higher share of government investment than of government debt. SNGs account for more than 30% of the general

government debt in only three Member States (Denmark, Germany and Sweden), and more than 20% in two more Member States (Belgium and Spain). Three of the aforementioned countries are federal or quasi-federal, and in these countries, states or autonomous regions tend to face less strict borrowing constraints. In the remaining 22 EU Member States, however, SNG debt accounts for less than 20% of general government total debt. This share has decreased since the early 2000s in 18 Member States, and increased in only nine Member States and by more than five percentage points only in Belgium, Denmark and Sweden.

Box 3.2.5: Subnational borrowing constraints within the context of the EU's macrofiscal framework

The EU's macrofiscal framework and national borrowing constraints

The fiscal positions of EU Member States are governed by the **Stability and Growth Pact (SGP)**, which establishes binding fiscal rules for the **general government** as a whole. Under the reformed SGP (Regulation (EU) 2024/1263, 2024), each Member State must adhere to a **country-specific net expenditure path** which ensures that debt is put on a plausibly downward path by the end of the adjustment period or is maintained at prudent levels below 60% GDP, while the general government deficit is brought and maintained below 3% GDP over the medium term. The 3% deficit and 60% debt reference values remain key thresholds. If they are exceeded, the Excessive Deficit Procedure (EDP) may be initiated, imposing additional fiscal adjustment obligations on the Member State concerned (European Commission, 2024).

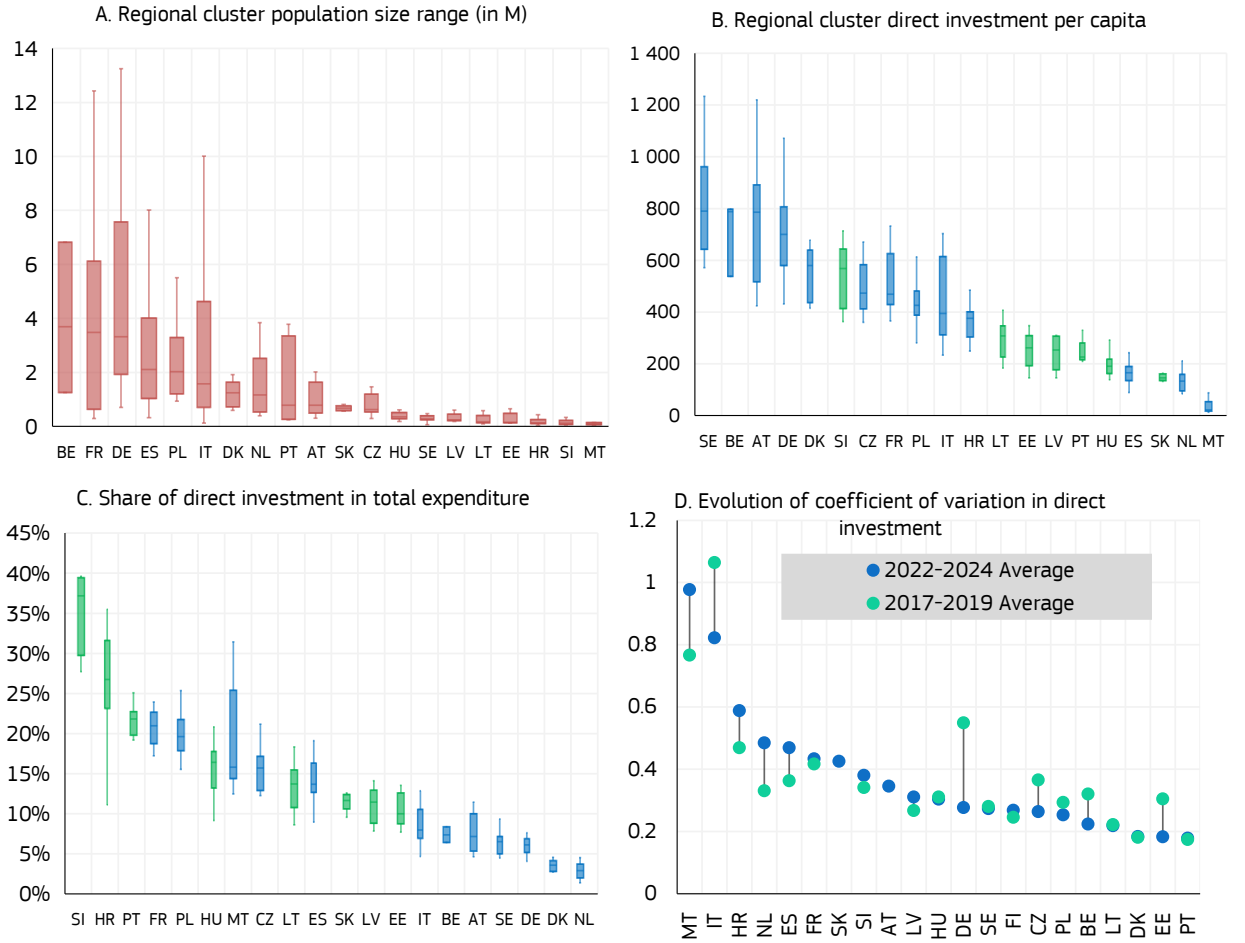
One relevant aspect of the reformed SGP is the treatment of **nationally co-financed expenditure for EU cohesion policy**. Under the renewed framework, Member States under the preventive arm of the SGP may be granted an extended adjustment path of up to seven years if they commit to a set of reforms and investments, including those co-financed by the EU. Moreover, the national co-financing expenditure for EU Cohesion Policy is excluded from the net expenditure indicator, against which compliance with the fiscal path is assessed (Regulation (EU) 2024/1263, 2024) Member States therefore cannot meet their net expenditure targets by cutting such expenditure, which is thus ring-fenced from potential expenditure cuts. This helps protect EU co-financed investment from pro-cyclical cuts (European Commission, 2024). However, this exclusion concerns only the net expenditure indicator: nationally co-financed expenditure remains part of the general government deficit and debt as defined in Protocol No 12 on the excessive deficit procedure, so the 3% and 60% of GDP reference values continue to apply in full.

The transmission of borrowing constraints to subnational governments

The SGP operates at the level of the **general government**, as defined in the European System of Accounts (ESA 2010),. This consolidates all government tiers into a single institutional sector. Rather than imposing borrowing ceilings directly on subnational governments (SNGs), the SGP makes **the Member State as a whole legally responsible for compliance**. However, since SNG deficits and borrowing are included in the general government balance monitored under the SGP, most Member States impose domestic fiscal rules on SNGs, including balanced budget requirements, borrowing ceilings and debt brakes to protect the national fiscal position (European Commission, 2021). The Two-Pack and the Fiscal Compact (Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, 2012) reinforced these incentives by requiring euro area Member States to establish independent fiscal institutions and automatic correction mechanisms at the national level. In some Member States, most notably Spain, Austria, Germany, Italy and Belgium, these obligations were explicitly cascaded to lower government tiers through domestic constitutional or legislative arrangements.

Consequently, any argument for expanding SNG borrowing capacity must be considered within the context of this multi-level fiscal governance structure. Even where the economic case for SNG investment borrowing is sound in principle (for example, when debt finances long-lived infrastructure whose benefits extend over several decades), **the fiscal space available at the subnational level is not determined autonomously by SNGs**. Instead, it is a residual of the Member State's overall fiscal position under the SGP and of the rules that central governments choose to cascade down to lower tiers. In Member States already operating under an EDP, the scope for subnational borrowing is heavily restricted in practice. Therefore, calls for greater SNG borrowing flexibility must be assessed in the context of national compliance obligations under the SGP rather than treating subnational and national fiscal positions as independent of one another (European Commission, 2022a); (European Commission, 2021).

Figure 3.2.4: Asymmetries in regional investment within and between Member States



In Panels B and C, the blue data points come from both the REGOFI and MUNIFI datasets, whereas the green data points come from the MUNIFI dataset only. The number of regional clusters varies by year and country. All figures are adjusted for purchasing power parity and reflect real values. Outliers in Panel B are omitted.

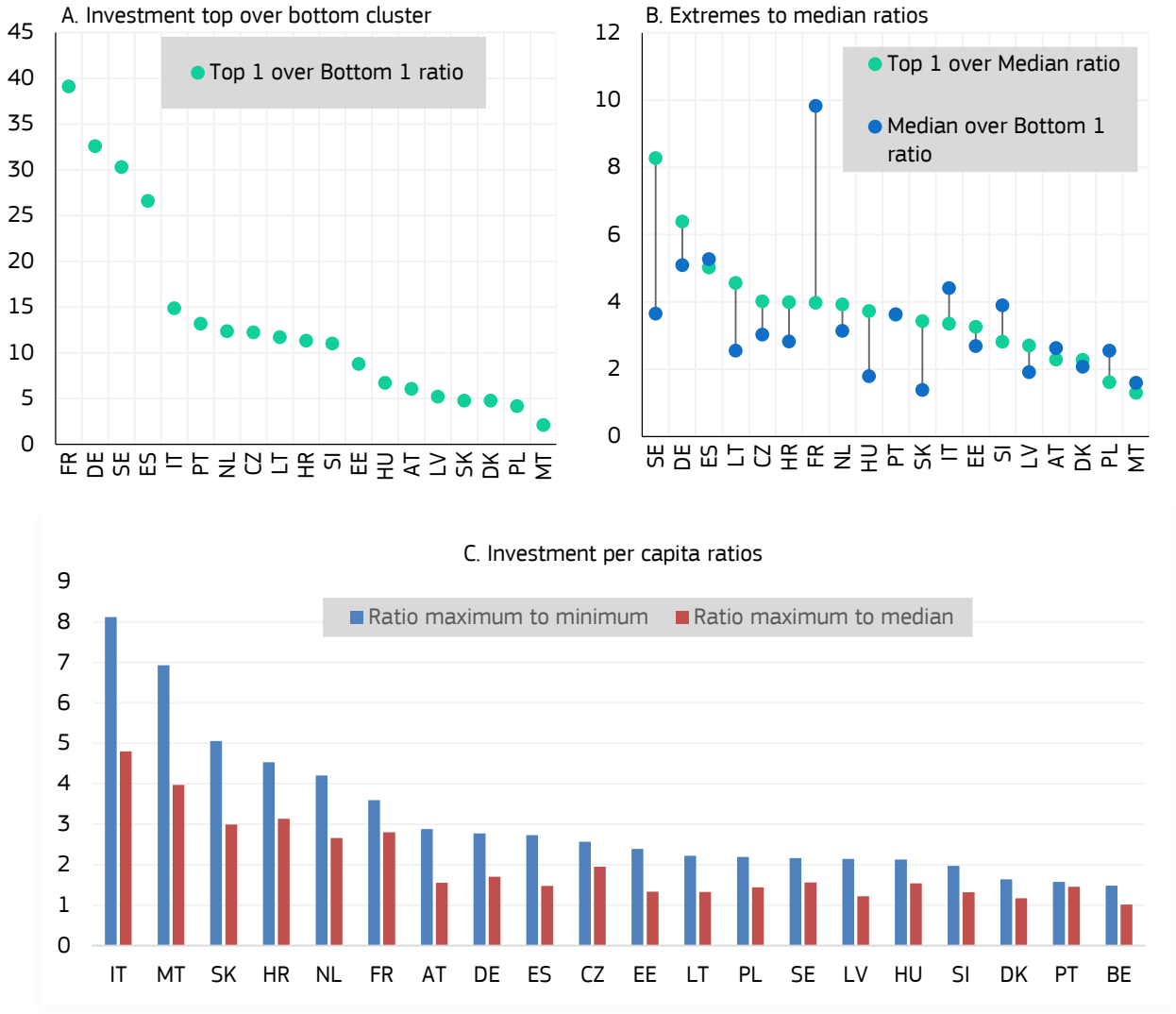
Source: OECD Disaggregated Municipal Finance (MUNIFI) database; OECD Disaggregated Regional Finance (REGOFI) database (OECD, 2027)

Most EU Member States apply 'golden rules' that restrict SNG borrowing to investment purposes, making debt a theoretically appropriate tool for financing long-term capital assets, given that public infrastructure generates benefits over several decades. Under these rules, borrowing can be economically justified as a way to spread the cost of an investment over the years in which it delivers benefits. However, in practice, SNG debt levels are considerably lower than their investment shares would suggest, reflecting the combined effect of prudential borrowing limits debt sustainability concerns, and the availability of alternative funding sources, in particular own revenues and capital transfers including EU funds (see Box 3.2.4).

3.2.2.3. Within Member States, there are significant disparities in subnational investments

Subnational levels of investment may be distributed in a highly uneven way in different EU countries, to the extent that disparities within countries often exceed differences between countries. National indicators of fiscal decentralisation can mask the territorial heterogeneity that matters for cohesion policy. To capture the territorial dimension, the following analysis uses aggregated subnational fiscal accounts at the regional level. The unit of analysis is therefore called a 'regional cluster', which is defined as the sum of the financial accounts of

Figure 3.2.5: SNG direct investment concentration effects



The number of regional clusters varies by year and country.

Source: OECD Disaggregated Municipal Finance (MUNIFI) database; OECD Disaggregated Regional Finance (REGOFI) database (OECD, 2027)

the regional government and all the municipal governments within the region ([175]).

([175]) The analysis is conducted at the regional and municipal levels using the OECD REGOFI and MUNIFI databases (OECD, 2027). Intermediate government levels between the state/regional and municipal tiers (e.g. departments in France) are excluded from the analysis based on REGOFI/MUNIFI data. Fiscal aggregates (e.g., revenues, expenditures and debt) combine the accounts of all municipalities within a region with those of the regional government itself, whenever available, in order to improve cross-country comparability, reduce volatility from small-municipality outliers, and account for institutional differences in the allocation of government functions across subnational tiers. Transfers between the regional government and the municipalities of the same cluster are not netted out, i.e. the data are unconsolidated.

Across the 20 countries analysed (OECD, 2027), the median investment per capita (adjusted for purchasing power parity) ranges from EUR 22 in Malta to EUR 790 in Sweden, representing a 36-fold difference at the country level (Figure 3.2.4, Panel B). However, this gap understates the true dispersion: the lowest-investing regional clusters in countries with high aggregate subnational investment per capita (such as Sweden, Austria, France and Italy) often invest at similar levels to the highest-investing regions in countries with much lower aggregates. Austria, for instance, has the third-highest subnational investment per capita in the sample, yet its weakest regional clusters invest roughly the same per capita as the median cluster in Croatia or Italy and the top clusters in Lithuania. The same holds when assessing subnational public investment as a

share of subnational total expenditures, with disparities within countries also outweighing disparities between countries (Figure 3.2.4, Panel C). This suggests that some regions have more in common fiscally with regions in other countries than with other regions in their own country.

Compared to pre-pandemic figures, investment disparities within countries have stayed the same primarily in countries that already exhibited lower levels of variation, while countries with a high degree of variation have tended to diverge further (Figure 3.2.4, Panel D). Two notable exceptions to this trend are Italy and Germany, which both showed significant convergence in the variation of direct investment. This divergence might point to a self-reinforcing dynamic: regional clusters that already invest more generate stronger fiscal bases, while lagging clusters lack the revenue-generating and borrowing capacity to sustain investment independently.

As regards subnational direct investment (not on a per capita basis), which also reflects differences in the population size of regional clusters, a small number of regional clusters account for a disproportionate share of total investment. Comparing regional clusters at the bottom of the distribution with those at the top shows that the top cluster invests twice as much as the bottom one in Malta (the smallest disparity), but 39 times more in France (the biggest disparity) (Figure 3.2.5, Panel A). However, as reported in Figure 3.2.5, Panel C, the biggest imbalances in per capita investment are in Italy – around eight times more investment per capita goes to the top cluster compared to the bottom cluster, and around five times more than the national median. The smallest disparities are in Belgium, followed closely by Portugal and Denmark. In Belgium, the two ratios are around 1.5 and 1.0, respectively (Figure 3.2.5, Panel C) indicating a more even regional fiscal structure.

As the previous findings suggest, disparities in subnational fiscal capacity within countries are often as big as, or even bigger than, the differences between countries. The share that transfers between tiers of government represent in total subnational revenues varies significantly between regional clusters (Figure 3.2.6, Panel A). The average range within a country is 23 percentage points, which is roughly the same as the difference between the country medians in France and Portugal, two countries with substantially different governmental frameworks, France being more decentralised than Portugal. In France, Italy and Hungary, this within-country range in subnational governments' dependency on transfers exceeds 40 percentage points (e.g. in Italy, transfers account for 13% of revenues in the autonomous province of Trento but 72% in Molise). National policies for regional and urban development may influence the variation that we see in transfers through redistributive mechanisms. As expected, greater variation in transfer dependency tends to be associated with Member States that have explicit territorial policies, while smaller variation is found in those that do not have such policies or that are completely reliant on EU funding (see Table 3.1.1). This association is only indicative and would require further assessment; part of the within-country variation also reflects the coexistence of special-autonomy and ordinary-statute entities in some Member States, as illustrated by the Italian example above.

Current account balances as a share of revenues vary less, both between and within countries, and their distributions overlap substantially across the countries in the sample (Figure 3.2.6, Panel B). This indicator is relevant for investment capacity, as a current account surplus gives subnational governments own resources that complement capital transfers and borrowing in financing investment. The overlap between countries suggests that the capacity to generate such savings may depend as much on regional characteristics as on national fiscal arrangements operating between different levels of government.

3.2.2.4. Conclusion: subnational governments play a central role in public investment in the EU

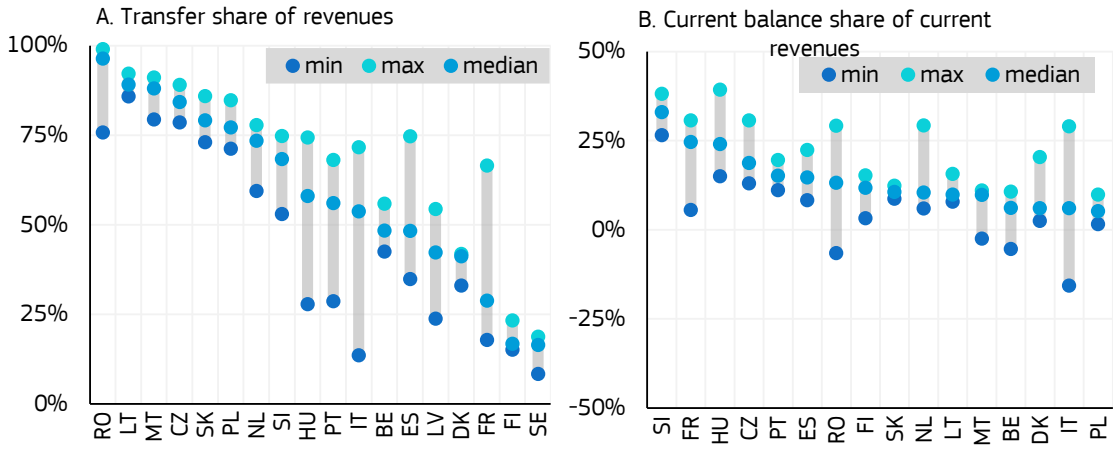
Subnational governments play a central role in public investment in the EU, accounting for over half of all general government gross fixed capital formation. SNGs face a structural misalignment between their investment responsibilities and financing capacity. Although real SNG investment has grown by around 40% since 2000, their share of total public debt remains modest at 14% in the EU overall, with a median of just 6%. The share of own-source non-tax revenues remains relatively low across the EU, accounting for only 12% of total subnational revenues.

Another interrelated issue is the growing vertical fiscal gap between SNG expenditure responsibilities and own-source revenue. SNGs now depend on central transfers for a median of 55% of their expenditure (up from 46% in the early 2000s), reflecting a decline in non-grant revenue shares in most Member States. This trend is most pronounced in smaller, less decentralised countries, whereas federal systems have maintained stability through constitutionally embedded revenue-sharing mechanisms.

Finally, both the vertical fiscal gap and the challenge of financing investment are distributed unevenly across the EU. Less developed regions often have lower revenue capacity, higher per capita service costs and limited access to sub-sovereign debt markets. In such regions, EU cohesion policy funds are an important source of support to complement national investment.

These findings suggest that three aspects are relevant for subnational investment capacity. First, how efficiently SNGs manage transfers, expenditure and investment responsibilities is closely linked to the quality of their fiscal governance and to their administrative and institutional capacities. Second, the degree of alignment between revenue arrangements and expenditure responsibilities, whether through own-taxing powers or the design of transfer systems, bears on the sustainability of decentralised service delivery. Third, subnational fiscal capacities vary considerably both between and within Member States, so that similar financing arrangements may have different effects depending on regional structural characteristics.

Figure 3.2.6: Selected fiscal indicators at territorial level



Data as of 2024 or closest. Outliers with extreme values were removed from both panels.

Source: OECD Disaggregated Municipal Finance (MUNIFI) database; OECD Disaggregated Regional Finance (REGOFI) database (OECD, 2027)