

*Summary*

The local government economy  
and sustainable public finances  
(RiR 2012:25)



## Summary

### The local government economy and sustainable public finances RiR 2012:25

The Swedish National Audit Office (Swedish NAO) has audited whether the Government has identified and analysed the long-term financing problems of the local government sector. The audit concerns both the Government's reporting to the Riksdag and the long-term effects of increased local government tax on the tax bases.

#### **Audit background**

*Reasons:* The costs of publicly financed welfare services will probably rise in the future. The majority of welfare services in the form of schools, healthcare and social services is produced by municipalities and county councils and is largely financed by local government tax revenues. In addition, municipalities and county councils receive significant funding from central government.

The Government gives a comprehensive treatment of the question of the future financing of welfare in its regular assessment of the long-term sustainability of fiscal policy. This assessment relates to the public sector as a whole. No analysis of the long-term development in the local government sector is presented by the Government. There is thus a risk that the analysis does not capture possible relationships between local government and central government finances.

The public sector's future financing needs is an issue that has been examined at length. However, the relationship between local government and central government finances in the long term has not received attention to the same extent. An audit of this area is urgent in light of the risk for economic ineffectiveness in the interaction between local government and central government finances in the long term. Any deficiencies in this regard may lead to the development of short-term solutions, which in turn risk having negative effects on central government and local government tax bases in the long term.

*Purpose:* The purpose of the audit is to examine whether the Government has identified and analysed the long-term financing problems of the local government sector.

*Implementation:* The audit has covered document studies of government bills and written communications, interviews as well as analyses of calculation data from the Ministry of Finance. In addition, with the help of Statistics Sweden, the Swedish NAO has performed calculations of the effects of an increase in average local income tax.

#### **Audit results**

The Swedish NAO finds that the Government's reporting to the Riksdag on the long-term sustainability of fiscal policy lacks a local government dimension. This is a deficiency because it is primarily in municipalities and county councils that there is a risk of future financing problems.

Using the calculation data for the Government's long-term calculations, we have been able to derive potential local government imbalances that are not reported to the Riksdag. At the same time, the Government's base scenario shows very large central government surpluses in the long term. The Government's long-term calculations presuppose that the local government sector will achieve the balanced budget requirement thanks to extensive funding through central government grants. As this funding is not reported to the Riksdag, the Swedish NAO finds that the Government's reporting of the calculation assumptions is deficient. Therefore, there is no presentation of the long-term financing problems of the local government sector or of the Government's view on this issue. Obscurities of this

nature add to the uncertainty of the long-term planning conditions for municipalities and county councils. Furthermore, large calculation imbalances between central and local government can lead to increased uncertainty in assessing the sustainability of public finances. To counteract this, these imbalances should be captured in the analysis and reported openly.

### **Increased local government tax erodes tax bases**

In times of deficit and uncertainty about the future, municipalities and county councils might have to increase local government tax rates in order to achieve the balanced budget requirement. In the event of increased local government taxes, the audit demonstrates a long-term erosion of the tax bases through an adjustment of the labour supply. According to our calculations, the effects on the labour supply are limited, but the overall impact on the public finances is significant. A large part of the calculated costs associated with local government tax increases is borne by central government.

The problem in financing the local government expenditure pressure is not primarily a question of lack of resources for the public sector as a whole, but rather a distribution problem. Central government has good long-term finances and has, for example, the opportunity to forestall local government tax increases by means of central government grants or to neutralise the effects of them by means of reductions in central government tax. In the longer term, it is also possible to move the responsibility for providing various public services between different public sectors. However, the long-term imbalances in the local government sector appear to be so extensive that planning is required well in advance regardless of the measures taken.

Overall, the Government's reporting of the long-term sustainability of public finances is not appropriate in terms of the relationship between the public sector's sub-sectors.

### *The Swedish National Audit Office's recommendations*

The Swedish NAO recommends the Government to:

- present an assessment of the local government sector's finances in the long term in conjunction with the Spring Fiscal Policy Bill
- clarify the assumptions about the local government economy that are made in conjunction with the long-term calculations for the public sector
- clarify the effects on the public finances of various alternatives for action with respect to solving the long-term financing problems of the local government sector.