



The municipal financial equalisation system

– a need for more equalisation and better management

The Swedish National Audit Office's (Swedish NAO) overall conclusion is that the system for financial equalisation between municipalities is not designed so that municipalities can provide their populations with a generally equivalent service level without large differences in tax rates. Municipalities have different demographic and geographic conditions. These conditions mean that municipalities have varying financial conditions, despite there being an equalisation system that is intended to result in equivalence. The Swedish NAO believes that there is unrealised improvement potential in the financial equalisation system in this regard. The Swedish NAO recommends that the Government develops the financial equalisation system so that it compensates for the different conditions in the municipalities to a greater degree. The Swedish NAO also recommends that the Government tasks the Swedish Agency for Economic and Regional Growth with developing and maintaining the financial equalisation system based on a management plan.

Audit findings

Overall, municipalities have significant costs because they are subject to different conditions, but for which they are not compensated through the financial equalisation system. The purpose of the system is to create equivalent financial conditions for all municipalities and county councils in Sweden to be able to provide their inhabitants with equivalent services, regardless of inhabitants' income and other structural conditions. But within the existing cost equalisation system, insufficient consideration is taken of cost differences between municipalities as a result of the area they cover, the number of inhabitants, population changes and socio-economic factors in metropolitan areas and municipalities close to large cities. In 2017, cost differences were equalised between

municipalities by a net amount of SEK 7.2 billion. According to our calculations, fairer cost equalisation, taking more account of the above-mentioned structural conditions, would have instead resulted in an amount of SEK 10.9 billion. At the same time, structural grants paid to certain municipalities with a historically weak population base could have been phased out.

Most municipalities would have received larger grants or had lower charges than in 2017. According to our calculations, 241 of Sweden's 290 municipalities were under-compensated in 2017. Municipalities covering a large area, with few inhabitants and large population decreases would have received significant contributions from the cost equalisation system.

The Government's current proposal increases cost equalisation to benefit municipalities with scattered population centres, but does not totally achieve the objective. Cost equalisation would need to increase by a significant amount in order to achieve the purpose of the system. In other words, there is untapped potential in the cost equalisation system.

Rural municipalities or other municipalities with scattered population centres or few inhabitants often have a high tax rate. Increased cost equalisation to benefit these municipalities would provide them with the conditions to lower the tax rate, given that they maintain the same level of service. Other municipalities would instead have to pay a higher charge and might need to raise their tax rates to maintain the same level of service. As a calculation example, it can be mentioned that increased cost equalisation as described above could have reduced the span of 2017 tax rates from 6.73 per cent to 4.84 per cent, if municipalities had maintained the current service level.

There are also cost differences as a result of differing geographical and demographic conditions in library services and adult education (including Swedish for immigrants). These mandatory services are not included in the cost equalisation system, but in the future adult education should be included, according to the Government's proposal. For some of the municipalities' voluntary services, there are also cost differences as a result of differing geographical and demographic conditions. It may appear natural for voluntary services not to be included in the cost equalisation system, but some of these services are not voluntary in practice.

It is intended that variations in charging municipal tax should mainly reflect the varying levels of ambition for services, efficiency or other priorities. But it is not the intention that these variations are the result of differences in municipalities' demographics and geography. The audit findings lead us to the overall conclusion that the equalisation system is not designed so that municipalities can provide their populations with a generally equivalent service level without major differences in tax rates. Thus, the system does not provide municipalities with equivalent financial conditions. This, in turn, risks leading to a

lack of equivalence in various municipal services. Another risk arising from unequal financial conditions is that the gap in municipal taxation may be greater than justified by different political priorities or the efficiency of the services. Management of the equalisation system has been neglected and this is probably a partial explanation for the shortcomings we have identified in this audit.

Recommendations

The Swedish National Audit Office recommends that the Government

- develops the existing cost equalisation system so that it compensates to a greater extent cost differences as a result of municipalities covering different areas, the number of inhabitants and population changes, as well as socio-economic factors in metropolitan areas and municipalities close to large cities
- expands the cost equalisation system to include library services
- considers the advantages and disadvantages of expanding the cost equalisation system to cover a greater number of voluntary services that are mainly tax-financed
- considers whether parts of the structural grant can be phased out
- tasks the Swedish Agency for Economic and Regional Growth with managing the equalisation system based on a management plan.