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Prevention of local government unsustainable behaviour – some Danish experiences¹

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1. Introduction - decentralisation and merit concerning responsible economic behaviour

1.1. Public sector, externalities and public goods

The public sector has its foundation in the existence of public goods and externalities.²

It is evident that the public sector deals with externalities in environmental protection, parks and recreation, general administration or defence. But externalities are also present for many publicly provided private goods – such as health care, primary schools and elderly care. The element of externality in such cases is “general health situation”, “fair distribution”, “minimum rights” etc.

In this paper I shall explore viewing also fiscal policy objectives as a kind of public good. The subject of this paper is the objective of stable, responsible and sustainable local governments.

When different levels of government exist the question arises: by what level of government should the different activities be carried out, at what level can the externalities best be handled properly or “internalized”? When it comes to the public good “responsible economic behaviour”, what level of government should be preferred for this task?

1.2. Handling economic responsible behaviour – on what level?

It is fairly obvious that economic responsibility primarily rests with the level of government that has the responsibility for finding the financing. This should be the same level as the one where the decisions are made about the services and their costs, and also where the effects of the activity can be monitored. This is the slogan that ‘responsibility and competence should go together’.

In Denmark the municipalities are run by elected councils, who are responsible to the citizens/electors for their decisions. This we see as a key element of a public sector consisting of separate local, regional and central authorities.

¹ I thank Jørgen Lotz for very helpful and useful comments and suggestions to an earlier draft of this paper.

² See the classical description in Musgrave (1959).

However, with a decentralised public sector conflicts of interests may arise. This is not a Danish problem - in most countries the problems of de-central responsibility and accountability need to be addressed. It is generally held that central governments have special interests and some extra responsibilities when it comes to fiscal policy (surplus or deficit), the overall tax level, and also to avoid an economically unsustainable public sector. And in this respect there is a special concern to minimize the risk of default of local public authorities.

The reason for this is the fact that the default of a municipality may result in disruption of local services deemed essential by the centre. In Denmark, like probably in most countries, the defaults of local governments raise the risk of bailing-out the local government in question to be carried by the rest of the country. Therefore, the central government also has the legitimacy of putting up (extra) measures to avoid such situations.

Aspects of creating the appropriate general incentives for the local government sector to carry out expenditures and raise revenues has been discussed formerly on the Copenhagen workshop of 2009 – under the headline “general grants versus specific grants”.³

This paper addresses the interplay between regulation and grants policies in setting of rules for the budget management of local governments taking into account the division of tasks, the system of grants, the local taxation powers, and other revenues. The centre for these reasons need to take into account the risk of irresponsible local economic behaviour, i.e. “Economic Unsustainable Behaviour” (abbreviated here EUB) of single municipalities? But: how best to address this risk? Or, in other words, how best to handle this aspect of economic risks in connection with decentralisation on the background of the national merit of stable delivery of services delegated to the local level?

In this connection we should also take into accordance the problem raised by de Figueiredo et al (2007) and second generation of fiscal federalism that a public sector in different tiers must foresee two kinds of systematic risks. On the one hand there is a risk that the central level to get control of local government behaviour undermines the advantages of decentralisation which were the reason for having a local level. On the other hand there is the risk that authorities display opportunistic behaviour, i.e. misuse their freedom and pursue irresponsible policies.

1.3. Programme

This paper attempts to analyse and illustrate some aspects as experienced in the Danish public sector assuming that responsible, sustainable budget policies are in the last end in most if not all countries the responsibility of the centre.

First, it will be discussed what motives and conditions can bring a local government in a situation where it may display EUB. Under what circumstances is the risk especially serious? Some hypothesis about this will be formulated.

Second, as a preparation to the evaluation of data, the economic and legal environment of the Danish municipalities will be shortly described.

Third, a small sample of cases will be presented to illustrate the Danish experiences. And fourth, those cases will be discussed in the light of the hypothesis put up earlier. We don't aim at any formal statistical verification but a sort of evaluation.

³ See Kim (2010).

Fifth, the way of regulation is assessed – both the successes and the spectacular exception to this. And finally there will be some conclusions.

2. Theories of explaining local economic behaviour and the risk of EUB

There are many factors explaining the economic decisions by local governments when we want to explain the risk of EUB. Is irresponsible behaviour of the municipal board simply to be understood as an aggregation of citizens' preferences – perhaps as represented by the utility function of the so-called median voter? Another factor is the personal interest of the local politicians in getting into power and be re-elected? But we also have to consider the role of local pressure groups and the civil servants with their personal motives – wages, prestige, job-security etc.

With no doubt, all dimensions should be given attention. Here we will only mention some *elements* and conditions that will likely motivate the economic responsible behaviour of the municipalities – as expressed by the decisions of the local politicians and made operational by the staff and the civil servants.

As already mentioned, the *starting point* or *main rule* will be that the municipalities will act economically responsible – and not get near any kind of EUB-situation. Getting a reputation of lax or - even worse - irresponsible economic behaviour will by the electorate be taken to be a lack of management skills. The citizens will possibly see a lack of economic control not only as a risk for budget deficits and “bills to be paid” by the municipality's local tax payers, but also as a sign of a more general lack of managerial competence. So the not very surprising hypothesis 1 is: municipalities will normally be governed in an economically sustainable way. This does not depend of the behaviour of the central government.

But there may be deviations. If the municipal board feels that they are treated in an unfair way and is hit by external shocks it might be seen as justified to loosen the economic management, a need that under the circumstances will be easy to communicate to the inhabitants. This may result in failure in keep the budgets and fulfilling the economic plans. So this leads to hypothesis 2: *external shocks* may increase the risk leading a municipality into an EUB-situation.

Such a situation will seem more attractive – or less frighteningly – if the costs of EUB in some way can be passed on to other municipalities or other parts of the public sector. So hypothesis 3 is: the risk of having a EUB for a municipality is relatively high if the *costs can be transferred* to other partners in the economy.

On the contrary, if the economy of the municipality is well consolidated the potential to handle external shocks will be better. Or put in another way – hypothesis 4: An economically *weak municipality* will be more likely to end up with EUB than others.

Another aspect is the degree of clearness of political responsibilities at the local level. Having a clear political responsibility may be less likely for a municipality to move into an EUB-situation. And on the contrary if the responsibilities are blurred. A hypothesis 5 then may be that a *weak political management* of a municipality means a higher risk of EUB.⁴

If a difficult economic situation has to be overcome the municipality must have some economic tools at hand. But it is sometimes heard that local governments in reality are both restricted by fixed economic conditions on the revenue side and tight regulation of their service-delivery

⁴ Also the degree of clear separation of responsibilities between the central level and the local level may have implications for the risk of EUB, cf. Ibsen & Lotz (2011). This cannot, however, be verified by studying the individual cases at the local government level, of course.

obligations so that – so they argue - really have no room for economic manoeuvre. So hypothesis 6 is that if the local government's economic *freedom is strongly restricted* there is a higher risk of EUB.

Finally, a characteristic of decentralisation is that the single local governments may compete for new (perhaps wealthy) inhabitants. But such a competition may be costly – whether it is carried out via taxes or via expenditures – and implies a risk of EUB in extreme situation. So as hypothesis 7: Local governments' *internal tax-/expenditure-competition* may increase the economic risk of EUB-situations.

3. Danish local government finances and borrowing regulations

3.1. General characteristics of the financial system

The Nordic countries are characterised by a certain type of decentralisation where the majority of the public sector tasks are managed at the local government level.

Municipalities in Denmark supply a long range of services – from child care and kindergartens, to elderly care, primary schools and roads, from labour market schemes to income compensation transfers to unemployed persons or households not covered by the unemployment compensation scheme. Other important income transfer schemes are managed and partly financed by municipalities, e.g. early retirement benefits, sick-leave benefits and housing. And finally, an important part of public infrastructure, planning and environmental protection is carried out by the municipalities.⁵

To finance those tasks the Danish municipalities have – like those in Finland and Sweden - as their main revenue sources local taxes, block grants and to some extent also specific grants and – of more modest importance - discretionary grants from the central government. There is a comprehensive formula driven equalisation system that aims at securing equally economic conditions across the local governments.⁶ An important part of the municipal expenditures are strongly influenced by the economic cycle and but the municipal financial system aims at neutralising the effects of the cycle on the local finances.⁷

All in all the financial system of Danish municipalities underlines the financial responsibility of the local authorities, sometimes expressed as the 'principle of self-financing'⁸, which means that municipalities normally cannot raise loans for financing local government services, cf. the next section.

3.2. Borrowing regulations of Danish municipalities

As a main rule or starting point every municipality has to finance all its activities -operating costs as well as investment and debt service - by the way of current revenues, i.e. not by loans.

The main rule is however modified in two respects. First, the municipalities have so-called automatic permission to raise (long term) loans for investments in certain areas: investment on

⁵ See also Mau (2010).

⁶ For a more detailed description see Mau (2008, 2010).

⁷ In The Danish system those corrections of block grants to compensate for cyclical swings in expenditures and revenues are foreseen in the law or established as a firm tradition, i.e. rather automatic. This is contrary to many other systems as e.g. the systems of other Nordic countries, where the discretionary element is more important. See on some of those aspects OECD (2010).

⁸ Cf. Silic et al (2002) and Mau (2002).

areas financed mainly by user fees (e.g. utilities and housing for elderly people) and investments which have been given a special political priority, e.g. urban renewal, energy saving measures and housing for refugees.

Second, the Ministry of the Interior and Health grants municipalities discretionary permissions to borrow, within yearly fixed ceilings of the aggregate value of such approvals.⁹

3.3. The overdraft facility rule (“kassekreditreglen”)

The final element of the borrowing regulations concerns the short-term debt.

The set of borrowing regulation rules acknowledges that municipalities meet significant swings in day-to-day outlays and revenues. Typically the municipality receives taxes and grants in the beginning of the month but has outlays for wages and transfers later or at the end of the month. To secure that the general restrictions on borrowing do not disturb the daily cash management of the municipality or forces the municipality to hold unreasonably high cash reserves they are free to manage short term debt and short term positive balances via short term loans (cash credits) – provided that the annual average of short term deposits and loans, computed for the latest 365 days, is positive. This is the so-called “kassekredit-regel” or overdraft facility rule.

This rule is especially interesting in connection with the assessment of a possibly EUB-situation. This is so because a violation of this overdraft facility rule is seen as an early sign of a municipality getting into a EUB-situation. If the local government does not comply with this rule it acts illegally. Consequently, a municipality having an open conflict with the law must expect sanctions from the central government (the Ministry of the Interior and Health).

The Ministry has an obligation to react to a violation of the rule. This is done in a standardized manner, consisting of those elements:

- 1) the municipality in question is granted a time-limited temporary approval to deviate from the overdraft rule for a certain period, typically 3-4 years
- 2) this approval is given on the condition that the municipality takes steps to restore the economic situation and resulting in cash reserves of a certain “robust” magnitude, possibly also to take steps to improve the economic management of the municipality
- 3) the central government may or may not add some limited discretionary grants or loan sanctions to ease the immediate economic situation
- 4) the municipality has to report frequently, typically every quarter if a year, on the economic (liquidity) situation to the Ministry.

The situation is – in everyday language – termed that the local government is “put under administration” (PUA).¹⁰ The popular term “put under administration” is used in the media and by the municipal sector itself and will also be used in this paper.

4. The data – municipalities “put under administration” (PUA) in the last decades

Since 1988 29 municipalities in 30 cases have been granted an approval to deviate from the overdraft facility rule, i.e. to raise extra short-term debt for a period of usually 3-4 years on the

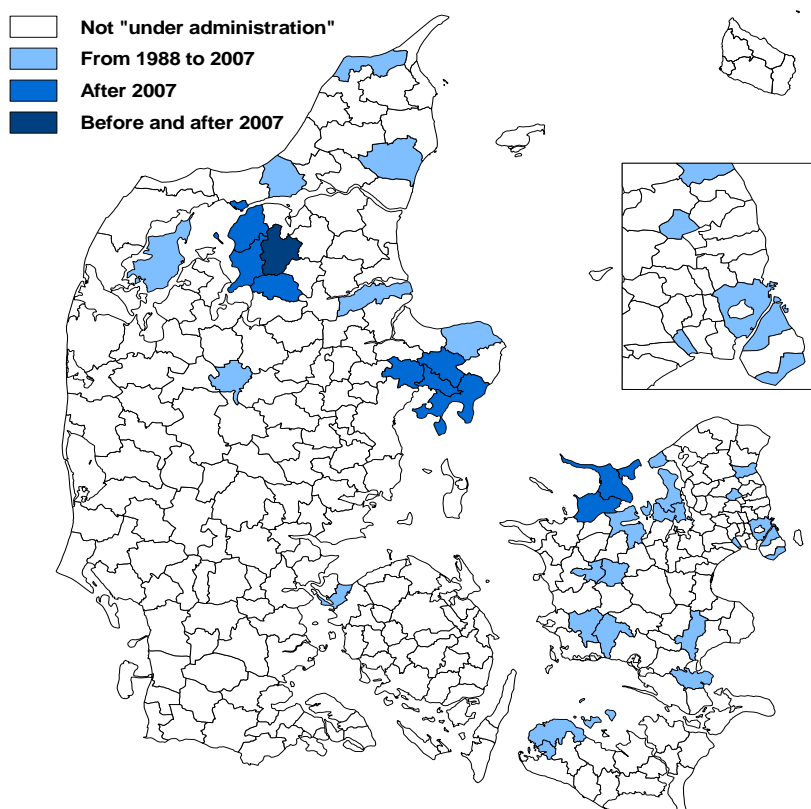
⁹ See for an English description of the Danish system Stanton (1996).

¹⁰ In Norway, cf. Kommunal- og Regionaldepartementet (2011), municipalities violating the rules about budget balance are included in a special register, the ROBEK-register (“Register om betinget godkjenning og kontroll” – Register of conditional approval and control). This sanction has some similarities with the Danish “put under administration”, but seems to be a more “soft” way of reaction from the central government (and its representatives, “fylkesmannen”).

condition that the authority fulfil the conditions set by the Ministry. Those municipalities have in the jargon been PUA.¹¹

In figure 1 the geography of the PUA municipalities are illustrated. Note that due to the structural reform of 2007 the three most recent PUA municipalities cover more than one of the before the reform independent municipalities.

Figure 1. The localisation of municipalities "put under administration", 1988-2011.



The more specific PUA cases are depicted in table 1.

¹¹ Also before 1988 rules about liquidity existed and some municipalities had to restore a weak financial situation. The rules were, however, different.

Table 1. Characteristics of municipalities "put under administration"/EUB, 1988-2011.

Name of municipality/ first year of administration	Small municipality ¹ (1)	Problems ² (2)	High social expenditure needs ³ (3)	Low tax capacity ⁴ (4)	Weak initial liquidity position ⁵ (5)	Tax/expenditure competition ⁶ (6)	Other characteristics reported (7)
Karlebo,1988		A	+	-	...	X	
Dronninglund,1989		B	-	-	...	X	Ministerial visit on location
Skibby, 1989	X	B	-	-	...		
Holbæk,1990		H,B	-	-	...	X	
Morsø,1991		B	-	-	...		
Stenlille, 1991	X	B	-	-	...		
Aars,1992	X	D,B	-	-	...		Sale-and-lease-back of furniture
Nakskov,1993	X	F,C	+	+	...	X	
København, 1994		G,E	+	-	...		1 year period, 'semi bail-out'?
Hundested, 1996	X	F	-	-	...	X	
Hashøj, 1997	X	C	-	-	...		
Nørre Aaby1998	X	C	-	-	...		
Mariager,1998	X	C	-	-	...		
Ravnsborg,1999	X	G	+	+	...		5 year period
Jægerspris,1999	X	A	-	-	...		
Brovst,2000	X	A	-	+	...		
Vallensbæk2000	X	C	-	-	...		
Nørre-Djurs,2001	X	A	-	+	...		
Dragør,2002	X	C	-	-	...		
Farum,2002		D,H	+	-	...	X	Bail-out
Fuglebjerg,2003	X	C	-	+	...		
Stenlille,2005	X	A	-	-	+		
Præstø,2005	X	A	-	-	-		
Hirtshals,2006	X	C	-	-	+		
Karup,2006	X	A	-	-	-		
Dianalund,2006	X	C	-	+	-		
Rønnede,2006	X	A	-	-	+		
Odsherred,2007/08		C,A	-	-	+		
Vesthimmerland,2008		A,H	-	+	-		inherited liquidity problems
Syddjurs, 2008/09		A	-	-	+		inherited liquidity problems
Average of municipalities ⁷	14.294		17,2 pct.	24,1 pct.	5+ 4-		
Average of all Danish municipalities ⁷	17.979 (2006) 50.962 (2007)		20 pct.	20 pct.	...		

Notes to table 1:

¹ Measured as municipalities with less than 18.000 inhabitants, i.e. the average size before the structural reform, assuming 274 municipalities and excluding Municipality of Copenhagen. Inhabitant measured from 2006/2007-data. See about categories of municipalities of different sizes, Indenrigsministeriet (2000).

² Reported in the application from the municipality or from reports from initial meetings. Categories:

A: past deficits on current budget

B: past overestimation of tax base

C: budget errors, financial mismanagement

D: not complying with borrowing regulations

E: unforeseen displacement of payments

F: external shocks

G: structural imbalances, e.g. "holes" in the equalisation system?

H: other

³ + = high social expenditure needs. Measured as a social index $\geq 1,04$ before 2007 (measured from 2002 data), $\geq 1,10$ from 2007 (measured from 2008 data), i.e. municipalities among the highest 20 pct. index values.

⁴ Measured as composite tax-capacity ≤ 106.019 DKK before 2007 (measured from 2002 data, ≤ 131.350 DKK from 2007 (measured from 2008 data), i.e. among the lowest 20 pct. tax capacity.

⁵ + = Weak position. Measured as average cash reserves according to the cash credit rule for 1 year before being put under administration < 1.000 DKK per inhabitant. Only data from Q4 2003 exists.

⁶ Taken as 1) special attention of avoiding future tax increases, or 2) aggressive tax cuts before EUB-situation.

⁷ Excluding Municipality of Copenhagen with more than $\frac{1}{2}$ mill. inhabitants.

Source: Indenrigsministeriet (2001, 2007) and data from Ministry of the Interior and Health.

5. Discussion of hypothesis in the light of data

From the data of table 1 it is possible to discuss the validity of the hypothesis proposed in section 3. The hypothesis may be confirmed, rejected or modified.

Municipalities normally act in an economically responsible manner (cf. hyp. 1)

It is not surprising but encouraging to the political system of the public sector in Denmark that municipalities normally act responsible in the sense that EUB-situations are mainly avoided. And if they occur they are rather quickly redressed. In a 24 years period as an average a little more than 1 or 2 municipalities are annually PUA. Furthermore, taking into account that no municipality has up to now been PUA since 2008, it may be a possibility that even fewer municipalities will be brought in that situation in the future. That may be supported by the fact that it seems that especially small municipalities has been put under administration, since around 70 pct. of them have less than 18.000 inhabitants (before 2007 the share was 77 pct.). The number of small municipalities is drastically reduced by the 2007 structural reform, cf. table 2.

Table 2. Number of small municipalities with less than 18.000 inhabitants

	before reform (2007)	after reform (2007)
number of municipalities	200 (73 pct.)	7 (7 pct.)

Note: Before 2007 counting Municipality of Bornholm as 5 single municipalities. Excluding Municipality of Copenhagen.

This prediction is also supported by some of the other hypothesis, e.g. hypothesis 2 and 3 about external shocks and transfer of costs, which may occur more seldom in big compared to small municipalities, cf. below.

However, it may be objected that the size of the municipality put under administration is only a little less than the average.

Unexpected events may increase the risk of having a EUB-situation (cf. hyp. 2 and 3)

The evidence is not very clear. What is an external shock? A closure of a big local company is an example, but this is rarely reported as a main cause of the financial difficulties – it has been mentioned only twice (7 pct.), cf. table 1. More often the municipalities in question mention unforeseen lack of tax revenues or revenues from sale of land, which may or may not be caused by the local cyclical developments, this being difficult to separate from “just” examples of poor budgeting skills. Overestimation of the tax base occur 6 times (20 pct.). Finally, “simple” errors and failures in the budgets are rather often mentioned as part of the difficult economic background – 10 times (33 pct.). The latter certainly is not an external shock, although it probably is felt as some kind of shock to the local decision-makers.

To conclude, hypothesis 2 may be modified to state that unexpected events – including external shocks - actually increases the risk of having a EUB-situation. But this is certainly not the only reason, also reported deficits on current budget, i.e. that budgeted expenditures are exceeded occur 11 times (37 pct.).

Small municipalities are more exposed to EUB than big municipalities (cf. hyp. 2, 3 and 4)

This is already mentioned as a possible conclusion in connection with the line of reasoning behind hypothesis 2 and 3. Moreover, it may be more realistic for a small municipality to hope for a discretionary grant than a bigger municipality may expect, simply because of lack of resources available for grants in the Ministry, i.e. there is a risk of opportunistic behaviour. Discretionary grants are not registered in table 1 but are – together with loans – used in connection with putting up a restoration plan for the economy of the municipality in question.¹²

The only (very) big municipality that has experienced PUA, the Municipality of Copenhagen (for only one year), did not directly receive discretionary grants. But an extra grant to the company of hospitals of the Metropolitan Area may be explained by the need for financial assistance to Copenhagen.¹³

It can also be noted that several small municipalities were PUA immediately before the 2007-structural reform when a bigger municipality would take over

Difficult external/initial economic conditions are not decisive to the risk of EUB (cf. hyp. 4 and 6)

It may be expected from hypothesis 4 and 6 that restrictions on economic behaviour for municipalities may be a main reason for bringing a municipality to a EUB-situation.

From table 1, column (5), it seems – although on the background of very few data – that there is not a tight connection between an initial very low level of liquidity (t –1 year) and the timing of PUA. So hypothesis 4 about an exposed initial economic situation having an implication for EUB-situation cannot be unambiguously confirmed.

¹² The discretionary grants are not that big that we would speak about a bail-out situation, cf. section 6 for description of a bail-out situation.

¹³ The Metropolitan Area in this sense includes only the municipalities of Copenhagen and Frederiksberg. The company, called H:S (Hovedstadens Sygehusfællesskab) received from the start in 1995 an extra grant of 1 bn. DKK, which were gradually reduced through the next ten years, Strukturkommissionen (2004), chp. 24.

Along the same lines the observations from table 1 seems to reject hypothesis 6, i.e. apparently tight restrictions on economic behaviour do not seem to involve a higher risk of being put under administration as the occurrence of high social expenditure needs, cf. column (3), and low tax capacity, cf. column (4), for EUB-municipalities does not deviate in any significant way from the national average. Low tax capacity is seen a little more frequent than the national score, but high expenditure needs are a little more rare in the EUB-municipalities.¹⁴ It suggests that every municipality has degrees of freedom and that the external conditions do not in any systematic way lead to EUB.

Local tax competition is not an important reason for EUB (cf. hyp. 7)

Table 1 counts 6 cases (20 pct.) of tax changes being given special attention in the EUB-situation. However, which cannot be seen from the table, this normally means that the municipality as part of the economic restoration plan, are forbidden to increase taxes (perhaps increases within a limit), so tax competition is not seen directly as (one of the) cause(s) for EUB. Only in the case of Farum Municipality a period of tax competition was part of the complex of municipal decisions leading to EUB. So hypothesis 7 is rejected. This is not surprising considering the central government tax freeze policy supported by annual agreements with the municipal sector.

Undecided if weak political management means risk of EUB (cf. hyp. 5)

Finally, table 1 does not help to tell to which extent a weak local political management has been the cause of EUB. The analysis of the cases has given the author the impression that weak political management, e.g. a weak or changing majority of the municipal board, may imply a higher risk for EUB. But naturally such a phenomenon is rarely reported in the case-files and may rather be seen as a catch all explanation too vague to be confirmed without more detailed studies of the different municipal political situations.

6. Evaluation of the way of redressing the EUB-situation

6.1. The normal course

The method of overcoming the EUB-situation – PUA - is already described as consisting of four steps, 1)-4). The question then is: has it worked?

The answer to this can also be found in table 1 and seems to be clearly positive. Since only one municipality, Farum, is restored by bail-out (see next section) the method must have succeeded. This is confirmed by the observation (not included in table 1) that almost all of the former EUB-municipalities end up with a level of liquidity significantly higher than demanded.

One municipality, Stenlille, occurs twice in the table, and one municipality (Aars) is part of Vesthimmerland (under administration later). This may demonstrate that having had a EUB-situation once does not immunize the municipality for experiencing EUB again – though this is not a typical outcome.

What has been the reason of this success of the method of “putting under administration”. I can offer three kinds of explanations:

¹⁴ The equalisation system modifies, but does not nullify, the economic consequences of differences in taxable incomes and social conditions across municipalities.

- “It is the law”: the municipality breaking the overdraft facility rule has to realize that it is in conflict with the rules and must anticipate sanctions from its regional supervising authorities (“statsforvaltninger”¹⁵). Those authorities have the competence to demand the municipal board to decide upon a new budget with an improved financial outcome than the current ‘illegal’ budget. If the municipal board refuses to make such decisions the supervising authority has the right to fine the single members of the board who voted against steps to legitimize the budget situation.

It is remarkable that the situation has never been brought to the point where the supervising authority has taken the sanction steps mentioned above. The possibility has been discussed in certain situations but never brought into play. But still, the fear of the possibility of legal action may have effects.

- Being “put under administration” is noted with displeasure by the municipal board – one may even say it is stigmatizing. The local press naturally will cover in depth the problems faced by the municipality. And the electorate will take into account when assessing the competence of their politicians that they have not been able to resolve the situation themselves – but need help from the central government.

If this explanation is relevant it involves a paradox: the instrument of the solution is on the surface highly centralistic since the central government intervenes into local government affairs. But the intended effect is reached via the local politicians’ responsibility towards the local citizens.

Finally, an element may also be:

- In the extraordinary situation it is legitimate for the central government also to use extraordinary means, including extra grants and loan sanctions. This may relieve the situation somewhat – as earlier described.

If this kind of explanations has relevance for the success of the method it is, however, obvious that it must – from the central government – be used with the utmost precaution. In the opposite situation it will be seen as a temptation to “get under administration” to receive extra grants and opportunistic behaviour must be foreseen. As a matter of fact the view has been expressed that the government has been too soft and has created a moral-hazard situation¹⁶. One mayor has been cited that “if he runs down his liquidity and expand his administrative costs he can obtain extra grants. My reaction is that this is exaggerated, and the extra grants that may come into play normally are only modest. However, one exception has been experienced:

6.2. The exception to the rule: the Municipality of Farum

Two municipalities appear twice in the table 1 bail-out list. They are the Municipality of Copenhagen and the Municipality of Farum.

For Copenhagen it is questionable to speak of bail-outs since the municipality did not directly receive discretionary grants (but some extra funding was made available for some years via the financing of the Metropolitan hospitals - see the text and footnote 12 above).

However, for Farum major discretionary grants were applied:

¹⁵ There exists 5 such regional supervising authorities in Denmark.

¹⁶ Ibsen and Lotz (2011).

- When the Municipality of Farum was amalgamated into the Municipality of Furesø in 2007 the new municipality received about 0,8 bn. DKK as extra grants
- The economic situation of Municipality of Furesø was re-negotiated in 2011 and the municipality received an extra 0,7 bn. DKK in grants and cheap loans.¹⁷

The size of the grants equals more than one year total budget of Farum Municipality and is a clear case of “bailing out”.

The explanation of why it “went wrong” in this situation is still, among other items, being scrutinized by a commission – now working in its 9th year.¹⁸ An important factor is the personality of the then mayor, who bullied his council not to comply with the borrowing regulations. Also, the book-keeping procedures of the municipality were questionable.¹⁹ The citizens of the municipality received a range of extra services in some of the years including a major sports stadium and other big building projects which they did not pay for.

All in all our assessment of this case is that it is an extraordinary and isolated, however very costly, exception

7. Conclusions

The decentralised decisions of local budgets are the most important acts of the local government sector. Still, even with economically very important municipalities overall sound fiscal policy and economic responsibility is a national merit-want.

A study of 30 Danish cases of what could be termed municipal “unsustainable economic behaviour”, EUB, over a recent 24 year period reveals that the risk of having a EUB-situation is highest in smaller municipalities – implying a positive scenario for fewer future EUB-situations in Denmark after the amalgamation reform of 2007. The data also indicates that the easier the municipality can transfer (some of) the costs of EUB to other economic agents, the higher the possibility of having such a situation. That is why the risk of EUB is higher before major structural reforms where the costs of the irresponsible economic decisions might be borne partly by future new municipalities.

Having a EUB-situation seems often to stem from internal factors – such as miscalculation of taxes, other budget errors or repeated overruns of expenditure budgets. But external factors cannot be shown to be decisive in the typical case. External shocks, such as major closures of big firms, are seldom seen as a course for EUB, and low tax capacity and high social expenditure needs do not in the whole exist more often in municipalities experiencing EUB than in other municipalities.

The so-called “put under administration”-arrangements seem to work quite effectively. The EUB-municipalities have their financial difficulties redressed, and their liquidity reserves improved according to – or exceeding – the plans. One exception is described of a municipality that was bailed-out, this was hopefully an extraordinary case with a criminal background.

¹⁷ More elements were involved, e.g. major local tax increases. See Indenrigsministeriet (2011).

¹⁸ The commission has its own permanent staff, own building facilities and own homepage: <http://www.farumkommissionen.dk/farumsubject.aspx?type=farumsubject&id=71200>. The costs up to now of the work of the commissions amount to 53,4 mio. DKK, cf. Farum-Kommissionen (2011).

¹⁹ The mayor received a prison sentence of the duration of two times two years.

One of the important reasons for the success of the “put under administration” procedure may be the embarrassment or “stigmatisation”-effects of the arrangement for the local politicians. So even though the processes are rather centralistic since they intervene into local decisions their effects work their way through the local environment. That, it is argued, confirms that in the end local responsibility is a decisive factor for having healthy local finances.

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