

# **Local government financial equalisation in Sweden**

**Yearly fluctuations in the cost equalisation and budget stability for the municipalities in Sweden**

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**September 2007**

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### **Yearly fluctuations in the cost equalisation and budget stability for the municipalities in Sweden**

The cost equalisation for the Swedish municipalities, used since 1996, is built up of some 10 distinct models. The different models refer to services like child care, elderly care and compulsory school etc. Many of the factors on which the equalisation is based are updated annually. The age structure and the factors that reflect the municipalities socio-economic structure are thus updated annually. It is perfectly natural that this updating leads to a variation in the result of cost equalisation for the individual municipality from year to year. The yearly variations can be large for municipalities with a low population making budgeting difficult. There is a conflict between stability and changes in the cost equalisation reflecting changes in expenditure needs. However the largest changes has happened when the system has been followed up which has happened every 4-5 years. This paper concentrate on the equalisation for municipalities but the system for the county councils is partly shortly described.

### **Why is local government equalisation necessary?**

Public expenditure in Sweden accounts for a high share of GDP and the scale of decentralisation of tasks to the 290 municipalities and the 20 county councils is substantial in international terms. Because municipalities and county councils account for the bulk of our welfare services by being responsible for schools, health care and other forms of care, local government expenditure accounts for a higher share of GDP than in any other country. At the same time, conditions vary greatly between local authorities and different parts of the country, as do conditions for fulfilling these tasks.

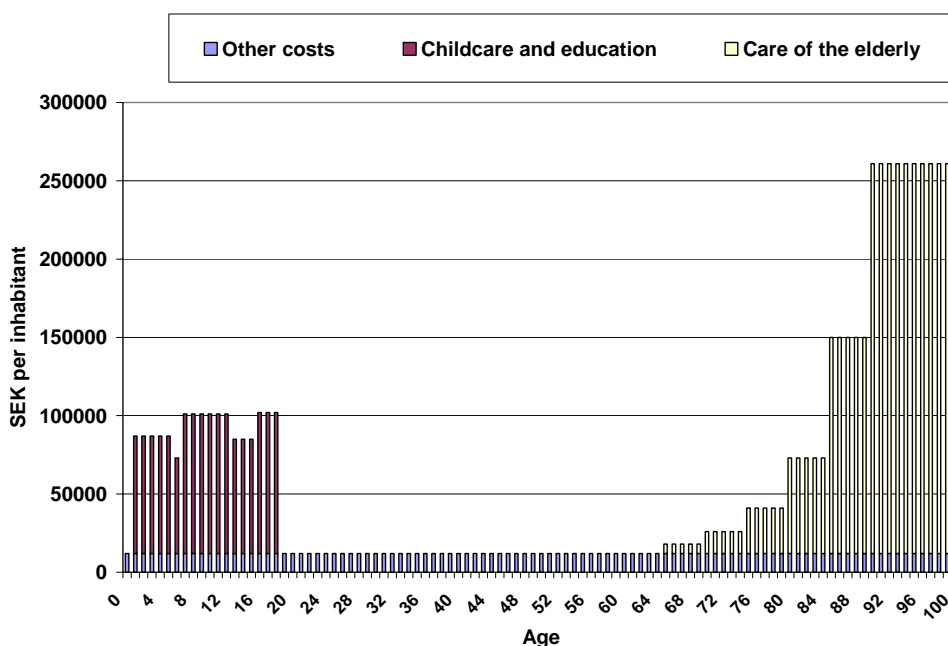
On average some 70 percent of municipal and county council costs for services are financed by local income tax. Only a small proportion of the revenues, 15 per cent on average including the equalisation grants, consists of central government grant. But local authorities differ in their ability to meet their tasks because there are major differences in taxable income per inhabitant (tax capacity) between municipalities and between county councils. This is due not only to differences in inhabitants' income from work but also to differences in employment levels and in the age structure of their population.

In 2005 the municipality in Sweden with highest tax capacity amounted to 174 per cent of the national average tax capacity (corresponding to an average taxable income of almost SEK 267 000 for inhabitants). The municipality with lowest tax capacity amounted to just under 79 per cent of average tax capacity (SEK 121 000 per inhabitant). Without an equalisation of tax capacity the inhabitants of a low income municipality would need to pay 26 per cent of their income in municipal tax, while people living in a high income municipality would only need to pay 12 per cent in municipal tax to give the two municipalities the same tax revenue per inhabitant as the national average.

This is an arithmetical example, but the difference in municipal and county council tax between residents of a low income municipality and a high income municipality would be almost 17 per cent of income or approaching SEK 26 000 for a middle income earner in the two municipalities.

In addition, on account of differences in the need for local government services, partly due to differences in population age structure, the cost differences between local authorities for delivering an equivalent level of services to inhabitants may be considerable.

**Figure 1 The average municipality cost per year for persons in different ages**



The costs of elderly care in the municipality, which has the lowest proportion of elderly in the country, has been calculated in cost equalisation as some SEK 3 000 per municipal inhabitant. In the municipalities, which have the highest proportion of elderly, these costs have been calculated as almost SEK 17 000 per municipal inhabitant. This difference corresponds to 9 per cent of municipal tax, based on the national average tax base per inhabitant. Without equalisation, a rural municipality with lots of elderly people in need of care would have difficulty in providing elderly care unless it levied a very high municipal tax.

In Sweden there has long been broad political agreement about the idea that people should have equal access to welfare, no matter where in Sweden they live. Both these examples point to the need for financial equalisation both for tax revenue and for structural cost differences in order to put municipalities and county councils on an equal financial footing for the conduct of their activities. The redistribution of resources that takes place in the equalisation system makes it possible to establish more equal conditions for the provision of welfare services.

### **Different systems for equalisation over the years**

For most of the 20th century municipalities and county councils have received some form of state grant in order to equalise for the differences in their financial situation. However, an equalisation system in the proper sense of term was

introduced in 1966. The system consists of two parts: income equalisation along with a separate equalisation grant to municipalities and county councils with high tax rates or a reduced grant for municipalities and county councils with low tax rates. There were a number of specific grants alongside the equalisation system. The main features of this system were to remain in force until the end of 1992, even though the system was modified on a number of occasions.

### **The 1993 reform of local government finances**

In 1993 an extensive reform was made of the systems of central government grants. Several specific government grants were replaced by a general grant, i.e. "all the money in one pot." The new equalisation system for municipalities consisted of three parts: income equalisation, cost equalisation and a supplement for municipalities with a large population decrease. However, criticism was directed at the cost equalisation component in particular and a new inquiry was therefore appointed to review it. An additional problem was municipalities with a very high tax capacity level fell outside the grant system. The government grant could not therefore be used for general financial adjustments between the State and municipalities.

### **1996 – a new government grant and equalisation system**

The 1996 government grant and equalisation system consisted of four parts: income equalisation, cost equalisation, a general government grant and transitional regulations. Unlike previous systems, all municipalities and county councils were now included. Equalisation was now also neutral in terms of central government finances, as both income and cost equalisation were financed by municipalities and county councils – both equalisations now became horizontal. Municipalities and county councils with a tax capacity below and/or structural costs above the average level received grants while other municipalities and county councils had to pay a charge. In principle the national total of charges was equal to the total amount of the grants.

Cost equalisation was designed according to the same principles in both the municipal and county council sectors. The method is called the standard cost method. It means that cost equalisation is built up of a number of models calculated using various factors (table 3). The various models refer either to specific services or to costs found in most services.

### **2000 – Reviews of the 1996 system**

From 2000 certain changes were made in the cost equalisation component of the system.

### **2005 – New changes**

A new system of local government financial equalisation was introduced in Sweden on 1 January 2005. It has the same purpose as the previous system: to put all municipalities and county councils in the country on an equal financial footing to deliver equivalent levels of services to their residents irrespective of the income of local authority residents and other structural factors. The intention

is for differences in local tax rates to basically reflect differences in efficiency and in levels of services and charges and not to be due to differences in structural conditions. The equalisation system consists since 2005 of five separate parts, income equalisation, cost equalisation, structural grant, transitional grant and adjustment grant/charge

Table 1 shows the total of the grants and charges included in the new system of local government financial equalisation and the total volume of the system in 2007.

**Table 1 Local government tax equalisation  
Calculations for 2007, SEK billion**

	<b>Municipalities</b>	<b>County councils</b>	<b>Total</b>
Income equalisation grant	48.1	15.8	63.9
Income equalisation charge	-3.3	-2.0	-5.2
Cost equalisation grant	4.9	1.2	6.0
Cost equalisation charge	-4.9	-1.2	-6.0
Structural grant	1.5	0.7	2.2
Transitional grant	0.5	0.2	0.7
Total	46.8	14.7	58.7
Adjustment grant	8.3	0.9	9.3
<b>Total</b>	<b>55.2</b>	<b>15.7</b>	<b>70.8</b>

The Swedish Tax Agency, which collects local tax revenue, administers the various grants and charges when it pays on local government tax revenue. The Tax Agency adjusts the tax revenue for any grants or charges.

## **2008 – New changes again**

From 2008 some new changes in the cost equalisation will be introduced. A new component from 2008 is structural differences in wage levels between municipals and between county councils.

The central government has proposed that a new parliamentary committee will start to look over all parts of the equalisation system with start in January 2008.

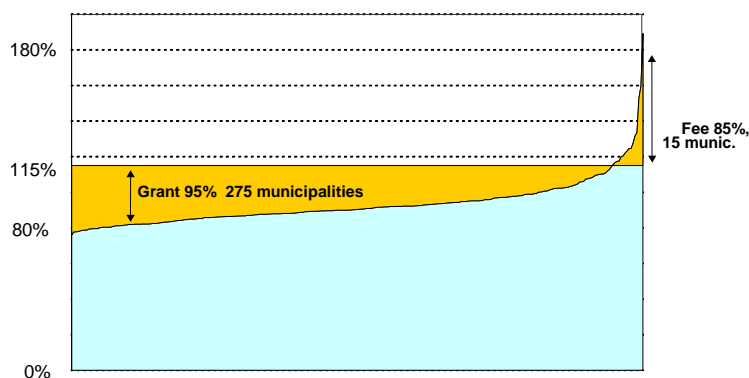
# New system for local government financial equalisation 2005

## Income equalisation

Income equalisation results in an equalisation of tax revenue between municipalities and between county councils. One fundamental difference compared with the previous system is that horizontal income equalisation between local authorities has been replaced by a mainly state-financed (vertical) income equalisation grant. The general central government per capita grant to municipalities and county councils was terminated at the same time.

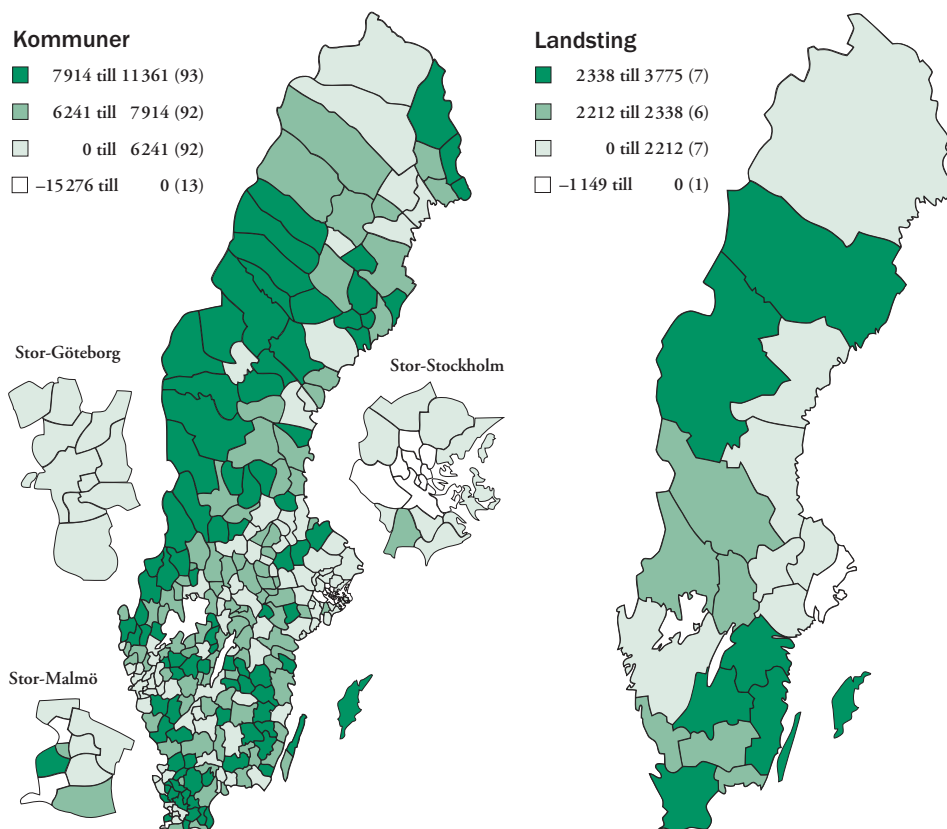
The income equalisation grant is calculated on the basis of difference between the local authority's own taxable income and a tax equalisation base that corresponds to 115 per cent of the national average tax capacity per capita for municipalities and 110 per cent for county councils. Municipalities and county councils whose taxable income exceeds these levels have to pay an income equalisation charge to central government instead.

**Figure 2 Income equalisation 2005, grant level and municipalities tax capacity per capita. Average tax capacity = 100 %**



For grant-entitled municipalities grant is calculated on the basis of 95 per cent of the national average tax rate in 2003 and for grant-entitled county councils that calculation is based on 90 per cent of national average tax rate in the same year. For municipalities and county councils that are liable to pay a charge that charge is calculated on the basis of 85 per cent of average tax rate instead. When tax rates (the county-level tax rate) are fixed in the calculation of grants and charges, account must also be taken of differences in tax shifts between municipalities and county councils in each county as a result of changes of responsibilities from and including 1991.

**Figure 3 Income equalisation 2005. SEK per inhabitant (kommuner=municipalities, landsting=county councils)**



### What local authorities get grants and what local authorities pay?

The main charge-payers are suburban municipalities in Stockholm County. Stockholm Municipality is the only one of the three metropolitan cities to pay a charge. Rural municipalities and other small municipalities receive the largest grants per inhabitant. In the income equalisation system for county councils only Stockholm County Council pays a charge in 2005. County councils in the rest of the county receive a grant.

## Cost equalisation

Cost equalisation evens out structural cost differences. These can be of two kinds. One is that the need for local authority services varies: for example, municipalities with a high proportion of old residents have a greater need of elderly care. The other is that the cost of producing a particular service varies: for example, schools can cost more in rural municipalities as teaching there may require smaller classes and the pupils more often need school transport.

Municipalities and county councils with an unfavourable cost structure receive a grant from the State, as they did in the previous system. Those that have a favourable structure pay a charge to the State. Cost equalisation is still neutral in terms of central government finances, as the total grants and charges are equal in size and therefore cancel one another out.

Cost equalisation equalises for costs that the local authority cannot itself influence. Measurable and objective factors are used to calculate a structural measure of the differences in conditions and needs.

One basic principle is to only equalise for structural differences that can arise in services that are mandatory for municipalities and county councils. In addition, cost equalisation is only to apply to cost and need differences in local authority activities and not to differences in inhabitants' private consumption, such as high housing costs.

Cost equalisation is designed according to the same principles in both the municipal and the county council sector. The method is called the standard cost method. It means that cost equalisation is built up of a number of distinct models. The different models refer to services like childcare or elderly care.

The service-based structure of cost equalisation has both advantages and disadvantages. By treating each area separately it is possible to capture the very different conditions that apply to different services. It is also possible to adjust cost equalisation when the services change.

The main disadvantage is that this equalisation is extensive with a large number of factors and separate models. On the other hand, a simpler system risks missing certain structural costs, resulting in a less fair system. So the design of cost equalisation is a balance between simplicity and fairness.

For municipalities nine services are included in equalisation, while for county councils one service – health and medical care – is covered. There is also one service with shared responsibility, namely public transport.

Differences in standard cost are intended to reflect structural cost differences, i.e. costs that municipalities and county councils cannot themselves control. The different services and variables in each model are set out in table 3.

### **What does cost equalisation cover?**

As mentioned above, cost equalisation equalises for differences due to age structure, ethnicity, socio-economic conditions and geography. The model for each service uses factors that explain the extra structural costs associated with that particular service. Table 2 shows what categories of extra costs the system provides compensation for in each model.



**Table 2 Structural extra costs by category**

Service	Age	Ethnicity	Socio-economic conditions	Geography
<b>Municipalities</b>				
Pre-school services and out-of-school care	•		•	•
Compulsory school and pre-school classes	•	•		•
Upper secondary school	•		•	•
Care of the elderly	•	•	•	•
Individual and family care	(•)	•	•	•
Children with a foreign background	(•)	•		
Population change	(•)			
Settlement structure				•
<b>County councils</b>				
Health and medical care	•		•	•
<b>Joint service</b>				
Public transport				•

Note: (•) means that age is included as a factor but that it is not the primary objective of equalisation for that particular model.

### Services included in cost equalisation

The standard cost in the different models is obtained by multiplying the various variables by the national average cost for each service. The standard cost for compulsory school is obtained by multiplying the proportion of children of school age by the national average cost per pupil and by multiplying the proportion of pupils born outside Sweden, Norway and Denmark by the average cost for mother tongue instruction. Moreover, additional costs are calculated for small schools and school transports.

Cost equalisation does not and is not intended to take account of the actual costs of municipalities or county councils. The standard cost is the cost that the municipality or county council would have if it ran the service at an average cost level, taking account of its own structural factors under cost equalisation.

**Table 3 Models in cost equalisation for municipalities and county councils**

<b>Service</b>	<b>Structural factors</b>
<b>Municipalities</b>	
Pre-school services and out-of-school care	Age structure, parents' activity rate, tax capacity and population density.
Compulsory school and pre-school classes	Age structure, children with a foreign background, rural area.
Upper secondary school	Age structure, programme choice, settlement structure
Care of the elderly	Age structure, sex distribution, professional background, civil status, non-Nordic background and rural area.
Individual and family care	<ul style="list-style-type: none"> <li>• Refugees born abroad and close relatives, other people born abroad from countries outside the Nordic region and the EU, unemployed people without benefit, single women with children, proportion of men with low incomes and settlement density.</li> </ul>
	<ul style="list-style-type: none"> <li>• Children of lone parents, young people prosecuted, children with a foreign background and local authority population.</li> </ul>
Children with a foreign background	Children aged 0-19 years with a foreign background.
Population change	<ul style="list-style-type: none"> <li>• Population reduction &gt; 2% in the past 10 years.</li> </ul>
	<ul style="list-style-type: none"> <li>• Change (positive and negative) in the number of school pupils.</li> </ul>
	<ul style="list-style-type: none"> <li>• Compensation for revenue delay in event of population increase.</li> </ul>
Settlement structure	<ul style="list-style-type: none"> <li>• Heating</li> </ul>
	<ul style="list-style-type: none"> <li>• Streets and roads</li> </ul>
	<ul style="list-style-type: none"> <li>• Building costs</li> </ul>
	<ul style="list-style-type: none"> <li>• Rural-specific extra costs for administration, travel and rescue services</li> </ul>
<b>County councils</b>	
Health and medical care	Care-demanding groups, sex, age, civil status, employment status, income and type of housing. Supplement for rural areas.
<b>Joint service</b>	
Public transport	Sparseness, work commuting and urban structure.

The use of the national average cost means that equalisation is carried out to the average service level, quality, charge level and efficiency. If a municipality or county council has higher costs because it provides a higher than average service level this must be financed through higher taxes, more efficient services or a higher level of charge-financing. In the case of lower costs, the opposite is true. No local authority is "punished" or "favoured" because it has a cost level that differs from the average cost level.

Table 4 shows that more than 85 percent of the standard costs refer to services that are very dependent to the age structure of the municipality.

**Table 4 Standard cost in cost equalisation SEK per inhabitant municipalities in the models used in cost equalisation 2007**

Model	Standard cost in SEK per inhabitant	
	Average	Percent of total
Child care	4903	17,1
Compulsory school	8640	30,1
Upper secondary school	3345	11,7
Individual and family care	2927	10,2
Children with a foreign background	80	0,3
Care of the elderly	7958	27,7
Population change	158	0,5
Settlement structure	173	0,6
Public transport	526	1,8
<b>Total</b>	<b>28713</b>	<b>100</b>

The equalisation system for municipalities has contained a compensation for population reduction for several decades. The purpose has been to compensate the municipalities for fixed capital costs that not can be reduced in the same rate as the reduction of inhabitants and revenues. Another reason for the compensation is the pension liabilities that will be more expensive per capita with a reduced population in the future. The municipalities are compensated when the population reduction in the last 10 years has been over 2 %.

Municipalities are also compensated for rapid changes (positive and negative) in the number of school pupils. Municipalities with a rapid population increase are since 2005 (and county councils since 2006) compensated within the equalisation system for revenue delay.

Some parts of the cost equalisation are partly based on the number of inhabitants (Rural-specific extra costs for administration, travel and rescue services). Other parts of the cost equalisation are based on population density (inhabitants/squarekm or other types of settlement densities). In the calculation of standard costs for the following services rural areas or other types of settlement densities are included: Pre-school services, Compulsory school, Upper secondary school, Individual and family care, Health and medical care (county councils) and Public transport (municipalities and county councils). A special structural grant is partly calculated from the number of inhabitants and population density.

### **Calculation of grant or charge in cost equalisation**

The total of the standard costs for all the models is called the municipality's or county council's structural cost. If the structural cost is above the national average, the municipality or county council receives a grant corresponding to the difference to the average. The municipality or county council is regarded as having an unfavourable structure in relation to other municipalities or county

councils respectively. Table 5 show the highest and lowest structural costs in 2007.

**Table 5 The highest and lowest municipal structural cost and the grant/charge in 2007. SEK per municipal inhabitant**

	Municipality	Grant/charge
Max.	38 835	10 122
Min.	24 872	-3 841
<b>Average</b>	<b>28 713</b>	<b>0</b>

Table 6 shows the differences in standard costs among the different models. The largest difference occur in the model for care of the elderly, almost 14 000 SEK per municipal inhabitant. For compulsory school, child care and individual and family care the differences are around 6 600, 5 700 and 4 100 SEK respectively.

**Table 6 Differences in standard costs for municipalities in the models used in cost equalisation. SEK per inhabitant 2007**

Model	Standard cost in cost equalisation SEK per inhabitant			
	Average	Minimum	Maximum	Difference
Child care	4903	2713	8403	5690
Compulsory school	8640	5070	11676	6606
Upper secondary school	3345	1746	5135	3387
Individual and family care	2927	1046	5133	4087
Children with a foreign background	80	0	799	799
Care of the elderly	7958	3018	16872	13844
Population change	158	0	1666	1666
Settlement structure	173	-140	1966	2106
Public transport	526	0	1035	1035
<b>Total</b>	<b>28713</b>	<b>24872</b>	<b>38835</b>	<b>13963</b>

If the structural cost is below the national average the municipality or county council is regarded as having a favourable structure in relation to other municipalities or county councils respectively and therefore pays a charge in the corresponding way.

### How much is redistributed?

The size of the redistribution in the various models depends both on the cost of the service concerned and the scale of the structural differences. Elderly care is the municipal service that costs most, and most money is also redistributed in that model. Individual and family care costs less than half as much as elderly care. However, in this area there are major structural differences that push up the amount redistributed in the model. The sum total of the redistribution made in the various models exceeds the total redistribution in cost equalisation. This is because a municipality can receive a supplement in one model at the same time as the municipality has a deduction in another model. No municipality receives supplements in every model. A few municipalities have a deduction in every

model. Each model is self-financed – that is to say that the supplements and deductions cancel one another out.

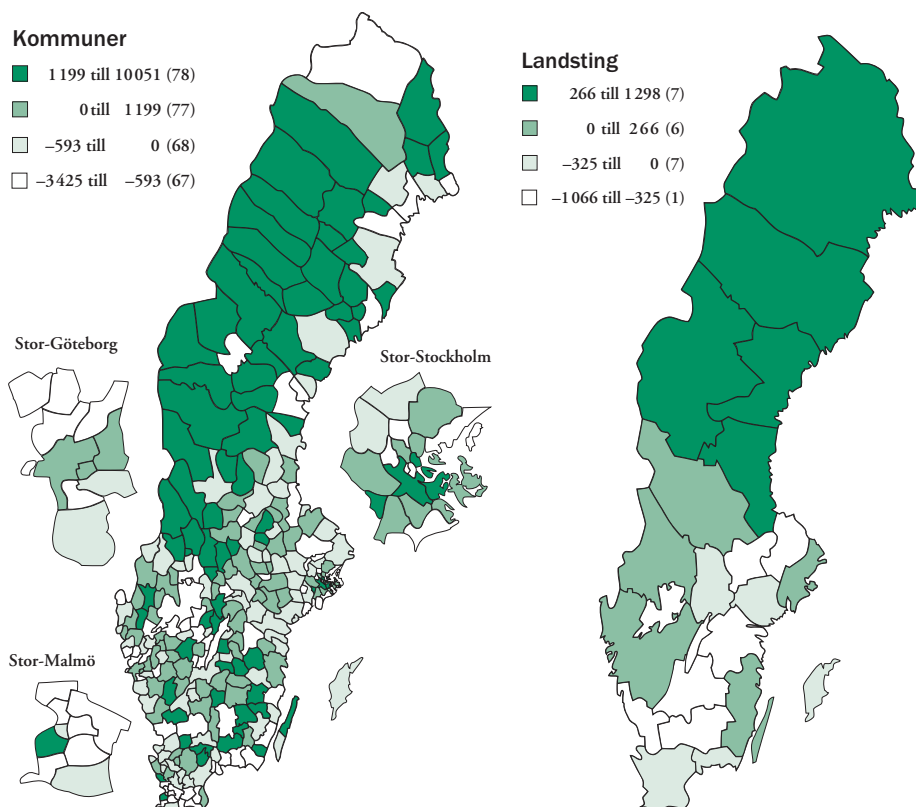
**Table 7 Redistribution and number of grant and charge municipalities in the models used in cost equalisation**

Model	SEK bn	Number of municipalities with	
		supplement	deduction
Children with a foreign background	0.45	25	265
Public transport	0.90	58	232
Population change	0.96	153	137
Settlement structure	1.31	86	204
Upper secondary school	1.62	239	51
Child care	3.37	57	233
Compulsory school	3.76	215	75
Individual and family care	4.01	31	257
Care of the elderly	6.16	205	85
<b>Net total</b>	<b>4.70</b>	<b>159</b>	<b>131</b>

### **What authorities pay and what authorities receive grants?**

In simple terms, a redistribution takes place in cost equalisation from southern Sweden (excluding the Stockholm region) to the north of the country. In northern Sweden the main recipients of major grants are rural municipalities in the interior and other small municipalities, while municipalities along the coast receive much less grant or pay a charge to cost equalisation. In southern Sweden it is mostly major cities and suburban municipalities that pay a charge. In some parts of southeast Götaland there are municipalities that receive substantial grants. In the Stockholm region, Stockholm Municipality and certain suburban municipalities with social problems are grant recipients.

**Figure 4 Cost equalisation 2005. SEK per inhabitant . SEK per inhabitant (kommuner=municipalities, landsting=county councils)**



### Structural grant

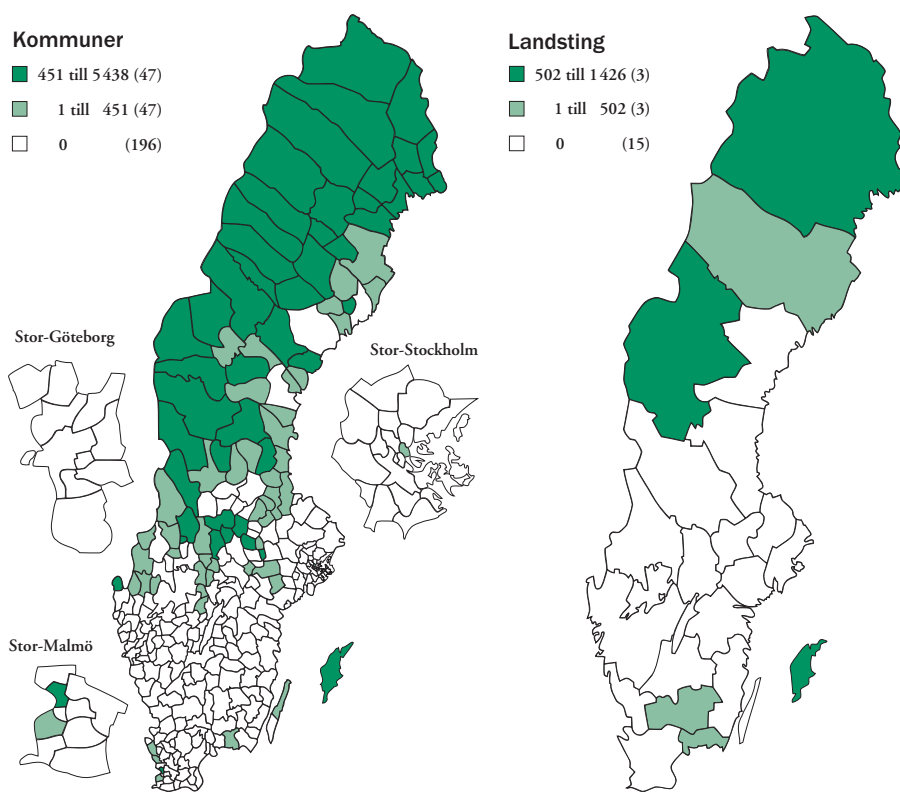
Structural grant consist of the parts of the previous equalisation system that have to do with regional policy and that are no longer to be included in cost equalisation. Structural grant has therefore been removed from cost equalisation and is intended to reinforce municipalities and county councils with a small population and/or labour market problems. This means that structural grant is not paid to all municipalities and county councils but is only paid to the local authorities that previously received supplements under certain models used in calculation of cost equalisation and/or have experienced major revenue decreases as a result of the change of system.

The grant is based on three factors. These are, first, the previous standard costs for business and employment promotion and for a weak population base that were included in cost equalisation up to and including 2004 and, second, compensation to municipalities and county councils whose revenue loss exceeded a set level due to changes in the equalisation system from 2005. Municipalities whose grant reduction exceeds 0.56 per cent of their own tax base receive a structural grant corresponding to the excess. The corresponding figure for county councils is 0.28 per cent. For municipalities and county councils with an average tax base per inhabitant this grant corresponds to some SEK 850 and SEK 425 per inhabitant respectively.

Structural grant is paid to 94 municipalities and 6 county councils. The grant is paid annually without any predetermined time limit and mainly goes to municipalities in the forest counties in Central and Northern Sweden, but also to municipalities in other parts of the country with weak employment, including

Malmö. The three northernmost county councils and three county councils (including Gotland Municipality) with small populations in Götaland also receive structural grant.

**Figure 5 Structural grant 2005. SEK per inhabitant (kommuner=municipalities, landsting=county councils)**



### Transitional grant

The new system results in major changes in revenue for many municipalities and some county councils. A special transitional grant is payable during the period 2005-2010 to moderate the redistributive effects for the authorities that have experienced revenue decreases. This grant spreads the negative revenue change due to the system over several years.

The municipalities and county councils that lose out in the new system are compensated through a transitional grant over a period of six years. This gives municipalities and county councils with negative changes a certain amount of time to adjust their costs if the reduction exceeds a particular level. The grant means that the annual income reduction must not be larger than 0.08 per cent of own tax base (or some SEK 120 per inhabitant) for municipalities and 0.04 per cent for county councils (some SEK 60 per inhabitant).

### Adjustment grant and adjustment charge

An adjustment grant and an adjustment charge have been introduced in order to ensure that the state grant is not affected by the level set in income equalisation and to ensure at the same time that central government has control over the total cost of the equalisation system. It must also be possible to regulate changes of responsibility between the local government sector and the State. These will also

be used for financial adjustments between central government and the local government sector, for example when the local government financing principle is used to compensate municipalities and county councils for increased costs due to new duties imposed on them by the State.

In the new government-financed income equalisation system costs for the income equalisation grant will increase in line with the growth of the local government tax base. This means that the State cannot know in advance what the final total amount will be. In view of the need to be able to influence the macroeconomic scope for the local government sector and also central government finances it should be possible to influence the total grant frame for municipalities and county councils.

The way this works is that if the sum of all grants minus all charges paid in is less than the amount that the State has decided to transfer to municipalities or county councils, then all municipalities or county councils receive an adjustment grant corresponding to the difference. The adjustment grant is paid as a uniform amount per inhabitant. If, instead, the sum of all grants minus all charges paid in is higher than the amount that central government has decided to transfer, then the difference has to be recovered through an adjustment charge on all municipalities and county councils, calculated in the same way as the adjustment grant. This enables the Riksdag to decide how much finance is to be allocated to municipalities and county councils.

### **Total outcome of the equalisation system**

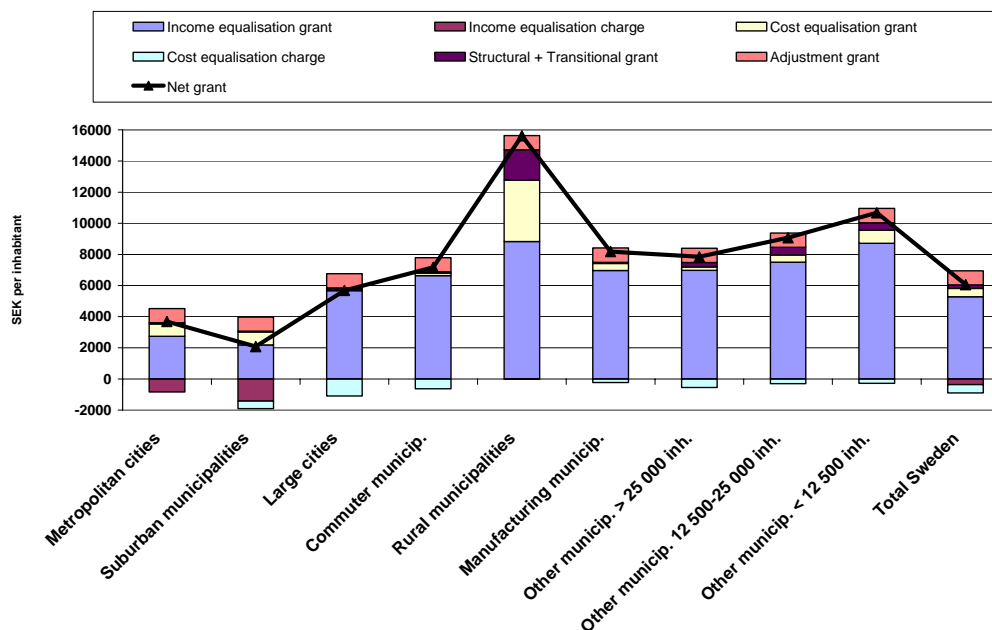
The total outcome of the equalisation system for the different municipality groups are shown in figure 6. Income equalisation charges are only paid by one (Stockholm) of the three metropolitan cities and some suburban municipalities.

Rural municipalities are the largest receivers of cost equalisation grants and structural grants.

For some rural municipalities with a very low population density, especially in Norrland, these parts of the cost equalisation is very important. Some municipalities become more than 1 500 SEK per inhabitant extra for population reduction, up to 1 900 SEK per inhabitant extra for the settlement structure, up to 2 300 SEK per inhabitant extra for low population density, up to 2 000 SEK per inhabitant extra for compulsory school in rural areas, up to 400 SEK per inhabitant extra for upper secondary school in rural areas up to 1 500 SEK per inhabitant extra for care of elderly in rural areas. That is more than 9 000 SEK per inhabitant extra for low population density.



**Figure 6 Total outcome of the equalisation system for municipalities in 2007 SEK per inhabitant per municipality group**



The metropolitan cities and some suburban municipalities receivers of cost equalisation grants. Larger cities are pay the highest cost equalisation charges. The adjustment grant has an identical level for all municipalities.

### Redistribution of grants and charges when the system is changed

When the system has been followed up and changed every 4-5 years there has been a redistribution of grants and charges between the municipalities and between the county councils.

In 1996 the municipal redistribution was from - 6 400 to + 2 400 SEK per inhabitant. 10 percent of the municipalities lost 2 000 SEK per inhabitant or more and 25 percent lost more than 1 000 SEK per inhabitant. This problem was partly solved with transitional grants for the losers and transitional charges for the winners. The reduction of the transitional grants was 250 SEK per year and inhabitant except the effects of the annual update of the cost equalisation. The transitional period therefore was very long. When certain changes were made in the cost equalisation component of the system from year 2000 still 25 percent of the municipalities had transitional grants from the former system.

In 2000 the changes of the cost equalisation system resulted in a new redistribution from - 1 350 to + 1 800 SEK per inhabitant. Even this change was solved with new transitional grants for the losers and transitional charges for the winners. The rest parts of the earlier transitional system was included in the new transitional rules and the reduction of the transitional grants was now 200 SEK per year and inhabitant.

The changes in the equalisation system in 2005 resulted in further new redistributions from - 3 800 to + 1 100 SEK per inhabitant including rest parts of old transitional grant from earlier system. A negative change exceeding 0,56 percent of the tax capacity (850 SEK per inhabitant in average) was put into a new structural grant. The rest of the negative change was partly solved with a

transitional grant with an yearly reduction of 0,08 percent of the tax capacity (120 SEK per inhabitant in average).

## **Annual update of cost equalisation**

In order for cost equalisation to take account of conditions in the individual municipality and county council each year, many of the factors on which this equalisation is based are updated annually. For municipalities this mainly applies to age structure and the factors that reflect the municipality's socio-economic structure. For county councils it applies to the factors that govern the outcome of the model for health and medical care. It is perfectly natural that updating certain models leads to a variation in the result of cost equalisation for the individual municipality/county council from year to year. As both grants and charges vary from year to year, the sum that is redistributed also varies.

### **Do more children, young people and elderly give more money?**

It is important to observe that grants or charges in the various models in cost equalisation depend on the municipality's or county council's relative structure in relation to the country as a whole, i.e. the difference between its own structure and the national average. This means that it is not certain that a municipality in which the number of young people is increasing will receive more money in cost equalisation. Let us use an example to illustrate this.

Suppose that a municipality has a higher proportion of young people aged 7-15 years than the country as a whole. The municipality is therefore deemed to have an unfavourable structure in cost terms and, as a result, receives a supplement in the model for compulsory school. If, over time, the proportion of young people in the municipality increases as much as in the country as a whole, the difference will remain unchanged. So the supplement for compulsory school will not be altered. In this case the municipality's cost increase is deemed to be the same as for the country as a whole.

The fact that a municipality gets more children, young people and elderly does not guarantee the municipality a higher grant in the way that the former specific grants did. Cost equalisation is an equalisation system, not a grant system. The important thing in terms of equalisation is how much the municipality's age structure deviates from the national average age structure.

So there is no direct link between the trend in the number of pupils or older people, for example, and central government grant to municipalities and county councils. Any additional funding for municipalities and county councils is provided when the Riksdag and the Government decide to increase the appropriation for municipalities and county councils in the central government budget. The result of this decision is seen as an adjustment item. If municipal or county council costs change because the State changes their duties, then compensation is provided through an adjustment.

## Effects of the annual update of cost equalisation

As shown above the changes in charges and grants when the system is changed every 4-5 years is solved with transitional grants. The yearly changes are rather moderate, 120-250 SEK per year and inhabitant, and they are initially known for the following years.

In order for cost equalisation to take account of conditions in the individual municipality and county council each year, many of the factors on which this equalisation is based are updated annually. For municipalities this mainly applies to age structure and the factors that reflect the municipality's socio-economic structure. For county councils it applies to the factors that govern the outcome of the model for health and medical care. It is perfectly natural that updating certain models leads to a variation in the result of cost equalisation for the individual municipality/county council from year to year. As both grants and charges vary from year to year, the sum that is redistributed also varies.

These yearly changes are not solved with transitional grants and for some municipalities the negative changes are much larger than the accepted changes in transitional grants. For about 25 percent of the municipalities the total negative changes between 2006 and 2007 exceed 200 SEK per inhabitant. At the same time the budget of the local authorities shall be drawn up in such a way that the income exceeds costs.

**Table 8 Changes in the cost equalisation 2006–2007. Number of municipalities and SEK per inhabitant**

Change in SEK per inhabitant	Model				
	Child care	Compulsory school	Upper secondary school	Care of the elderly	Net Total
Max	623	358	532	687	1041
Min	-629	-538	-498	-458	-1262
Min, % of average cost	-12,8	-6,2	-14,9	-5,8	-4,4
<-500	1	1	0	0	8
-400-499	1	4	1	3	8
-300-399	9	6	2	4	19
-200-299	46	12	12	5	35
-100-199	84	45	24	26	43
-1--+99	125	174	177	145	97
100-199	17	31	51	59	29
200-299	6	14	15	24	20
300-399	7	3	5	14	13
400-499	1	0	2	6	8
>500	3	0	1	4	10

The yearly variations can be large especially for municipalities with a low population making budgeting difficult. There is a conflict between stability and changes in the cost equalisation reflecting changes in expenditure needs. Some municipalities have asked for some kind of transitional grant to compensate for larger negative changes. But these changes reflect changes in the municipalities' needs and the costs for the services.

One problem is that the municipalities become the result of preliminary calculations of grants and charges for the next year first in October. Most municipalities take the budget decision for the next year before the summer. The complexity of the cost equalisation system makes it difficult to calculate the effects in the cost equalisation of changes in the municipalities' age structure. Some 70 percent of the municipalities' costs are financed by local income tax. The changes in the average tax capacity must be calculated with forecasts. One percent lower growth in the tax capacity means about 350 SEK per inhabitant in income from local tax and income equalisation grant.

The budget problem must therefore be solved with improvements in the budget planning process. To partly solve the problem the Swedish Association of Local Authorities and Regions serve their members with calculations of the equalisation system before the summer. And if the municipality has good demographic forecasts for the coming years their organisation can support with calculations of the outcome of the equalisation even for the coming years.