

## Chapter 9 A summary, and four theses on state-local relationships

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Conditions in the municipal sector and the relationships between the state and the municipalities have been analysed in a number of different perspectives by the contributors to this book – economical, democratic, and legal. In this concluding chapter, we summarise some of the findings and present a handful of theses on state-local relationships. These theses to some extent draw upon the earlier chapters but are also based on the international literature.

### 9.1 By way of summary

In their closing discussion, Boadway and Johansson summarise a number of points that could possibly qualify for being included in the constitution. The first of these points serve to stress the common interest that national and local government are intended to serve: social justice and nationwide redistributive equity, equality of opportunity and the efficient functioning of the national economy. Second, the constitution could include a section outlining the responsibilities of local government, both exclusive and shared. There is also the problem of residual power, which according to the authors is most naturally assigned to the national level in unitary states. But no matter what is finally decided in these respects, there is a need for permanent re-interpretation, and disputes will never be fully eliminated.

Von Hagen and Dahlberg, in their detailed analysis of the bailout mechanism, conclude that a moral hazard mechanism is in fact at work, but that the main problem at least in Sweden seems to lie on the supply side. A tradition of high ambitions in welfare policy, ambiguity and discretion in dealing with local financial difficulties, and a strong commitment to macroeconomic stabilisation are all factors that favour bailouts. By contrast, the relatively high degree of financial autonomy at the local level reduces this risk. In an isolated bailout perspective, there is thus a strong case for a high degree of local autonomy. But the final division of powers, financial and other, of course needs to take other aspects into account as well.

Equalisation is a contentious issue. In countries where the state assigns a large number of costly tasks to the local level, some sort of equalisation of resources is necessary, either via explicit equalisation systems, or by state grants, or both. According to Chernick, the present design has its pros and cons. Equalisation acts as an insurance against economic shocks and reduces the incentives for potentially costly beggar-thy-neighbour policies, but it may also reduce the incentive for each municipality to stimulate economic growth, more specifically per-capita labour supply. At present, it is not possible to judge which of these effects dominates. Nonetheless, there may be reasons for considering alternative designs of the equalisation system.

Grants represent a carrot rather than a stick, but as Gillette points out in his chapter, the use of grants does not put an end to the discussion about state interventions and local autonomy. By tying more or less specific conditions to grants, the state may impose restrictions that are in reality as far-reaching as if they were imposed by legislation. Thus, even in an ideal world of positive stimuli, there is a need for some sort of mechanism for conflict resolution.

Mueller and Uddhammar draw attention to the fact that state-local issues are in fact a subset of a wider collection of problems pertaining to freedom and resource allocation in general in society. A strengthened federalist system requires both democratically elected governments at the local level, and a clear link in the citizens' eyes between the taxes that they pay and the services that they receive from government. Whether fees or taxes are chosen as sources of financing for public services affects the borderline between public and private, and therefore indirectly also the need for equalisation and state transfers. On the other hand, extensive use of fees as advocated by the authors calls for risk pooling via insurances or taxes and consequently leads to other design problems.

The creation of the European Union, as Olof Petersson stresses, has added another layer to an already complex structure of interdependencies. There is a need for a permanent development of mechanisms of accountability in order to counter the downside effects of this increasing complexity. But even so – and here several of the authors join in their conclusions – there is no “solution” that will eliminate the problems under investigation.

It is because of this absence of a definite solution that so many authors, irrespectively of their point of departure, reach the conclusion that there is need for an ongoing debate and that dispute solving has to be formalised. In order to assure some reasonable degree of rule of law, accountability and predictability, as much as possible of the division of powers should be specified in the constitution. But no lawmaker can foresee all situations that will emerge and all trade-offs between conflicting goals that will have to be made. This is why the constitution should also delineate a formal legal procedure for solving disputes between the various levels (see section 9.4).

## 9.2 On the functioning of the public sector

The literature on multi-level democracy is voluminous, and a large part of it is devoted to the search for a division of powers and responsibilities that is in some sense optimal. The *principle of subsidiarity* epitomises the idea that responsibility should be as far down the hierarchy as possible. The motives may be based on democracy theory, as in the European Charter of Self-Governance<sup>1</sup>, the treaty of the European Union or chapters 7 and 8 of this book, or largely economical, as when Brennan and Buchanan claim that low-level decisions lead to lower expenditure levels allegedly more in accordance with voter preferences<sup>2</sup>. Irrespectively of the motives put forward, there is an implicit hypothesis about a best solution.

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<sup>1</sup> European Council (1985).

<sup>2</sup> Brennan and Buchanan (1980).

A different hypothesis, presented by Scharpf<sup>3</sup>, is that it is precisely in the interaction between the various levels that problems arise. According to Scharpf, public decision-making functions less well both in Germany and in the European Union because the central level is dependent on lower level for its decisions and, further, that unanimity or almost full unanimity is required by the decision-making framework. The deadlocks that arise lead in Scharpf's view to irrational decisions and to institutional sclerosis that make institutional reforms impossible.

Hypotheses of this kind are of course neither comprehensive nor unambiguous. As is clear from the discussion in chapter 2, general principles seldom admit of clear-cut conclusions. Both the European Charter and the Amsterdam treaty have escape clauses from the principle of subsidiarity, implying that it often remains an open question what is in a concrete situation the solution to be preferred<sup>4</sup>. Further, the complete veto power that Scharpf assumes in his argument is seldom or never at hand. What is common to the two modes of explanation is that the functioning of the system is assumed to depend mainly the division of power and resources at the macro-level.

An alternative view would be that the functioning of the public sector is to a considerable extent decided at the level where the activity is located.

*Thesis no. 1: How well the public sector works at a certain level depends more by control and audit mechanisms at the level in question than by the general division of powers or the interaction between the levels. A basic requirement is that a reasonably clear division of responsibilities actually obtains.*

In order to justify this proposition, let us start from the essence of the democratic mission. Political decision-makers face the electorate in general elections and, more informally and with varying intensity, between elections. In order for the electorate to be able to judge how the task is handled during the election period, information about what is happening in the public sector is required – how various activities develop, if the total expenditure level is under control, if actual decisions are in line with political priorities, and if service production is efficient. In general terms, we know what is necessary for this to be accomplished – a well-functioning budget process, reliable accounts, autonomous audit, and, for the most complicated problems, resources for qualified evaluation and research. This is true whether activities are run at the municipal, state, or supranational level. *A certain division of powers cannot replace these basic requirements on control of activities and financial flows.*

For the sake of clarity it is necessary to underline the need for a clear definition of responsibilities as a basis for this process. In order for standard instruments of economic control (in a wide sense) to be efficient, a clearly defined task is necessary. This is far from a trivial requirement; many of the problems currently encountered in the public

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<sup>3</sup> Scharpf (1985).

<sup>4</sup> The European Charter has the formulation, "Allocation of responsibility to another authority should weigh up the extent and nature of the task and requirements of efficiency and economy"; the phrasing of the Amsterdam treaty is similar.

sector stem from unclear interfaces between the state on the one hand and municipality or county council on the other.

International experiences point in the same direction. For a number of years, a wave of decentralisation has swept across the administration in many countries. This process of decentralisation has both a geographic dimension – in the sense of devolution of power to regions and local governments – and within the central administration, by the creation of agencies. The experience from these experiments is mixed. As pointed out by Allen Schick<sup>5</sup>, new forms of governance based on contracts assume norms and modes of thinking that cannot be taken for granted in all environments. In a study of decentralisation of financial power in 78 countries, De Mello and Barenstein<sup>6</sup> show that the quality of governance (measured for instance by corruption indices or efficiency) does not correlate in any simple way with the degree of decentralisation. In fact the quality of governance tends to deteriorate when the revenue from local taxes pass a certain threshold, which the authors explain by the difficulties of maintaining accountability at the local level. Similar conclusions have been drawn from studies made at the initiative of the World Bank<sup>7</sup>. In addition, the ability of the state to live up to its responsibility for macroeconomic management can be undermined if financial policy at the local or regional level is not sufficiently disciplined<sup>8</sup>.

Against this background it is clear that a basic condition for successful decentralisation is that mechanisms quality control and financial control that are standard at the national level are maintained also the local level<sup>9</sup>. Concerning audit, there is room for substantial improvement in the municipal sector, but it must be stressed that the situation is highly variable<sup>10</sup>. Also the sources of revenue may be of importance. Empirical tax research indicates that the visibility may be of importance, and Rattsö's analysis of Norwegian municipalities indicate that a municipal property tax can lead to higher efficiency in local government<sup>11</sup>. A likely explanation is that capitalisation creates an incentive for local politicians to manage well. A stronger role for fees as a source of revenue, as argued in chapters 7 and 8 in this book, can be expected to have similar effects. Yet another mechanism that strengthens the position of the citizen in the encounter with local service producers is the possibility to choose among the producers of for instance child-care or care for the elderly<sup>12</sup>. The source of financing is of less importance in this context, given that it is the possibility to choose that is important.

What could be perceived as a counterexample to the thesis presented is the bailout problem analysed in chapter 3. The origin of this problem is precisely the interaction between two levels of the public hierarchy and the risk of irresponsible behaviour that

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<sup>5</sup> Schick (1998).

<sup>6</sup> De Mello and Barenstein (2001).

<sup>7</sup> See Kahkonen (2001) with further references.

<sup>8</sup> Ter-Minassian and Craig (1997).

<sup>9</sup> Molander (1999), Rattsö (2002).

<sup>10</sup> Lundin (1999), Cassel (2000).

<sup>11</sup> Rattsö (2002).

<sup>12</sup> See the report from the SNS economic Policy Group (2000) with further references.

goes with expectations on the state level. But it is important to notice in this context that bailout situations do not emerge automatically as soon as multilevel uncertainties of this kind prevail; the source of the problem is rather inadequate economic control at the lower level. As shown by von Hagen and Dahlberg, it is not the poorest municipalities that run the greatest risk of failing. The main antidote against bailouts is by consequence improvement of the control function, and the responsibility of the state in this context is to maintain and develop the regulatory framework.

Economic control mechanisms in a narrow sense are of course not the only ones that are important. Democratic, legal, and mass media routines and institutions are needless to say of vital importance to the functioning of the public sector.

Summarising, the search for the final ideal division of powers and responsibilities between the various levels of the public sector appears somewhat misdirected. The development and systematic strengthening of mechanisms of economic control must be pursued, irrespectively of the division of responsibilities chosen. This is not to say that the basic division of powers is uninteresting; there are obviously highly unpractical solutions to be avoided. But within the spectrum of reasonable divisions of responsibilities, the success of the democratic system to a considerable extent is determined by other factors than precisely which activities have been assigned to one or the other level.

### 9.3 On state responsibilities

In order for the public sector to function properly a comprehensive regulatory framework is required. Further, a continuous flow of information is necessary – information about activities, quality, finances – and part of the regulatory framework is devoted precisely to specifying the requirements on this flow of information. Only the state can in the final instance assume responsibility for maintaining and developing this framework.

*Thesis no. 2: The state is responsible for maintaining and developing the regulatory framework for municipal activities necessary for their proper functioning. The requirements on the local government budget process should be strengthened.*

In the context of fundamental human rights guaranteed by the Swedish constitution, the above proposition is not an issue, not even in federal states with far-reaching autonomy for its member states. At a more down-to-earth level, the Swedish law on local government stipulates the conditions for local government activities concerning mandates, administration, the basics of the budget process and a range of other aspects. Sector legislation likewise regulates conditions for the activities that municipalities and county councils are responsible for. This is quite natural, just as private-sector activities, by definition autonomous, must conform to general requirements such as formulated in corporate law, legislation on working conditions, etc.

There is similarly a strong case for state as regulator of the requirements on information about local government conditions. Information is obviously a key resource in the principal-agent relationship that citizens and decision-makers are involved in. Information is collective good, not only in the municipality that it concerns directly but also more generally when aggregated with information about other municipalities, as a basis for comparison between different solutions or more qualified evaluation efforts. The Council for Municipal Analyses and Comparisons, created by the Swedish parliament in 2002, illustrates the collective nature of this sort of information, and how the coordination problem can be handled.

It is sometimes claimed that nationally regulated requirements on information about local government would imply a threat to local autonomy. This seems hard to defend, given that collection and aggregation of information falls well within the boundaries suggested by the European Charter of what can be justified in order to secure efficiency<sup>13</sup>. Nor is it an argument that the information about a municipality concerns only the members of that municipality. Such an argument presumes that each and every municipality be self-sufficient concerning knowledge about the partly very complicated issues that public-sector governance gives rise to. The typical (median) Swedish municipality has a population of about 16.000 inhabitants and cannot be assumed to possess all the expertise needed to maintain the control mechanisms necessary for quality and efficiency requirements to be satisfied.

Another objection sometimes heard – and one that to some extent runs counter to the previous one – is that information about the various activities can only be understood by representatives of the profession involved. Thus, statistical information about educational results could only be understood by people with pedagogical training. Within the health care system, certain clinics may specialise in difficult cases, something that would bias the statistical record. But this does not appear to be a legitimate objection. One could for instance compare with another security-related activity such as the mandatory regular motor vehicle inspection. The state-owned company in charge of this service publishes annual data from these tests, with detailed information about the results for various car brands. Also in this case it is reasonable to imagine that certain types of cars are owned and run by persons with typical manners of driving that bias the result, but this is something that the manufacturers have to live with, and it is certainly not considered as an argument for handing over the responsibility for the inspections to the manufacturers, including the right to decide what results should be published.

The Association of Local Authorities and the Federation of County Councils have for a number of years been involved in developing key indicators for the activities that their members are responsible for. As mentioned above, a new agency was created in 2002 with the task of coordinating the work on data bases, standardisation etc.<sup>14</sup> It is important that this work takes into account not only the interests of the producers but above all defends the perspective of the citizens. A national, comprehensive database

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<sup>13</sup> ”requirements on efficiency and economy”.

<sup>14</sup> Ds 2000:48, SOU 2001:75, Dir. 2002:91.

has the potential of becoming a powerful instrument for quality and efficiency control in the local government sector.

The financial area is of course central; the bailout problematique is, as was shown in chapter 3, a most real one. In a country with a well-developed welfare state it is difficult to imagine that the state would *not* intervene if a municipality finds itself in a financial quandary. Even if the state support that has been granted in recent years has to some extent been coupled to tangible restrictions on the municipal administrations involved, there is no guarantee against the repetition of the same patterns of behaviour in the future. That the financial well-being of every municipality is carefully monitored can only be seen as a necessary component of the implicit insurance relationship that exists between the state and the local government sector.

In the local government act the state formulates some basic requirements on both the budget process and the substance of the decisions involved. The latter part concerns in particular the requirement on a balanced budget, coupled to a requirement on recuperation of unintended deficits within (in principle) two years. It can be questioned whether this is sufficient in municipalities suffering from a long-term financial deterioration, quite apart from the fact that the condition in itself has been criticised for being too rigidly formulated. It should be noted that the paragraph in question has an escape clause (“very strong reasons”).

In view of what has been said it would be natural for the state to formulate more far-reaching requirements on the municipal budget process. The requirements should have the same character as are currently maintained at the state level, with due adaptations to the special conditions of the municipal sector. This route also has the advantage of being less authoritarian, given that the conditions are formulated for the process rather than its outcomes<sup>15</sup>.

#### 9.4 On dispute solving

An economic analysis of what may be a reasonable division of responsibilities between state and local government gives certain indications but in most cases no definite answer (chapter 2). That the military defence of the territory and the legal system belong to the state level and that public parks and sports grounds to the local is easy to justify, but beside such clear-cut cases there is a broad spectrum of tasks for which there are arguments in both directions.

In all important policy areas the state codifies ends and to a considerable extent also means. Areas such as basic education and health care are characterised by high ambitions, partly materialised in documents such as national curricula. In these cases, we are dealing with delegation of production responsibilities to the local level, not with activities that are the result of local initiatives. In order for delegation to function, a clearly defined task is required, as well as a continuous flow of information that is

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<sup>15</sup> There are certain parallels here to the EU stability and growth pact, the conditions of which are formulated for measurable entities such as the deficit, accumulated debt etc. A protocol to the Maastricht agreement contains conditions also on national procedures in the budgetary area, but these conditions have not been operationalised, nor have they been used in the implementation of the treaty.

processed at the state level, and a repertoire of sanctions to be used when the nationally defined level of ambition is not reached or restrictions of various kinds are violated. Unfortunately, central agencies such as the National School Board or the national Board of Health and Welfare are to some extent circumscribed in their efforts by the idea of local autonomy, something that must be taken into account when responsibilities are divided between the levels. Agencies such as these often lack in evaluative capacity, even if important progress has been made in recent years.

There is a natural expansive drive in most administrations, including local government. But the main point of dispute between the state and local government is in most cases not about the fundamental issue who should be responsible for a given task but rather how this responsibility should be exercised once it has been assigned to the local level. There is a strong feeling at the local level that the state, once it has delegated responsibility downwards, must also allow this delegation to find its true expression. If the state delegates a major task but arrogates to itself the power to intervene in details, much of the potential gains to be reaped from delegation risk being lost, both with respect to economic efficiency and sense of autonomy. Assistance to the handicapped and the supply of library services are some recent cases in point from the Swedish scene.

If the requirement on accountability is pushed very hard, the conclusion will be full state responsibility both for production and financing, the reason being that legislation is national by origin. But this requirement on accountability must be balanced against other requirements, and a certain lack of clarity will always prevail. There seems to be no way of solving this conflict once and for all by some form of legal invention. It is noteworthy that the European Court of Justice has so far not in any of its cases relied exclusively upon the principle of subsidiarity, in spite of its inclusion into the Treaty and a rather expansive policy on the part of the Court. Discussions in the EU convention on an extended role for the principle and the possibility indicate that it can form the basis for developing legal practice in this area. It is likely that the application of the principle be limited to severe infringements on lower-level autonomy (see further the discussion by Gillette in chapter 5).

The situation for the principle of financing – the requirement that new state initiatives be fully financed – is in a sense easier. Even though the application in practice of this principle sometimes calls for rather intricate economic analysis, it is in most cases easier to give a relatively precise answer to the question what compensation is necessary.

*Thesis no. 3: If a conflict arises between the state and a municipality or a group of municipalities concerning the application of the principle of subsidiarity or the principle of financing, the conflict should be solved by a legal procedure of arbitration.*

That higher levels in the public hierarchy assign tasks to lower levels without guaranteeing proper financing is a universal problem. In the United States and Canada for instance, there is a lively debate on unfounded mandates. The principle of financing laid down in Sweden in 1993 requires that the state compensate the municipalities for

increased costs stemming from new legislation, and in reverse, that state grants can be adjusted downwards if costs are reduced. New legislation that affects municipalities or county councils generally, for instance in their role as employers, is not taken into account. In practice only parliamentary decisions have been affected, but also regulations and ordinances decided and enforced by agencies may of course have economic implications for local government.

When the principle of financing was introduced, the government in office claimed that there was no need for legislation<sup>16</sup>. The period during which the system of annual negotiations has been in operation has however been marred by recurrent conflicts about the application of the principle in practice. The fact that the government has the last word when it comes to the interpretation of the principle in concrete situations threatens the legitimacy of the system. The discussion is about decision-making with economic consequences for legal entities outside the state, and it is not conformal to the constitution that such decision-making does not occur “under the laws”. There is consequently a strong case for codifying the principle. A codification would require a formula that is unambiguous enough to be used in normal legal practice. If the conflicts that may arise are considered to be so complicated that they require special competence, it is possible to create a special court of arbitration for this purpose. It would be appropriate for such a court to deal also with conflicts concerning the division of responsibilities, restrictions on state grants etc. that Gillette analyses in his contribution (chapter 5).

### 9.5 On a modified system of equalisation

As noted in the European Charter of Self-Government (art. 9), some sort of equalisation procedure compensating for differences in expenditures and revenue sources is necessary. Equalisation may be accomplished in more than one way, however, and the level of ambition also varies between countries.

Equalisation is an important topic on the political agenda, mostly in relation to individuals and households, and the central issue is what level of equality should be accomplished using taxes and benefits. It is well known that such equalisation sometimes, though far from always, leads to socio-economic costs. Arthur Okun has used the metaphor of a leaky bucket; the more one carries, the more is lost, but the desire to equalise makes most people prepared to accept a certain cost<sup>17</sup>. The core problem of redistribution is consequently a trade-off between equality and efficiency.

Against this background it seems necessary to stress that equalisation between municipalities in order to finance public-service production has a totally different character than equalisation of disposable incomes at the individual or household level. In the absence of intra-municipal equalisation, inhabitants of a high-income municipality would pay lower taxes than inhabitants of a low-income ditto, even if service levels and underlying cost structures were the same. This would create an incentive to move to the high-income municipality that, unlike classical Tiebout

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<sup>16</sup> Gov. bill 1991/92:150, p. 24-25

<sup>17</sup> Okun (1975).

migration, would *not* be socio-economically efficient. A certain equalisation of tax bases and compensation for differences in cost structures is by consequence economically justified.

Equalisation of tax bases has another beneficial effect: it reduces incentives to potentially costly competition for industrial location. If the revenue source of the single municipality depends strongly on its own tax base, there is a strong temptation to attract industries via various forms of subsidies – in the form of subsidised land prices or even tax rebates. The risk of ending up in an inefficient equilibrium characterised by large industrial subsidies is substantial, and international experience shows that such apprehensions are well grounded.

This is not to say that all equalisation can be justified by reference to socio-economic efficiency arguments; if this were the case, the differences in equalising ambitions would be smaller than is currently the case. Even within the group of Nordic countries that have a common tradition of ambitious welfare policies, there are noticeable differences in the systems of equalisation. What is common to the Nordic systems is the desire to raise the poorest municipalities to a level that makes it possible to deliver public services at the decided minimal level with reasonable economic sacrifice. What differs is the policy towards high-income municipalities, where the Swedish system to a higher extent absorbs the part of the tax base above the mean.

As noted by Chernick (chapter 4), it is difficult to verify in practice what are the actual costs of the system of equalisation. Critics of the system claim it affects the incentives to work and growth significantly. Some care must be exercised in this discussion, however. Taxes, benefits and income-dependent fees affect the labour supply and saving behaviour of single individuals in a way that can be assumed to imply socio-economic costs. This is not a contentious issue, although economists differ in their appreciation of the precise size of the effects. But the choices of individuals or households in these respects are not affected by the inter-municipal system of equalisation, because what the municipality (indirectly, its members) gets or contributes is independent of these choices.

Critics of the system then claim that there is an analogy with the classical debate on the excess burden of taxation in the sense that inter-municipal equalisation would affect the incentives in the municipal leadership to stimulate per capita labour supply. This is possible but to our knowledge has not been tested empirically. First, it is uncertain to what extent municipalities actually affect per-capita labour supply. Econometric studies indicate that female labour supply is somewhat elastic and can be affected by policy. The most important measures in this context are well functioning child-care and a generous system of parental leave. Of these measures, the first is mostly and the second fully decided by the state. There is of course also a possibility that municipalities decide on measures that affect labour supply positively irrespectively of the direct economic incentives involved, because there are other effects on prosperity.

There is probably more substance to the criticism that the Swedish system is overly ambitious, in the sense that it compensates for differences that are not based on the mandatory part of municipal expenditures. Given that equalisation affects total revenues and expenditures, compensation will be made also for the part of public services that

municipalities have decided on voluntarily. It is of course possible to defend equalisation also for this category of public expenditures, but the case is obviously stronger for the mandatory part.

What estimates can be given for the socio-economic cost of equalisation? As long as the system is based on the principle that the net contribution to the single municipality is independent of decisions made in that municipality, the costs are probably moderate. Nonetheless, it is likely that budget constraints, because of equalisation, are perceived as softer than they would otherwise be, and that leads to a weaker pressure for rationalisation than would prevail if equalisation were less ambitious.

Independently of the level of ambition, there is reason to discuss the technique of equalisation.

*Thesis no. 4: There is reason to consider replacing the present system of inter-municipal equalisation by a system of state grants in which the levels are adapted to the revenue bases and expenditure structures of the municipalities.*

The Nordic method of equalisation is unusual, both by international comparison and in relation to equalisation within the systems of welfare policy in general. The normal route followed is a system of state grants that is adapted to the own resources of the recipient and its burden of expenditures. The Swedish system – the “Robin Hood system” in colloquial language – instead creates an explicit zero-sum game between the municipalities, in which a limited number of municipalities carry the financial burden. Down to the last dollar it is possible to see how much each average inhabitant gets or contributes.

The method contrasts starkly with the policy style developed in welfare policy at large. The Scandinavian model is based on relatively large gross flows aimed at integrating the overwhelming majority of citizens into one and the same system – a principle that consciously or unconsciously makes it very difficult for the single household to find out what the net flow from the system actually is.

The Robin Hood system generates conflict because of its focus on details in net flows – a level of detail that significantly exaggerates the actual degree of precision and redistributive justice embedded in the system. Statistical estimates are in fact highly uncertain; it is difficult or impossible to know whether the “right” explanatory factors have been used in the estimates, and a stochastic element always remains. The models do not recognise effects of crowding in large municipalities. Revenues from other sources than taxes are not taken into account; a municipality may for instance be a large owner of hydropower production facilities while still being a large net recipient of equalisation transfers. As in the case of individual taxation it is difficult to decide what should be weighed into the equation.

The mode of presentation invites a winner/loser perspective. When the public commission on inter-municipal equalisation published its report<sup>18</sup> in 1998, 90 per cent of the mass media reports and comments had a winner/loser perspective<sup>19</sup>. This concentration on the redistributive effect stands in no reasonable relation to the actual effect. In fact, differences in standards of living stemming from differences in price levels, housing costs, state transfers to households, and differences in municipal service production not compensated for in the inter-municipal system are much greater.

It is possible to achieve approximately the same type of redistribution as in the current system via a system of state transfers, with levels adapted to local conditions. A condition is that the state takes care of a larger part of personal income taxation than today, so that all municipalities become net recipients of transfers. This implies a tax-sharing model of a kind that is frequently used abroad. The state would in that case levy perhaps one third or half of personal income taxation instead of just the progressive part. The excess burden would not be different from that of the present system. The distribution of transfers would of course have to take into account local or regional differences in conditions – related to demography, population density etc. Given that the revenues of the system would come from individuals and not municipalities, it would not be possible as it is today to compute net flows at the municipal level. The public debate would focus less on the counterproductive winner/loser perspective and instead concentrate on what is actually accomplished.

A potential downside – that may have played a role in the design of the current system – is that all the municipalities would end up on the same side of the negotiation table facing the government, something that could in the long run affect the total expenditure level. If a court of arbitration of the kind sketched in previous paragraph were created, this would be a manageable difficulty.

## 9.6 Constitutional regulation

Many of the measures presented above or in earlier chapters do not call for constitutional change. In some instances they do, and in other cases it may be wise to codify changes even when, strictly speaking, it is not necessary to do so. Some of the candidates for constitutional regulation are:

- The principle of subsidiarity, with some concrete examples of what would be considered national and local responsibilities, respectively.
- The principle of financing, requiring economic compensation at the municipal level for national legislation or other binding regulations that affect the general cost level.
- The principles of a court of arbitration, with the task of resolving disputes between the state and municipalities or groups of municipalities concerning the interpretation of the principles of subsidiarity and financing.

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<sup>18</sup> SOU 1998:151.

<sup>19</sup> Own calculations on the basis of a synthesis made by Stockholm-based mass media consultant Observer.

The European Convention<sup>20</sup> has published an interesting discussion of the principle of subsidiarity, allowing for a truly dynamic perspective. The proposal put forward includes both a legal test maintained by the European Court and a political control function to be exercised by the member states parliaments. This is a model that might be of relevance also to the national/sub-national level.

A reformed system of equalisation does not in itself call for any amendment to the constitution. What may be appropriate is:

- A general paragraph establishing that the same principle of efficient use of public resources as holds for the state is valid for the municipal sector. Special reference should be made to a municipal budget act (organic law) specifying basic requirements on the budget process, accounting for finances and results, and external audit.

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<sup>20</sup> [european-convention.eu.int](http://european-convention.eu.int).

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