

The Economy Report.

ON SWEDISH MUNICIPAL AND COUNTY COUNCIL FINANCES
- OCTOBER 2015



Swedish Association
of Local Authorities
and Regions

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Foreword

The Economy Report illustrates the financial situation and conditions of county councils and municipalities and the development of the Swedish economy over the next few years. It is published twice yearly by the Swedish Association of Local Authorities and Regions (SALAR). The calculations in this issue extend to 2019.

In this autumn's report we can conclude that the financial situation in the local government sector is still troubling. Many municipalities and county councils are struggling with deficits and severe cost pressure. There are several explanations for this. In this report we take a particular look at the cost increases resulting from staffing problems in healthcare. We also describe the problems we can see with central government control. There are many examples of targeted government grants creating rather than solving problems in the local government sector. This is particularly apparent in the area of school education. Central government also expects local government to play a part in financing the planned high speed railway. The estimates in the report build on a very substantial revision of the population forecast as a result of greater immigration.

This is an abridged version of the report. It contains the Conclusions and summary (supplemented with some diagrams from the main report), and the chapter on the new population forecast from Statistics Sweden (see Contents on page 2), as well as the Annex. It has been written by staff at the SALAR Section for Economic Analysis and has not been considered at political level within the Association. The persons who can reply to questions are given on the inside cover page. Other SALAR staff have also contributed facts and valuable comments. The translation is by Ian MacArthur, following slight revisions by Elisabet Jonsson. We are very grateful to the municipalities and county councils that have contributed basic data to our report.

Stockholm, October 2015

Annika Wallenskog
Section for Economic Analysis

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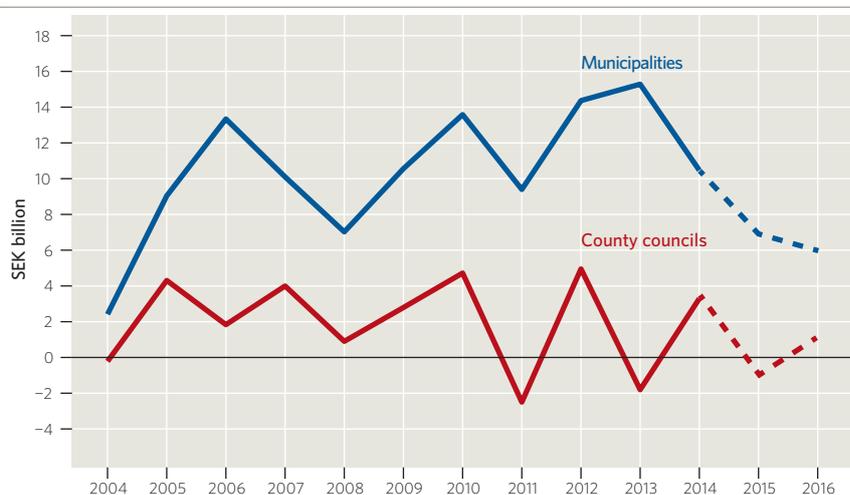
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Conclusions and summary

The cost pressure in the local government sector is now rising so sharply that substantial tax increases will be needed in the future, almost 2 percentage points on the tax rate up until 2019. To break this trend, completely new measures will be required from municipalities and county councils and also from central government. Revenue growth is relatively positive but is still not sufficient to address the cost increases indicated by our calculations: about SEK 270 billion in current prices in the period 2014–2019.

The financial situation in the local government sector is getting increasingly difficult. Aggregate net income for county councils is expected to deteriorate substantially in 2015, to a deficit of SEK 1 billion. A substantial deterioration is also expected in aggregate net income for the municipalities, for the second successive year, to SEK 7 billion, despite cash injections from sources including refunds of insurance premiums paid to AFA Försäkring. In 2016 we expect the municipalities to be able to deliver their services without any tax increases and with only a small deterioration of net income. But we expect some

Diagram ■ Local government net income 2004–2014, prognosis 2015 and 2016
SEK billion



Sources: Statistics Sweden and Swedish Association of Local Authorities and Regions.

For the municipalities net income has been greatly affected in recent years by temporary factors such as refunds of AFA Försäkring payments and cyclical support. The county councils are also affected by non-recurring effects, such as refunds of AFA Försäkring repayments and a reduction of the interest rate used in pension calculations.

tax increases in the county councils. Even though 2016 will offer the highest tax base increase so far in the 21st century, 5.4 per cent.

Large population increase driving up costs

The most important cause of these poor finances is the high cost pressure. The major underlying factor is population change. More elderly people drive costs in healthcare and in elderly care and more children drive up school costs. It has long been known that demographic trends along with greater demand for welfare services will result in greater cost pressure, but this is now becoming more and more apparent.

The additional factor now is substantial immigration, which is affecting a number of services in both municipalities and county councils. The fact that a relatively large proportion of the immigrants are of working age ought, in the longer term, to have a positive impact on the possibilities of financing welfare services by improving the dependency ratio. If the establishment of the new arrivals in the labour market is a success, this will improve the conditions for the long-term financing of welfare services. In the next few years, however, it is not likely that new arrivals will be able to support themselves right away and to pay tax to the same extent as the rest of the population. Experience shows that it takes a long time for refugees/asylum-seekers to get established in the Swedish labour market. A larger population means higher costs, irrespective of where people come from. In our calculations we assume that immigrants have the same need of schools, health care and social care as the rest of the same-age population, even though it is more likely that new arrivals need more measures. But this is not something that is taken into account in our calculations since the information to support such an assessment is not available. The result of our calculations, which only extend to 2019, is that the new population forecast places an additional burden on the finances of the local government sector. In the longer term the calculations get more positive.

Targeted governments grants hamper development and drive up costs

Another factor driving costs is the targeted temporary government grants to municipalities and county councils. But this is something that central government can influence. At present there are more than 80 targeted government grants, each of which corresponds to a central government reform hoping to improve local government services. Spending initiatives can be good if they really lead to improvements, but to do that they have to be well-considered, anchored and long term. Unfortunately, this is not always the case. There are a number of examples of targeted government grants that do more to create than to solve problems. So it is actually possible to ask whether the targeted government grants in which central government defines important areas for development, are a danger to the strength of Swedish welfare provision: its decentralised character. This form of governance takes responsibility away from local leaders and reduces the development capacity and local adaptability to be found in a decentralised system of welfare services.

Another – new – ingredient in relations between central and local government is that the local government sector is expected to take part and finance investments that are surely central government undertakings.

Other factors behind the cost pressure

There are also other factors that contribute to the increased cost pressure. Several have been raised in previous *Economy Reports*; examples are demands for more provision and higher quality regarding welfare services; new medicines and treatment methods; pressure for transitions between services for demographic reasons; and strong pressure for transitions in municipalities and county councils that are growing or shrinking as both population growth and population decline require adjustment.

In healthcare we see growing staffing problems that lead to disturbances of services and higher costs. Higher investments result in higher depreciation and interest costs. Other topical matters are new investments in housing and public transport and a greater volume of replacement investments. There is also an underlying increase in pension costs, which are getting ever steeper, as the number of local government pensioners is rising at the same time as the costs for pensions earned by current employees are rising. One contributing factor is the central government career posts for teachers, which result in higher pensions costs. The latest forecast points to a further burden on account of new indexation rules for the national pension that result in a shift of pension costs from central government to the local government sector amounting to about SEK 2.5 billion at the end of our calculation period, 2019.

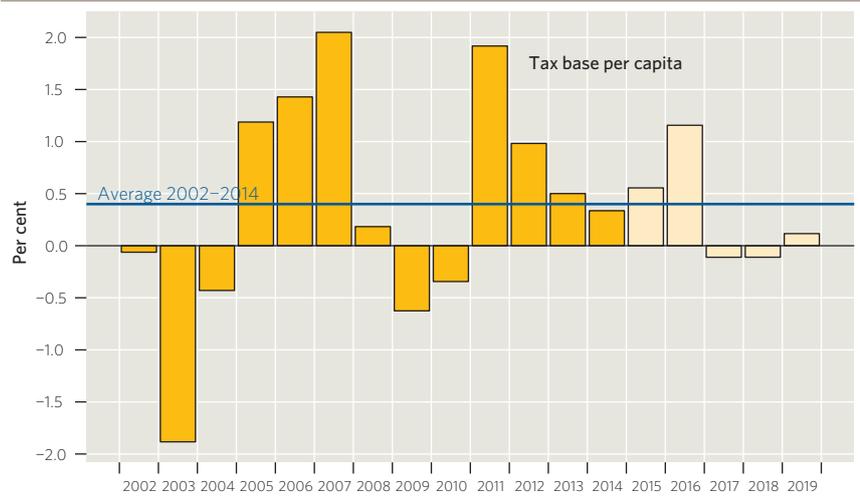
Costs thus increase on account of factors other than those that follow solely from a larger population and a larger share of older people. For 2015–2016 this component is substantial, about 1.5 per cent per year in fixed prices. In the calculation for 2017–2019 we expect it to be reduced.

The Swedish economy is growing

But there are also positive factors. Despite moderate international growth the Swedish economy is being kept going by domestic demand and is growing fairly strongly. GDP is expected to grow by more than 3 per cent both this year and next year. As a result employment is increasing and unemployment is being forced down towards 6½ per cent, which means that we are already expected to reach balance in the labour market in 2016. The increase in employment and growing pension income means that tax base growth will accelerate in 2016.

The development of the macroeconomy in 2017–2019 is more uncertain. Our calculations show slower growth than along with rising interest rates. We expect public finances to show a deficit for all the years up until 2019, but the deficit is expected to decrease gradually. The years after 2016 in our calculations also show more moderate employment growth and stagnant unemployment. One problem in these years is weak per capita growth of GDP and employment. While the new labour market measure of extra jobs provides some added pull to help employment growth, the hours worked are still not expected to rise as fast as in the final phase of the economic upturn. Tax base growth is fairly good in nominal terms, but is poorer in real terms on account of larger price increases in the local government sector. Moreover, the tax base is being diluted because of a greater number of new inhabitants with lower labour market participation. The overall effect will be that the tax base will decline in real terms per inhabitant in 2017–2019, as shown in diagram 1 on page 6.

Diagram 1 • Real percentage change in the tax base per inhabitant and year
Per cent



Sources: Statistics Sweden, the Swedish Tax Agency and Swedish Association of Local Authorities and Regions.

As a result of the slower growth rate, the higher price and pay increases and a considerably larger population, the tax base will decrease in real terms per inhabitant in 2017–2019.

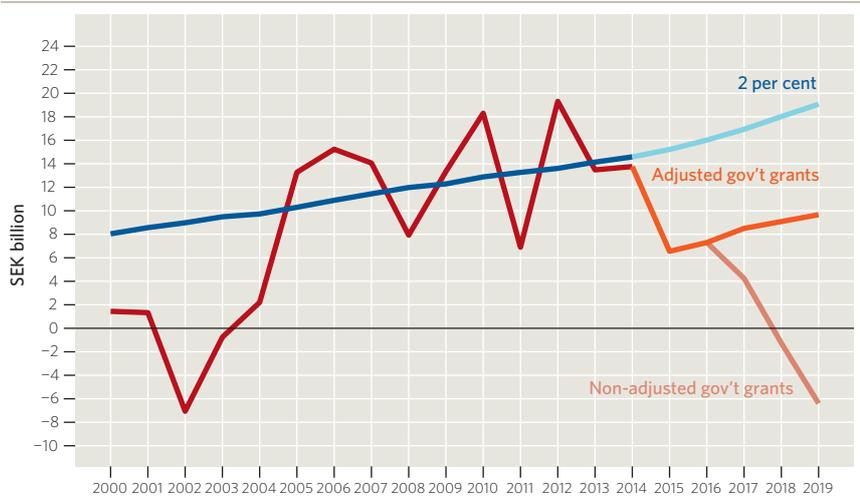
Future developments appear increasingly unsustainable

Our picture of developments up until 2019 is worrying. The total costs in the local government sector are expected to increase by about SEK 270 billion in current prices between 2014 and 2019, on account of the factors described above. To prevent any substantial deterioration of net income, there must thus be an equivalent increase in revenue. The most important contribution is the increase in the tax base. On top of this, several additional revenue-enhancing measures are required. The calculation assumes that, in the future, central government will increase government grants by 2 per cent per year in fixed prices as of 2017, which is in line with a long historical trend. In addition, tax rate increases of almost 2 percentage points are needed to make the calculation balance.

To achieve net income of one per cent of taxes and government grants, about SEK 10 billion, the tax rate will have to be increased by 1.92 percentage points from the present level up until 2019. In today's money this corresponds to a revenue increase of SEK 38 billion in 2019. Moreover, central government will have to increase government grants by 2 per cent per year in real terms in 2017–2019, which corresponds to an increase of SEK 16 billion in the level of these grants. We have chosen to lock net income at one per cent of taxes and government grants. The reason for not locking net income at the level of 2 per cent, which is a rule of thumb for healthy finances in the sector, is that net income at that level is hardly reasonable.

Diagram 2 • Net income in municipalities and county councils, including tax rate increases of just under 2 percentage points up until 2019

SEK billion and per cent of taxes and government grants



Source: Swedish Association of Local Authorities and Regions.

The question is whether developments like this are sustainable. To avoid tax increases of this order, municipalities and county councils will have to find new ways of meeting their undertakings. Central government should also contribute, by providing a better context for planning. What municipalities and county councils need is a stable, long-term context for their planning and general government grants that are not eroded.

The local government sector has faced major challenges before. There was a similar situation in the early 1990s. In healthcare, for example, the sector was able on that occasion to combine major cost and staff reductions with a strong expansion of healthcare delivery, especially for older people. The key was new technology and new approaches that made it possible to provide healthcare with shorter hospital stays and to also deliver interventions previously carried out in in-patient care as out-patient care. On that occasion central government helped to transform targeted grants into general grants in order to facilitate the transformation.

We thus see a need of a better dialogue between central and local government and would therefore welcome an investigation of central government control of the local government sector, providing it leads to rapid action.

Can new technology be a solution?

One area with great potential is technological development through digitalisation. E-health is an umbrella term for digital services in healthcare that are advancing strongly and are seen globally as an important tool to address the challenges of the future. In the long term e-health can result in substantial improvements for both patients and healthcare professionals. People will be more in control regarding their own health, and this may become very important in the future in terms of prevention. Information management, which is a central part of healthcare but also of several other services, can be made more efficient. There are several examples of major steps now being taken in introducing this technology.

New population forecast creates a new situation

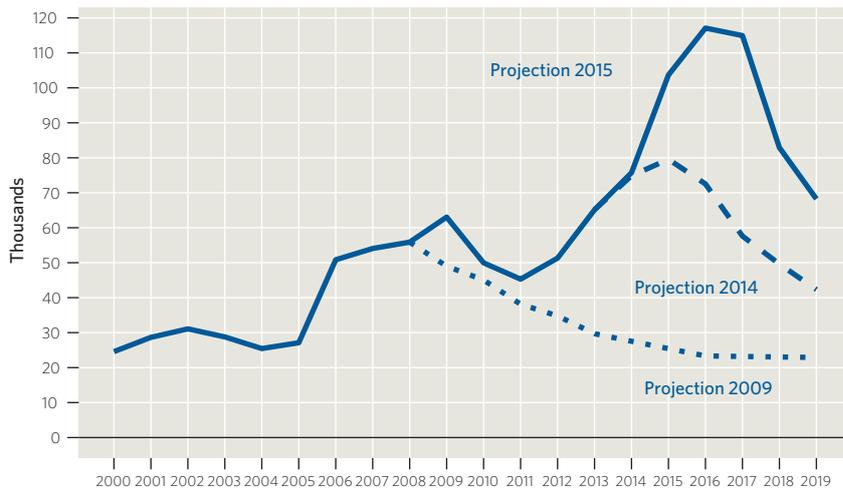
In this report we assume much greater immigration than before, in line with Statistics Sweden's revised population forecast. This means that the labour force and employment will grow and that the tax base will therefore increase. But the positive effect will be limited by the fact that it is more difficult for refugee immigrants to get established in the labour market. Refugee reception, resulting in a larger population, also entails increased costs for municipalities and county councils. In the next few years these cost increases will be much larger than the additional revenue arising in the form of higher tax income. This will put considerable pressure on municipal and county council finances in the next few years.

The most recent population forecast by Statistics Sweden, which was published in May, entails a significant upward adjustment of net immigration compared with the assessment made the previous year. It is highly likely that this population forecast will also require further upward adjustment. Such upward adjustments have also been made in the past. Diagram 3 on page 9 compares the forecasts made in the past two years with the one made in 2009.

The latest forecast by Statistics Sweden estimates that net immigration in the period 2010–2019 will total about 775 000 individuals compared with just under 300 000 in the assessment made by Statistics Sweden in 2009. This means that the population is estimated to be much larger in 2019 than in previous forecasts. The 2009 assessment put population at the end of 2019 at 9.8 million, compared with 10.4 million in the latest Statistics Sweden estimate. Virtually all of this increase consists of greater net immigration.

As shown in diagram 3, there is also a large difference in net immigration between Statistics Sweden's latest forecast and the one made last year. This difference is of importance for the calculations in this Economy Report. Diagram 4 shows the difference in the number of inhabitants in different age groups between the 2015 and 2014 population forecasts. As can be seen the ad-

Diagram 3 • Net immigration in various forecasts by Statistics Sweden
Number of immigrants in relation to number of emigrants



Sources: Statistics Sweden and Swedish Association of Local Authorities and Regions.

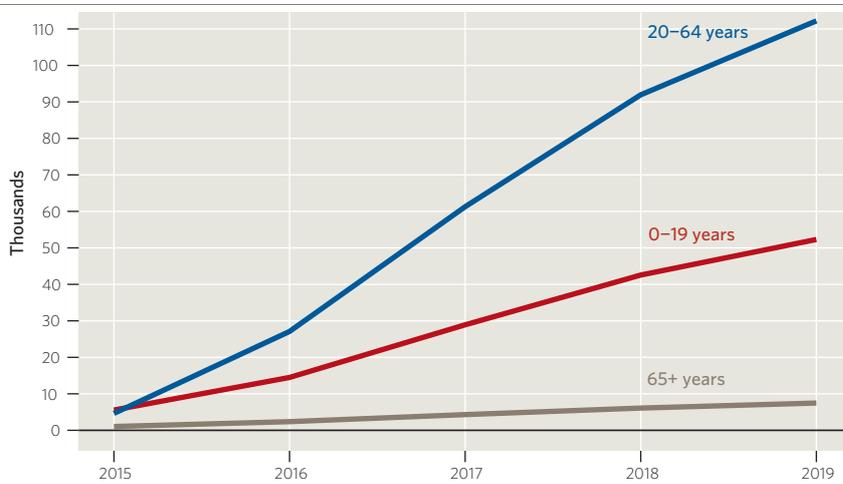
The figure shows that Statistics Sweden has had to revise net immigration upwards in a succession of population forecasts. What looks like a decline in 2019 is still a net immigration of 70 000 people per year.

dition of population in working age (i.e. 20–64 years) is much higher than the additions in the groups children and older people.

The fact that a relatively large proportion of the immigrants are of working age ought, in the longer term, to have a positive impact on the possibilities of financing welfare services. But this is not the case for the next few years because a very large share of immigrants today consists of refugees. It is hardly reasonable to expect them to be able to support themselves and pay tax right away to the same extent as the rest of the population. In reality it takes a long time for refugees/asylum-seekers to get established in the Swedish labour market. This is also something we take account of in our calculations.

A larger population not only means that there will be more people who can work and pay tax but also entails greater costs for municipalities and county councils – and this is so irrespective of where the people come from. In our calculations we assume that immigrants have the same need of schools, health care and social care as the rest of the same-age population, even though it is more likely that new arrivals need more measures and therefore generate more costs than the rest of the population. But this is not something that is

Diagram 4 • Comparison of the population in the 2015 and 2014 population forecasts
Comparison of the number of inhabitants in different age groups.



Sources: Statistics Sweden and Swedish Association of Local Authorities and Regions.

The figure shows the difference in the number of inhabitants in different age groups between Statistics Sweden's latest forecast and Statistics Sweden's previous forecast.

taken into accounts in our calculations since the information to support such an assessment is not available.

The result of our calculations, which only extend to 2019, is, as expected, that the new population forecast places an additional burden on the finances of the local government sector that must be addressed. In the longer term the calculations become more positive, but we do not do such long-term calculations in this report.

The demands on municipal and county council services in 2019 are estimated to be 1.5 per cent larger with the new population forecast than with the population forecast that was the basis for the previous Economy Report. This corresponds to increased costs of about SEK 17 billion this year.* At the same time the upwards adjustment of the population forecast is estimated to give a surplus of just under 1 per cent of the tax base, which increases tax income by around SEK 7 billion. This means that there is still a gap of about SEK 10 billion between increased costs and increased revenue for the local government sector. If this gap is covered via higher taxes, it corresponds to an overall increase in municipal and county council tax of just over 0.40 percentage points.

*1. The total population is estimated to be 1.7 per cent larger in 2019 than in the previous population forecast.

This annex presents some key indicators and the overall income statements of municipalities and of county councils, as well as an aggregate income statement for the sector to give an overall picture.

For diagrams showing the distribution of costs and revenue for municipalities and county councils separately, tables presenting overviews of central government grants and other data that we usually present in the Annex to the *Economy Report*, we refer to our website, a page called *Sektorn i siffror* (The sector in figures). Go to www.skl.se, choose *Ekonomi, juridik, statistik/Ekonomi/Sektorn i siffror*.

An aggregate picture of municipalities and county councils

Table 24 • Key indicators for municipalities and county councils, 2014–2019
Per cent and thousands of people

	Outcome		Forecast	Calculation		
	2014	2015	2016	2017	2018	2019
Average tax rate, %	31.86	31.99	32.11	32.64	33.34	33.91
municipalities, incl. Gotland	20.65	20.70	20.70	20.87	21.30	21.74
county councils*, excl. Gotland	11.26	11.35	11.47	11.83	12.10	12.23
	Outcome	Forecast		Calculation		
	2014	2015	2016	2017	2018	2019
No of employees**, thousands	1,099	1,111	1,143	1,172	1,195	1,216
Municipalities	829	838	865	887	906	922
County councils	270	273	279	284	289	295
Volume change, %	2.2	3.0	3.2	2.7	2.3	2.1
Municipalities	1.8	2.7	3.4	2.6	2.2	1.9
County councils	2.8	3.6	2.9	2.8	2.4	2.3

*The tax base of Gotland is not included, which is why the totals do not add up.

**Average number of people in employment according to the National Accounts.

Sources: Statistics Sweden and the Swedish Association of Local Authorities and Regions.

Table 25 • Aggregate income statement for the sector, 2014-2019

SEK billion

	Outcome	Forecast		Calculation		
	2014	2015	2016	2017	2018	2019
Income of activities*	177	187	203	219	232	241
Expenses of activities	-870	-914	-967	-1,022	-1,083	-1,140
Depreciation	-28	-30	-33	-35	-37	-40
Net expenses of activities	-721	-757	-797	-838	-889	-939
Tax revenue	602	634	671	712	761	807
Gen. gov. grants and equalisation	127	127	130	134	140	146
Net financial income	6	3	3	0	-3	-5
Net income before extra-ordinary items	14	6	7	9	9	10
Share of taxes and grants, %	1.9	0.9	0.9	1.0	1.0	1.0

Note: Purchases between the sectors have been consolidated.

*The non-recurring effect of a repayment of AFA premiums of SEK 5 billion is included in Income of activities for 2015.

Table 26 • Income statement for the municipalities, 2014-2019

SEK billion

	Outcome	Forecast		Calculation		
	2014	2015	2016	2017	2018	2019
Income of activities*	128	136	151	164	173	179
Expenses of activities	-573	-601	-638	-676	-716	-755
Depreciation	-19	-21	-22	-23	-25	-27
Net expenses of activities	-465	-485	-510	-536	-568	-602
Tax revenue	390	410	433	455	486	517
Gen. gov. grants and equalisation	80	80	81	85	89	93
Net financial income	4	3	3	1	-1	-3
Net income before extra-ordinary items	10	7	6	5	6	6
Share of taxes and grants, %	2.2	1.5	1.2	1.0	1.0	1.0

*The non-recurring effect of repayments of AFA premiums of SEK 3.5 billion is included in Income of activities for 2015.

Table 27 • Income statement for the county councils, 2014-2019

SEK billion

	Outcome	Forecast		Calculation		
	2014	2015	2016	2017	2018	2019
Income of activities*	51	53	54	57	61	64
Expenses of activities	-299	-315	-331	-348	-368	-388
Depreciation	-9	-10	-11	-12	-12	-13
Net expenses of activities	-257	-272	-287	-302	-320	-337
Tax revenue	212	224	238	257	275	290
Gen. gov. grants and equalisation	47	47	49	50	52	53
Net financial income	1	0	1	-1	-3	-3
Net income before extra-ordinary items	3.3	-1.0	1.0	3.1	3.4	3.6
Share of taxes and grants, %	1.3	-0.4	0.3	1.0	1.0	1.0

*The non-recurring effect of repayments of AFA premiums of SEK 1.4 billion is included in Income of activities for 2015.

Source: The Swedish Association of Local Authorities and Regions.



The Economy Report. October 2015

On Swedish Municipal and County Council Finances

is a series published twice yearly by the Swedish Association of Local Authorities and Regions (SALAR). In it we deal with the present economic situation and developments in municipalities and county councils. The calculations in this issue extend to 2019.

There are several examples of targeted government grants creating rather than solving problems in the local government sector. This is particularly apparent in the area of school education. In this autumn's report we take a close look at central government grants to municipalities and county councils. Central government also expects local government to play a part in financing the planned high speed railway. Immigration has increased very substantially in recent years and considerable upward adjustments have been made to forecasts. This report gives an overall description of the consequences for municipalities and county councils.

The financial situation is troubling in many municipalities and county councils. For the sector as a whole we expect a sharp deterioration in net income between 2014 and 2015. This is mainly due to higher costs. Thereafter we estimate that net income will remain at a low level despite tax increases. There are several explanations of the strong cost increases. In this report we take a particular look at the cost increases resulting from staffing problems in healthcare.

While the challenges are great, there are also opportunities. E-health is an umbrella term for digital services in health care that are advancing strongly. Globally e-health is seen as an important tool to address the challenges of the future. In this report we give a picture of the potential of the technology and present some examples of ongoing activities in the local government sector.

The report is not for sale, but it can be downloaded from the website of Sveriges Kommuner och Landsting: www.skl.se. Choose In English and then Publication and reports.

Download at [www.skl.se/In English, Publications and reports](http://www.skl.se/In%20English,%20Publications%20and%20reports).

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