



State Transfers to the Finnish Municipalities

Is performance budgeting possible?

Dr. Markus Sovala

Deputy Head of the Budget Department

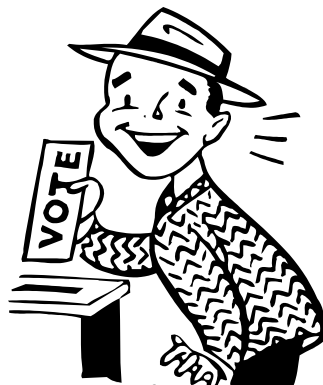
Ministry of Finance, Finland



Local government view:

DEMOCRATIC SELF-GOVERNMENT BASED ON THE CONSTITUTION

- ***The municipal delegate elected in a general election holds the highest power of decision in a municipality.***
- ***“Municipal local government shall be based on the self-government of the citizens.” (The Constitution Act of Finland 51§, clause 2)***
- ***The municipality has the power to levy taxes***
- ***The State can assign duties to municipalities or it can revoke them only in accordance with legislation.***



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- ***“FINLAND IS DIVIDED INTO LOCAL AUTHORITIES WHERE THE AUTONOMY OF RESIDENTS IS SAFEGUARDED IN THE CONSTITUTION” (The Local Government Act, Chapter 1).***

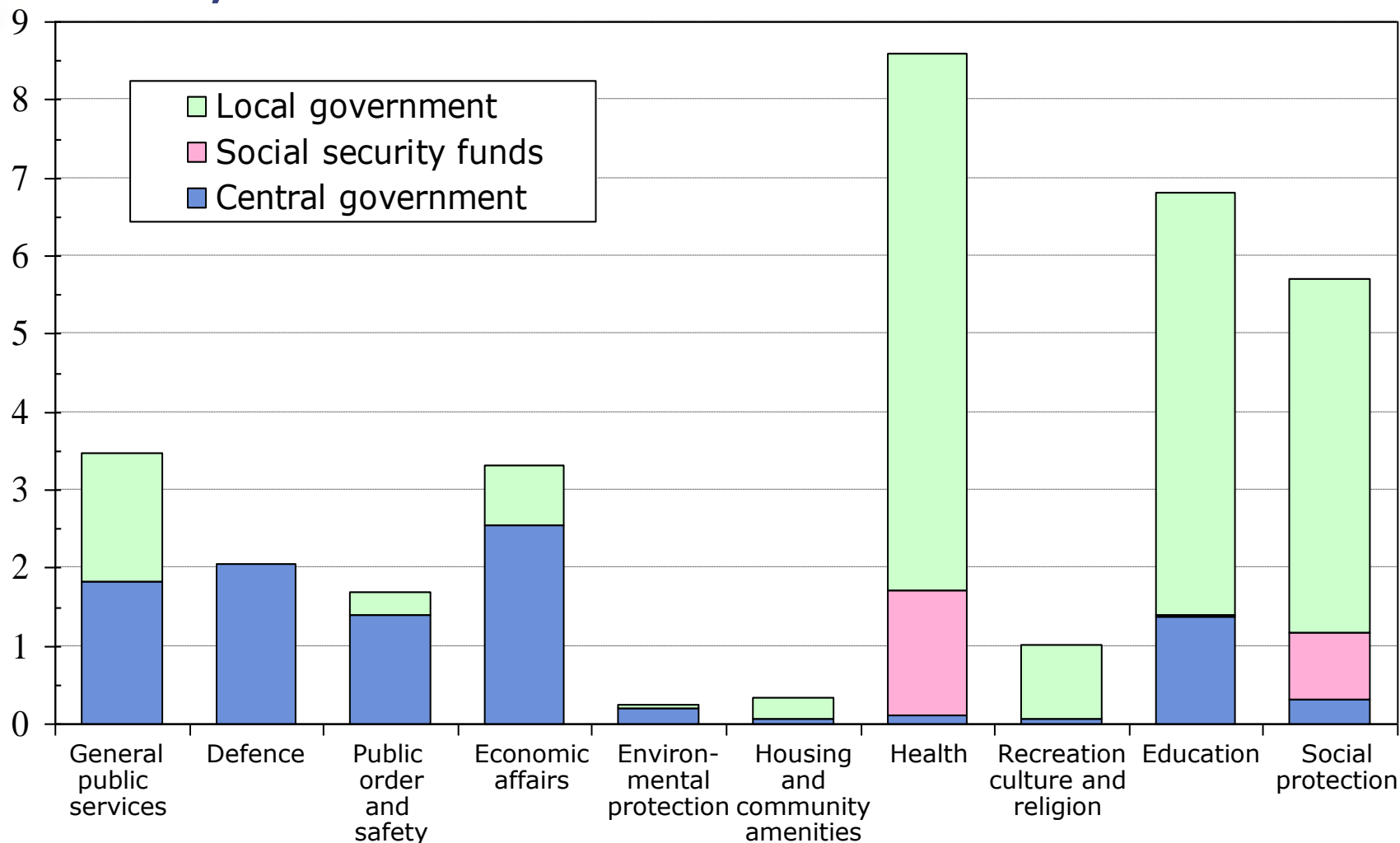


Population of 5,3 million people is distributed in 416 local governments

	Average	Smallest	Largest
Population 31.12.2003	12 083	134	559 330
Population density inh./km²	17,1	0,2	3 032,1
Area (net of water areas) km²	705	6	15 173
Economic structure			
Agriculture and forestry %	4,3	0,1	32,0
Manufacturing %	25,8	5,5	50,6
Services %	68,1	35,8	84,8
Age structure			
0–14 year-olds %	17,6	9,6	31,7
15–64 year-olds %	66,8	55,3	71,8
65 and over %	15,6	6,0	32,4
Local tax rate 2005, % of taxable income	18,30	16,00	21,00



General government consumption expenditure 2004, EUR billion





Total municipal sector expenditure and income (estimate for 2006)

Salaries and wages 41 %
Social security funds and pensions 13 %
Purchase of goods 10 %
Purchase of services 16 %
Subsidies 6 %
Loan costs 3 %
Investments 9 %
Other expenditure 2 %

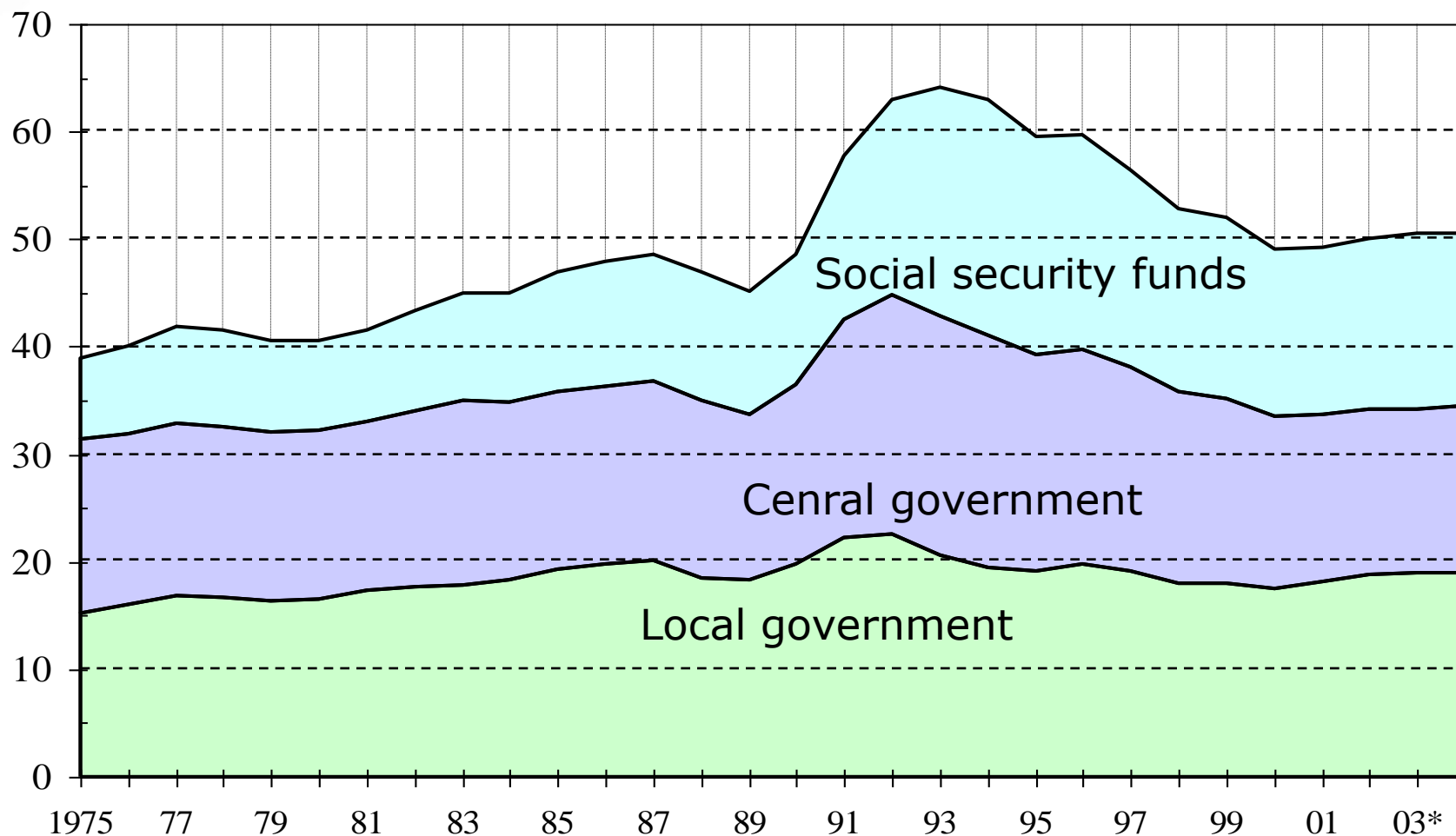
Social welfare and health care 51 % (Current expenditure and investments)
Education and culture 26 % (Current expenditure and investments)
Other 19 % (Current expenditure and investments)
Financing and other expenditure 4 %

Tax revenues 46 %
State grants 17 %
Sales of goods and services 28 %
Borrowing 5 %
Other revenues 4 %

Source: The Association of Finnish Local and Regional Authorities



General government expenditure, % of GDP

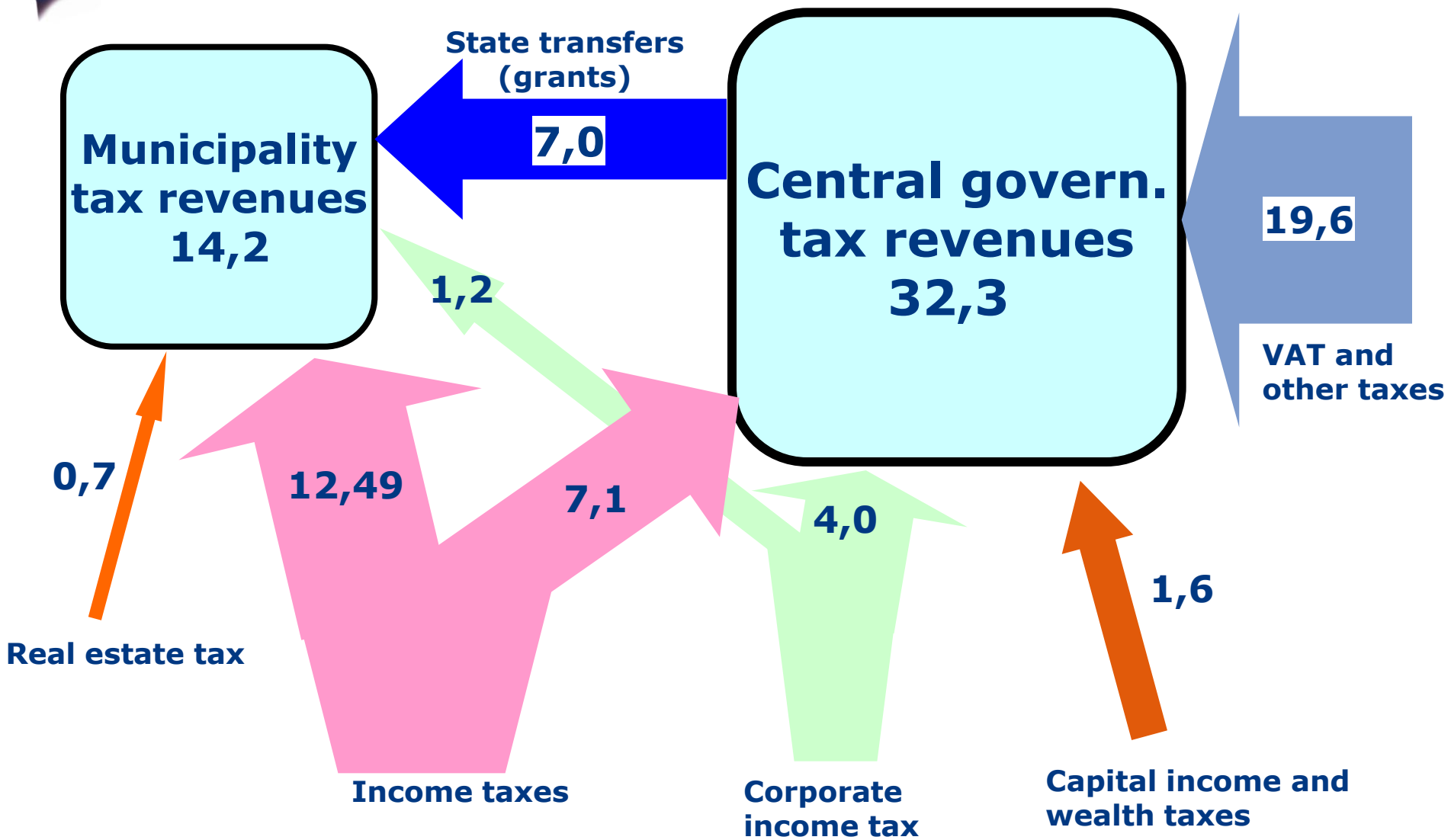


Source: Statistics Finland.

Source: The Association of Finnish Local and Regional Authorities



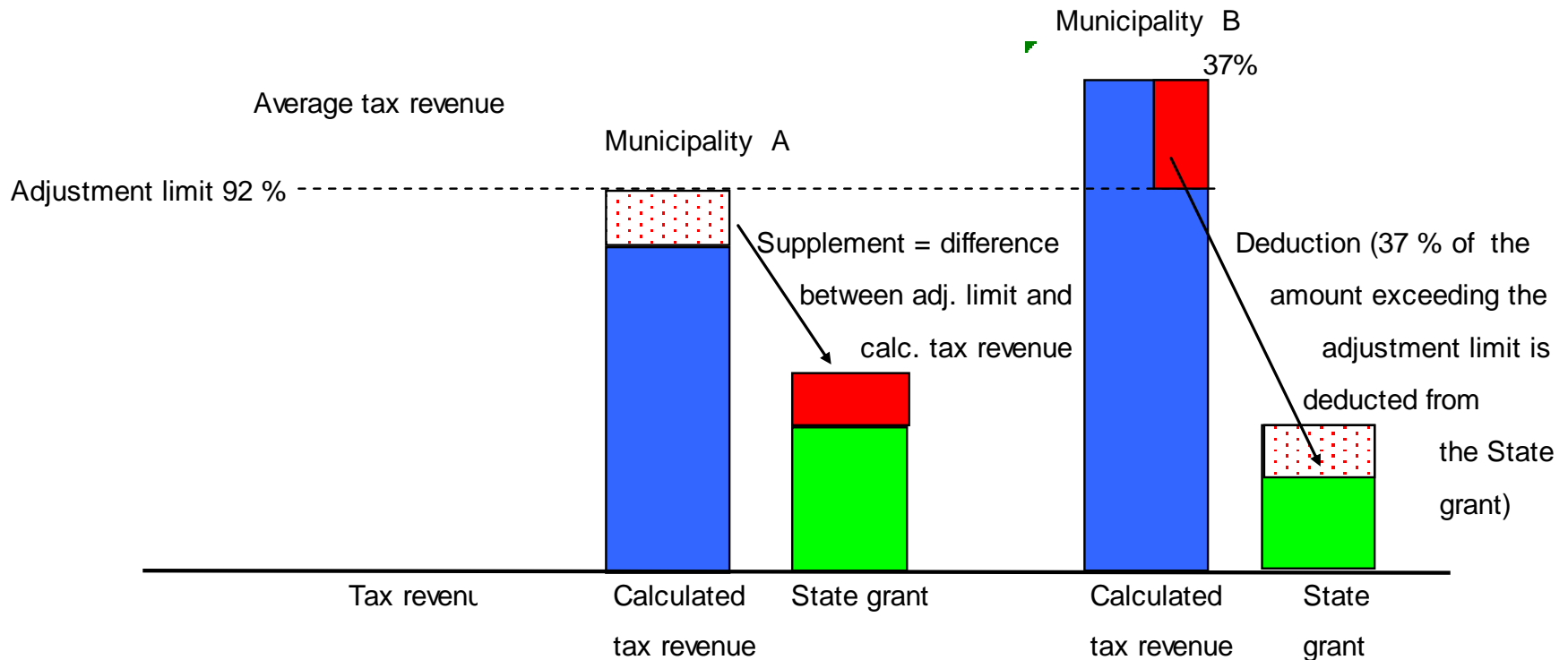
Tax financing 2005, billion €





Tax equalization makes local government tax income quite independent of the tax base

Adjustment of State shares





Municipality / Citizen / State

- The constitution guarantees an autonomous status for the local governments ...
- ... but also defines citizens' basic rights for education, health & social care, housing etc. Municipalities have a responsibility to provide the services.
- Transfers to the Local Government are about 20 % of the Central Government expenditure. Overall level of grants reflects the costs of providing defined level of services but is outcome from political processes.
- Grants to individual municipalities are based on demographic and geographic facts but tend to favor "weak" municipalities.



Incentives that a municipality faces

- Strong equalization of the tax incomes between municipalities can be seen as a “right to tax” central government and weakens the incentives to promote a local economy.
- Companies are better tax payers than the inhabitants as they do not require health care, daycare for the children, housing nor education.
- As tasks/duties and (a major share of income) are given, a municipality has an incentive to produce services efficiently ...
- ... but if it fails, it can always borrow money, rise the local government tax rate or start to lobby higher Central Government grants/transfers.



Performance budgeting

- For an individual municipality there is a scope for performance budgeting ...
- ... but if it fails, tax equalization and political processes transfer the problem to the national level.
- Applying performance budgeting to the Central government transfers to municipalities may require:
 - less and stronger municipalities
 - weaker tax equalization between municipalities
 - a contract between the State and the municipalities (IMF recommends a “stability pact”)
 - and perhaps weakening citizens’ constitutional rights.