

# Local Government Equalisation in Denmark

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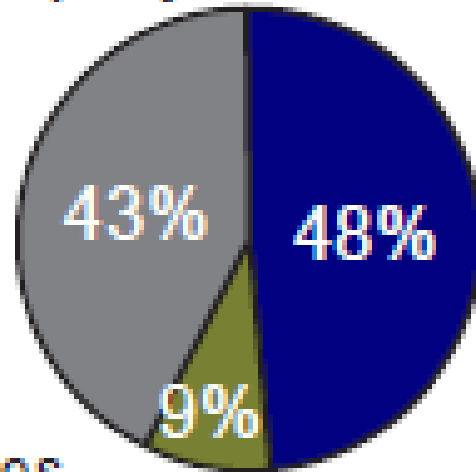
# Our first equalisation scheme



# Local Governments in Denmark

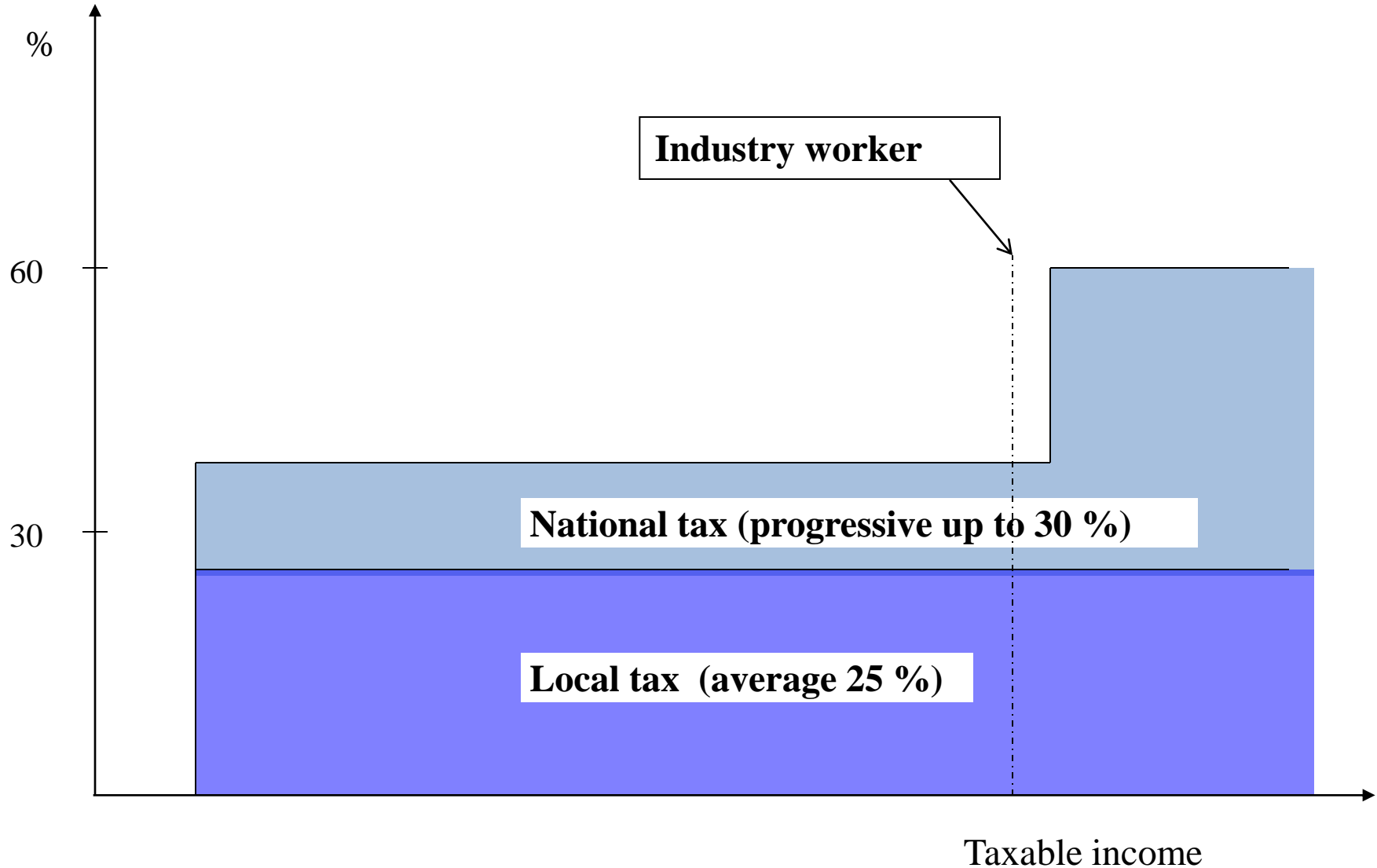
- A major reform in 2007 reduced the number of municipalities from 270 to 98
- Average population: 55.000 inhabitants
- Median population: 40.000 inhabitants
- Minimum size according to law: 20.000 inhabitants (a few exceptions)

## Distribution of Tasks after the Local Government Reform (Expenditure)



- Municipalities
- Counties
- State, including official private institutions + social funds

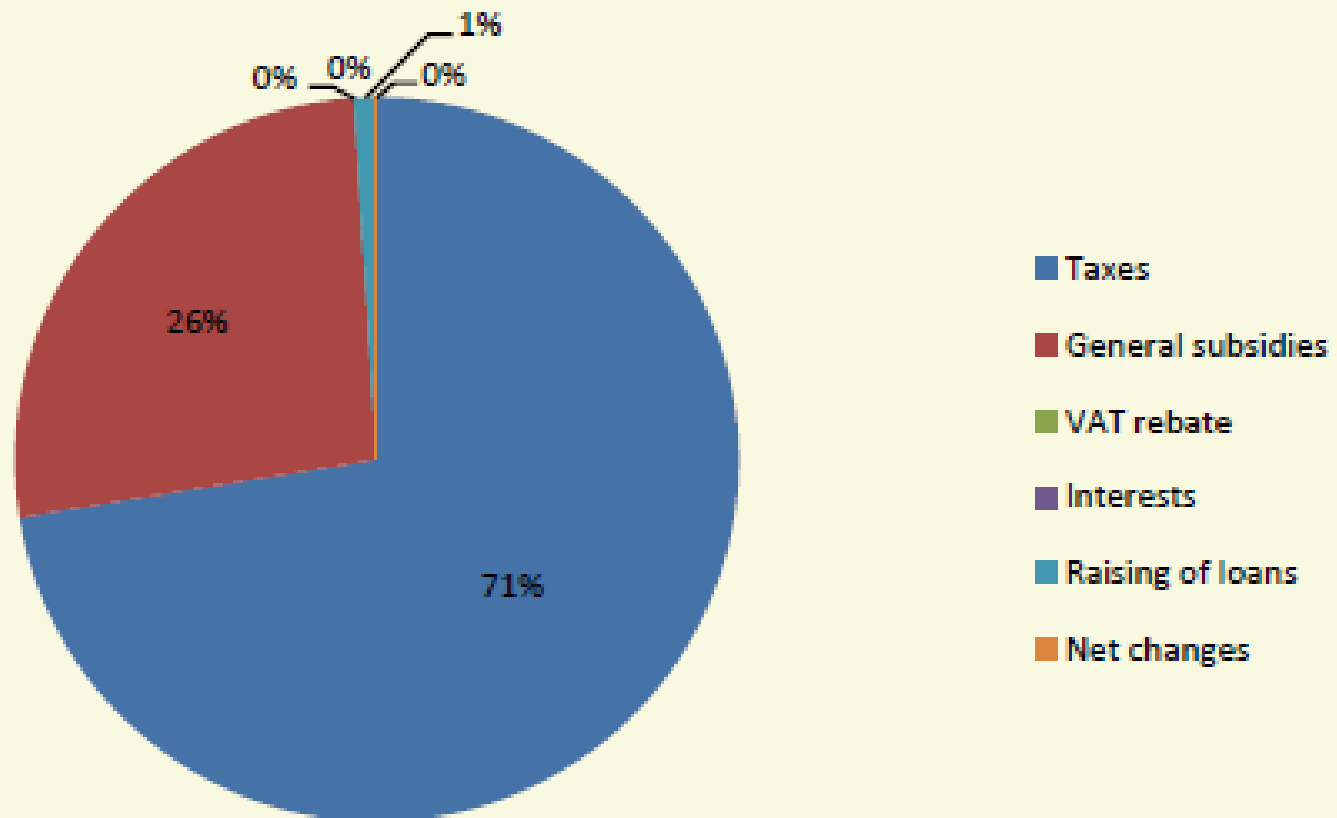
# Danish Personal Income Taxes



# Local Revenue

## Revenue for the 2014 budget

The financing revenue of the municipalities is in the 2014 budget estimated at DKK 357.7 billion. The funds are allocated as follows:



# ”Structural deficit”

- On average a municipality would be able to finance  $\frac{3}{4}$  of it's expenditure with it's own taxes
- The un-financed share is called the ”structural deficit”

# Differences in structural deficit

On average local governments have a deficit equal to  $\frac{1}{4}$  of local expenditure, but:

- The richest communities have a "structural surplus" needing no government grants at all
- The poorest communities are heavily dependent on grants/ equalisation schemes



# Illustration of differences

Differences in tax base per inhabitant:

- Average taxable income in poorest municipality is less than half of average income in richest municipality

Expenditure needs are also different:

- Calculated expenditure level varies from 6.800 € per inhabitant to 9.600 €

# The equalisation scheme

- In our basic equalisation system we equalise 58 per cent of differences in "structural deficit" per inhabitant
- This means that we in one system equalise 58 percent of
  - differences in tax base
  - differences in expenditure needs
  - ("The Net Method")

# Structural deficit

Calculation of the structural deficit in a municipality:

The municipality's tax revenue (with average tax rate)

minus

The expected expenditure level (calculated)

=

The structural deficit (on average  $\frac{1}{4}$  of expenditure)

# Calculation of the revenue part

- The tax base in each community is calculated as a weighted sum of the local income tax base and the local property tax base
- It is then calculated which revenue the local government would get with an average tax rate

# Calculation of the expenditure part

- We calculate the expenditure we would expect the municipality to have based on "objective criteria" – expenditure needs

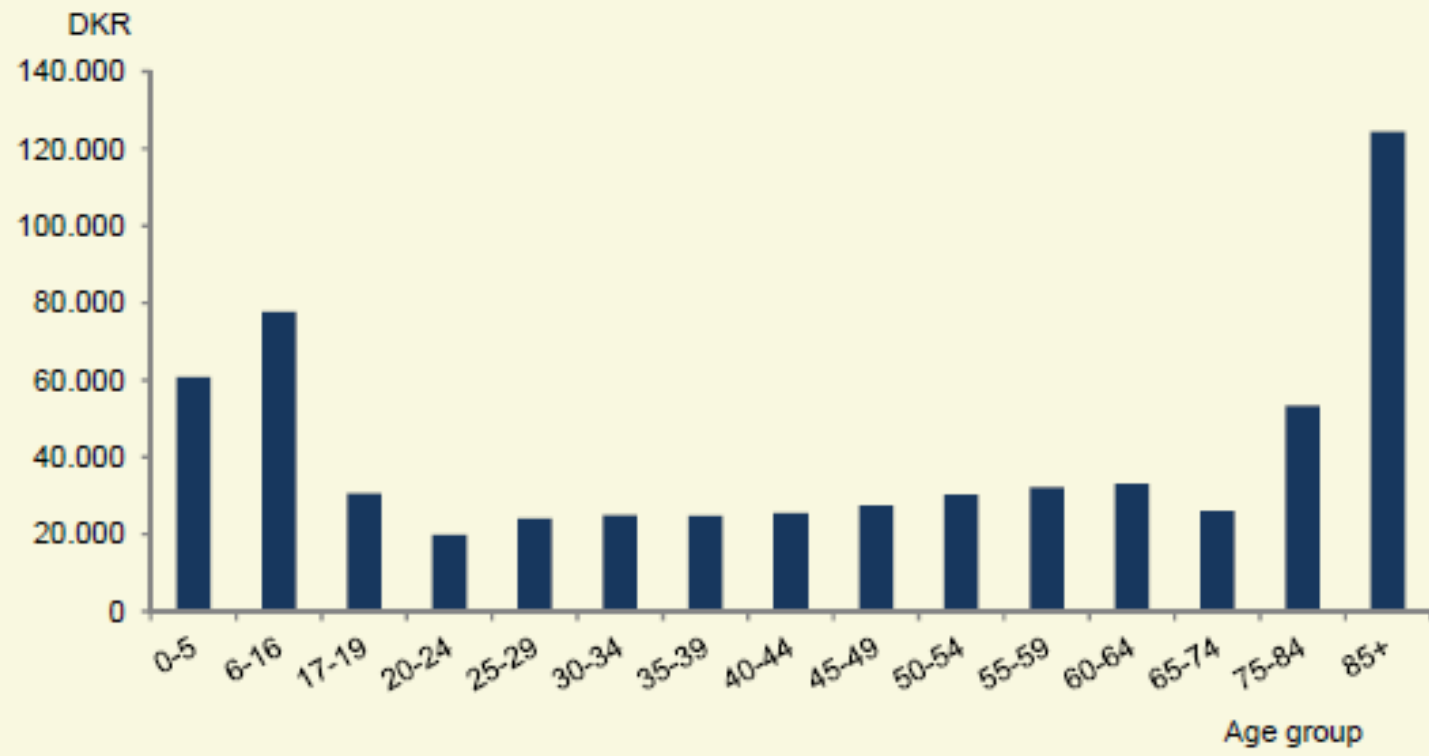
# Criteria used for calculation of the expected expenditure level

- 68 % of local expenditure is explained by the demographic composition of the single municipality
- 32 % is expected to be dependent of socio-economic differences in local communities

# Demography:

## Unit costs related to age groups

Graph of unit amounts for the age-related expenditure need in the national equalisation for 2014



# Socio-economic differences in local expenditure

- A "socio-economic index" is calculated trying to measure the non-demographic factors determining demand for municipal services and income transfers
- The criteria used in calculation are supposed to be independent of local decisions

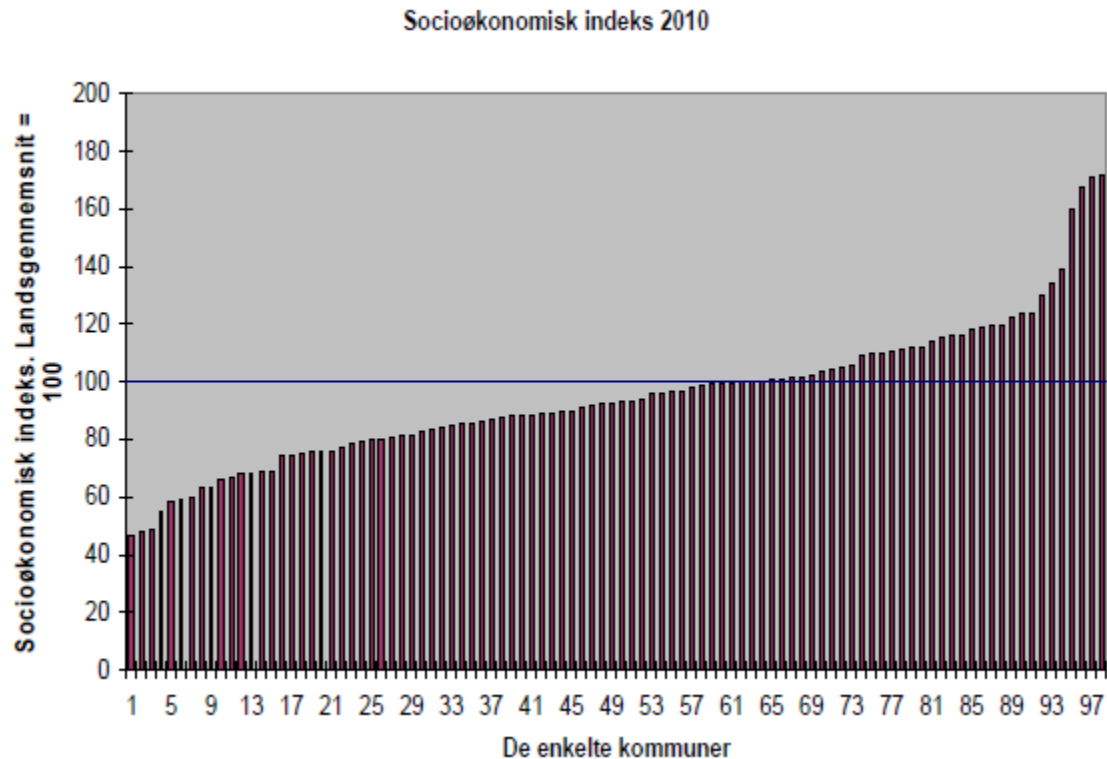


# Socio-economic criteria

Criteria and weights for the socioeconomic expenditure need in the national equalisation for 2014

Criterion	Weight in the national equalisation
20-59 year olds without employment over 5% 1)	19%
25-49 year olds without vocational training	16%
Rented apartments	5%
Psychiatric patients	5%
Families in certain types of housing	15%
Children in families where the parents have no or little education	8%
Singles of 65 years and older	2.5%
Individuals with a low income in three out of four years	8%
Number of mentally handicapped	5%
Number of immigrants and descendants	3%
20-59 year olds with basic skills	5%
Estimated annual reduction of the population	2%
Children with single parents	4%
Children who have moved to another municipality at least three times	2.5%

# Local governments distributed according to the socio-economic index



# Socio-economic index

- A value exceeding 100 indicates that your population is composed in such a way that it will need more services or transfers than the population in an average community
- Example  
Children in families where parents have little or no education are supposed to need some extra attention either in school or in the social care system

# Calculation of the expected expenditure level in a municipality

**Age derived expenditure need** calculated by multiplying the number of inhabitants in each age group with the national unit cost related to this age group

+

**The socio-economic expenditure need** calculated on the basis of the local authority's socio-economic index value

=

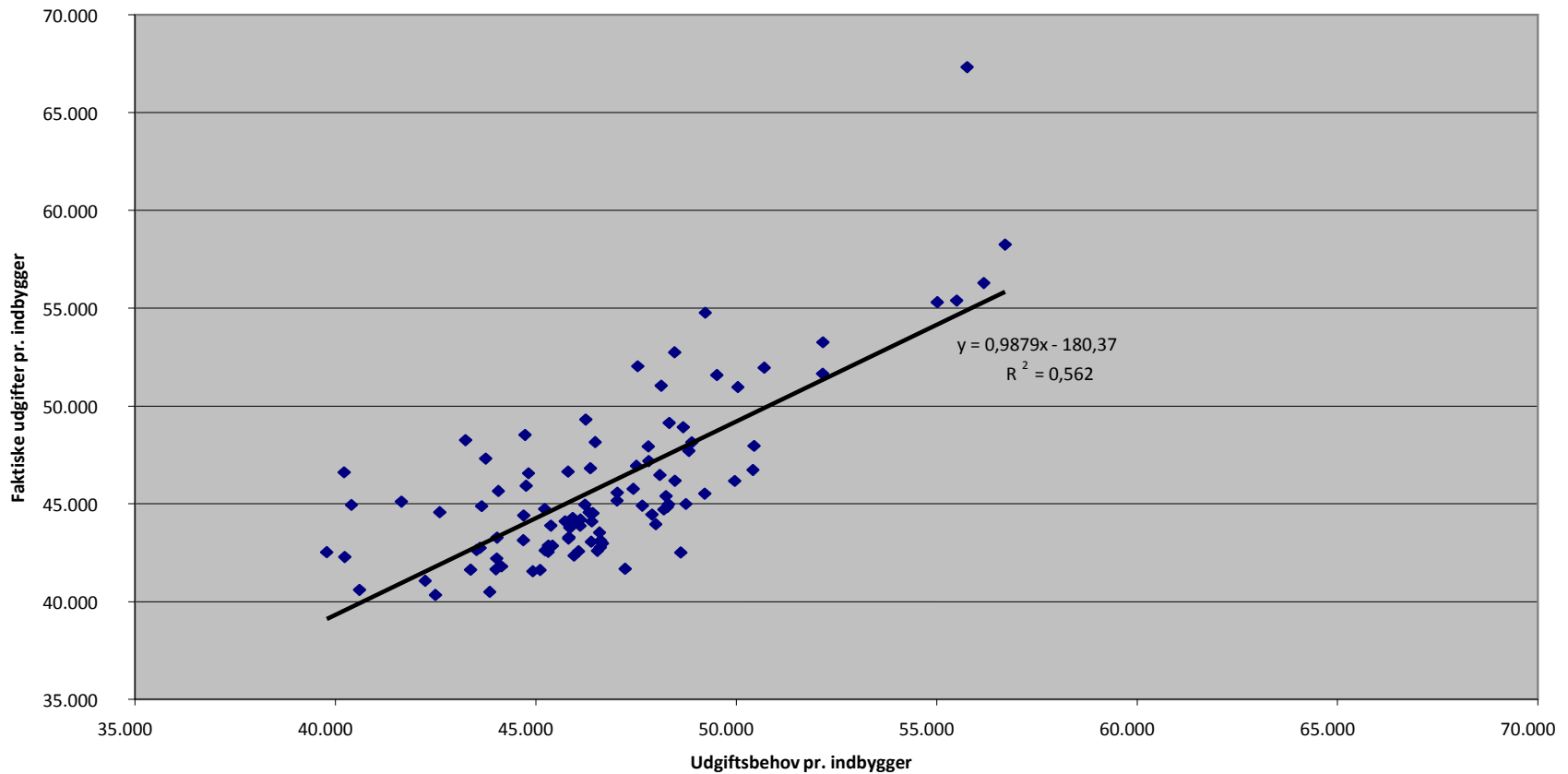
**The municipality's total expected expenditure**  
(expenditure need)

# Calculated expenditure level is not equal to actual local expenditure

Why?:

- The local government may choose another level of expenditure (service)
- There are differences in effectiveness
- The calculation is not able to take into account all factors determining the local demand of public services

# Calculated expenditure vs. de facto expenditure



# Financing the equalisation scheme

The 58 % equalisation system is financed by:

- state grants (the major part)
- contributions from the few municipalities with a structural surplus (58 % of their surplus)

# Supplementary equalisation schemes

- An extra "turbo-equalisation" scheme is added for the local governments with the largest deficits:  
A further 32 percent coverage of "structural deficits" exceeding national average is added financed by state grants.
- A special equalisation scheme is used within The Copenhagen Metropolitan area



# Resulting level of equalisation

- The poorest communities: 90 per cent equalisation (58 + 32)
- Other communities: 58 per cent

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The exact level is a political choice - but also take into account:

- the uncertainty in calculation of the expenditure needs
- incentives to create growth ?

# Structural deficits before and after equalisation grants

