

Prepared for inclusion in Peter Munk Christiansen, Jørgen Elklit, & Peter Nedergaard (eds.), *Oxford Handbook of Danish Politics*, Oxford: OUP (2020?)

## **Incomplete draft!**

### **Chapter 9**

## **Municipalities and Regions**

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#### **Abstract (max 200 ord)**

Denmark is a highly decentralized unitary state with a three-tier administrative system consisting of central government, five regions and 98 municipalities. Danish municipalities are some of the largest compared to the rest of Europe. They deliver a broad range of functions and are entitled with a high level of autonomy. Taxes are the most important revenue source accounting for nearly 60% of all municipal revenues, whereof income tax is the most relevant and locally flexible. Municipalities are responsible for about half of the total public expenditure. The five regions xx..

**Key words:** decentralization, structural reform, central-local relations, multi-purpose municipalities

### **Local Politics in the Eye of Decentralization, a Big-Bang Structural reform and a toughened National Spending Regime**

Denmark is among the most decentralised countries in the world, both when it comes to fiscal decentralisation (Ivanyna and Shah 2014; Rodden 2014) and local autonomy (Ladner et al. 2016). The three-tier level of government today encompasses two levels of

subnational governments besides the state level: regions and municipalities. After decades with gradual consolidation and stabilization (Blom-Hansen 1999, 359) and no dramatic changes in the Danish local government system (Elklit and Kjær 2006), the turn of the millennium soon marked dramatic changes. In 2007 a major structural reform was implemented. The reform was quick and radical (Mouritzen 2010). In 2002 the Minister of the Interior stated that the government had no plans to change the structure of the local governments, four months later a Commission on Administrative Structure was formed and after another four years the biggest structural reform of local government in thirty-five years was implemented by 1.1.2007 (Mouritzen 2009). This included amalgamation of 271 municipalities into 98 municipalities and replacement of 14 counties with five new regions as well as simultaneous transfers of functions between the three tiers. As a consequence of the mergers the average population size of municipalities changed dramatically from approximately 20,000 inhabitants to 55,000 inhabitants (Blom-Hansen et al. 2014), and Danish municipalities are now relatively large in comparative terms (Baldersheim and Rose 2010). At regional level the size of the jurisdictions simultaneously increased from 340.000 to 1.1 mio. inhabitants.

Less than two years after the structural reform Denmark were hit by the financial crisis and in the wake of the crisis the national government implemented a strengthened spending regime on all three tiers of government, including law-enforced spending ceilings for municipalities overall and the regions overall (Houlberg 2018, Suenson et al. 2016). This so-called “Budget Law” has been labeled the most important public spending act ever (Suenson et al. 2016) and has affected central-local relations, the role of Local Government Denmark (LGDK) and the Association of Danish Regions (ADR) as well as local discretion and fiscal management focus. Budget overruns usually characterized the municipalities at large and the regions at large prior to

the Budget Law, whereas budget *underruns* seem to be a permanent feature after the implementation of the sanction regime (Houlberg 2018).

This chapter describes and discusses the local political system and democracy, the administrative and political structure of municipalities and regions, revenues and expenditures and changes in central-local relations and local discretion in the wake of the structural reform and a strengthened national spending regime. Initially we briefly describe the administrative structure of Denmark after the structural reform.

### The Administrative Structure of Denmark

Denmark is a unitary state consisting of central government, 5 regions and 98 municipalities. As part of the structural reform in 2007 tasks were transferred from counties to the state (e.g., youth education and larger roads) and to the municipalities (e.g., environmental regulation and specialized institutions for disabled), and from municipalities to the state (e.g., tax assessment). Figure 9.1 shows the functions of the three tiers after 2007, including the subsequent transfer of responsibility for insured unemployed from central government to municipalities in 2009.

Figure 9.1: Functions of central government, regions and municipalities

Functions	Central Government	Regions	Municipalities
Service	<ul style="list-style-type: none"> <li>• General planning of health care</li> <li>• Education and research - except primary and secondary school</li> <li>• The Social area: National Knowledge</li> <li>• Some cultural arrangements</li> <li>• Reception of Asylum Applicants.</li> </ul>	<ul style="list-style-type: none"> <li>• Hospitals, general practitioners</li> <li>• Operation of services for espoused groups and groups with special needs and institutions for children and young people with social and behavioural</li> </ul>	<ul style="list-style-type: none"> <li>• Child Care</li> <li>• Primary school including special education</li> <li>• Elderly Care</li> <li>• Special education for adults</li> <li>• The social area: financial, supply and regulation. Including responsibility for espoused groups and groups with special needs and institutions for children and</li> </ul>

		problems that has not been taken over by the municipalities	young people with social and behavioural problems (of which some are operated by the regions) <ul style="list-style-type: none"> <li>• Health Care: out-patient treatment and joint financial responsibility</li> <li>• Libraries and other cultural areas</li> <li>• Employment Service</li> <li>• Integration of immigrants</li> <li>• Business service and promotion of tourism</li> </ul>
Infra Structure	<ul style="list-style-type: none"> <li>• Road and rail system</li> </ul>	<ul style="list-style-type: none"> <li>• Responsible for setting up Regional Transportation</li> </ul>	<ul style="list-style-type: none"> <li>• Part of Regional Collective Transportation</li> <li>• The local road system</li> <li>• Supply company and emergency services</li> </ul>
Regulation	<ul style="list-style-type: none"> <li>• Police, defence, administration of justice</li> <li>• Tax assessment</li> <li>• General planning of nature and environment</li> <li>• Business Economy subsidies</li> </ul>	<ul style="list-style-type: none"> <li>• Few functions in the area of environment, planning and (business) development.</li> </ul>	<ul style="list-style-type: none"> <li>• Town and district plans</li> <li>• Construction Projects</li> <li>• Environment</li> </ul>

Note: adopted from Andersen (2010) and The Ministry of Interior and Health (2005)

The structural reform was at the same time a centralisation and a decentralisation reform. On one hand, the main direction of task transfers was from regional to local level, i.e. increased decentralisation. On the other hand, the main entities for local democracy and provision of public services, the municipalities, got larger and thus increased the distance between citizens and politicians. Transfers of tasks to central level from municipal level (tax assessment) and regional level (youth education) represent other elements of centralisation.

As illustrated in figure 9.1, the municipalities are multi-purpose units responsible for large, expensive, politically salient, and important tasks. Apart from hospitals, the municipalities are responsible for all citizen-related public services and account for 50 percent of total public

expenditures. In 2007, the regions on the other hand were stripped of almost all other tasks than hospitals and today therefore resembles single-purpose jurisdictions. In sum, the regional tasks account for 12 percent of total public expenditures (Christiansen 2014:87). Thus, the municipal level is more than ever the focal pivot for balancing between local democracy and implementing agency of the state (Blom-Hansen and Heeager 2011).

### **Local Political System and Democracy**

The political system in the municipalities consists of three bodies: a council, a set of standing committees, and a mayor (Blom-Hansen and Heeager 2011). The political rule of the system may be termed a committee-leader rule (Mouritzen and Svava 2002, 60). The municipalities are governed by the city councils with between 9 and 31 members elected by citizens every four years. The mayor is elected by and among local councillors on a simple majority basis and is the formal head of the administration as well as the chair of the financial committee. The mayor is the only fulltime politician. The mandatory financial executive committee is responsible for and supervises the budget and other financial affairs of the municipality. The tasks of the financial executive committee are determined by statute. There are fewer legal restrictions to the establishment of the standing committees; however, at least one in addition to the financial committee should be established. Most municipalities have between 4-7 standing committees. Besides from the financial committee these are typically a social committee, a school and culture committee and a technical committee responsible for public utilities, roads and environmental regulation (Blom-Hansen 2002, 88). The members of the standing committees are also elected by and among the council members, but on a proportional basis. All elected councillors are guaranteed a seat in a committee. As a result, power is spread between the committees, the

financial executive committee and the mayor (Andersen 2010). The committees are responsible for the day-to-day administration of the various policy areas and elect their chairman on a simple majority basis (Blom-Hansen and Heeager 2011). Although the chairmen in contrast to the mayor are only part-time politicians and only have few formal powers, they can be quite powerful since considerable influence is often delegated to them in practice. A consequence of the committee rule is that there rarely can be identified one centre of power in the municipalities. The power is dispersed between different political bodies as well as between local politicians and council officials. Denmark has formally prioritised a layman rule, dispersion of power and consensus with the consequence that the power structure between the mayor, committees and administration is unclarified (Andersen 2010; Kjær and Mouritzen 2003, 204-5).

At the regional level, the counties had a political system similar to the municipalities until the 2007 reform, but important changes in the regional political system were implemented as part of the 2007 reform (Blom-Hansen and Heeager 2011). The regional council, which has 41 members, is the supreme body. In addition there is a regional chairman holding a position comparable to the municipal mayor. However, the regions do not have a committee system. They may, but are not obliged to, leave daily administrative matters to an executive committee, both cannot establish standing sectoral committees like the municipalities and the old counties (Blom-Hansen and Heeager 2011).

Elections for municipal and regional boards are held simultaneously every four years. The turn-out has remained relatively stable and comparatively high at approximately 70 % (see table 9.1).

However, the turn-out for local elections is lower compared to the turn-out of national elections

and as citizens identify more with municipalities than with regions, the turn-out at regional elections would probably be lower if elections days for regional councils were not coinciding with municipal elections.

Table 9.1: Turn-out at local elections, 1985-2017

Election year	1985	1989	1993	1997	2001*	2005	2009	2013	2017
Municipal level	69,8	67,6	71,2	70,1	85,0	69,4			
Regional level									

Note: \*At the election in 2001 the turn-out was substantial higher due to the election for the national parliament was held at the same time. [table to be updated]

As the turn-out has been stable for many years the Danish municipalities have not experienced a political crisis regarding local democratic legitimacy (Andersen 2010). However, the historically high level of political trust and political self-efficacy at local level as well as identification with the municipality have been showing declining tendencies, not at least in the municipalities amalgamated in 2007 and not at least in the first years after the 2007-reform (Hansen and Hjelmar 2015; Kjær et al. 2010; Lassen and Serritzlew 2011).

### **Administrative Structure of Municipalities and Regions**

The administrative structure in Danish municipalities has always been subject for change (Hansen et.al. 2010) and there has been a considerable variation in structural arrangements (Bækgaard 2008; Ejersbo 1998).

The municipality's administration follow typically one of two models. About half of the municipalities use some variation of the “Department-model” (Ibsen 2016). This model has been

the traditional model for organizing the administration in the municipalities, but are subject to considerable local variation. In this model, the administration is divided into a number of departments/sections representing the major welfare services, each managed by a Director with responsibility for the preparation of policy decisions as well as for subsequent execution (Christensen, Christiansen & Ibsen 2017). The average number of departments in each municipality has changed over time and since the structural reform, we see an increase in the number of departments (Bækgaard 2008). The department model gives a close relationship between the political committee (and especially the chairman) and the director of the department and potentially increase the departmentalization of the political system. The other model is termed the “directors model” where a number of directors form a top management team that collectively are in charge of the administration. The top management team prepare policy decisions and service the committee not the individual director. The model is supposed to increase coordination and collaboration across the departments and committees (Bækgaard 2013) and strengthen the overall management of the municipality.

[To be continued]

### **Local Discretion in the Light of Changed Central-local relations**

Within the framework of national regulation and the so-called ‘budget cooperation system’, the Danish municipalities along with other Nordic countries are entitled a comparatively high level of local autonomy (Ladner et al. 2016). Recent changes in central-local relations however affects the level and content of local discretion.

According to the Danish Constitution the right of municipalities to manage their own affairs independently – under State supervision – shall be laid down by statute. The Constitution also prescribes that

some of the public tasks should be allocated to the local governments and that the Danish Parliament decides how much should be allocated. Denmark has no single local government act defining the tasks of the municipalities but over time the Danish municipalities have been granted a wide scope of predefined tasks laid down by law in various acts and legal statutes. In addition municipalities have the ability to perform certain tasks based on the so-called municipal authority rules (“Kommunalfuldmagtsreglerne”), which is a general term for the unwritten rules (principles) of the local non-statutory duties. The precise definition of the municipal authority rules is often complex as the authority rules composes a series of inaccurate and often overlapping unwritten rules. In practice the municipal authority rules imply that tasks the municipality wants to perform must be of some benefit to the community, must not be tasks delegated to other levels of government, and must not be providing support for individuals or individual companies without specific legal cover. Municipalities are basically not allowed to engage in trade or industry. A classic example of tasks that municipalities may carry out according to the municipal authority rules is public transport and initiatives in leisure, culture and sport.

Within the framework of Fiscal federalism Denmark is among the most fiscally decentralised countries in the world (Ivanyna and Shah, 2014; Rodden, 2014) and over the last four decades an increasing number of task and responsibilities have been transferred to the municipalities (Blom-Hansen et al. 2012). Financial and budgetary reforms in this period aimed at strengthening the financial responsibility of local government as well as providing tools for assessing the total public budget by standardizing budgets and accounts (Blom-Hansen et al. 2012). A general feature of many reforms have been a decrease in conditional grants/reimbursements rates for specific municipal expenditures and a gradual conversion of these to general grants (Pedersen and Frandsen 2017). There are few formal or legal requirements regarding local economic activity. The most important constraint is that local revenues and expenditures are required to balance within some limits (Andersen 2010). Furthermore, budgets and accounts must be specified according to standards set by the Ministry of the Interior and the

local government act stipulates the procedure for setting a budget e.g. it must be debated twice in the council and be presented and decided upon at a certain date (Serritzlew and Blom-Hansen 2014).<sup>1</sup> However, economic activities of the municipalities are mainly regulated through informal procedures. The most important of these is the 'budget cooperation system'.

Increasing decentralisation have made coordinating of local economic activity with national economic policies an increasingly important issue and since the beginning of the 1980s the 'budget cooperation system' have been institutionalised in form of annual negotiations and agreements between the national government (NG) represented by the Treasury and the Association of Local Governments (LGDK) and the Association of Danish Regions (ADR)<sup>2</sup> respectively (Andersen 2010; Blom-Hansen et al. 2012: 117ff). These annual agreements set collective guidelines for the annual general expenditure and income for the municipalities and regions respectively. Over the years, the agreements have changed from a few pages setting guidelines for the overall taxation and expenditures to more voluminous documents of 25-30 pages setting not only the overall guidelines but a number of common understandings and agreements on the desired development of specific sectors or policies. The level of detail varies from merely recommending a rate of real expenditure growth to for example specifying that taxes cannot be raised and to setting of specific growth rates for particular sectors (Juul and Kyvsgaard 2004, 242-4) and/or setting specific aims for the level of out-sourcing of services or aims for efficiency gains to be achieved from more coordinated procurement of goods. The economic agreements are agreements of the tax and expenditure level for the municipalities collectively (Blom-Hansen et al 2012, Houlberg 2018). No frames are set for the individual municipality, and the agreement is not binding for the individual municipality (or region). In principal, each municipality is still able to set its own rates and policy– as long as the collective limits for the municipalities at large are not violated. In order to keep the collective budgets of the municipalities within the agreed level LGDK thus have an active role to coordinate the budget processes of the individual municipalities. Not at least since 2011

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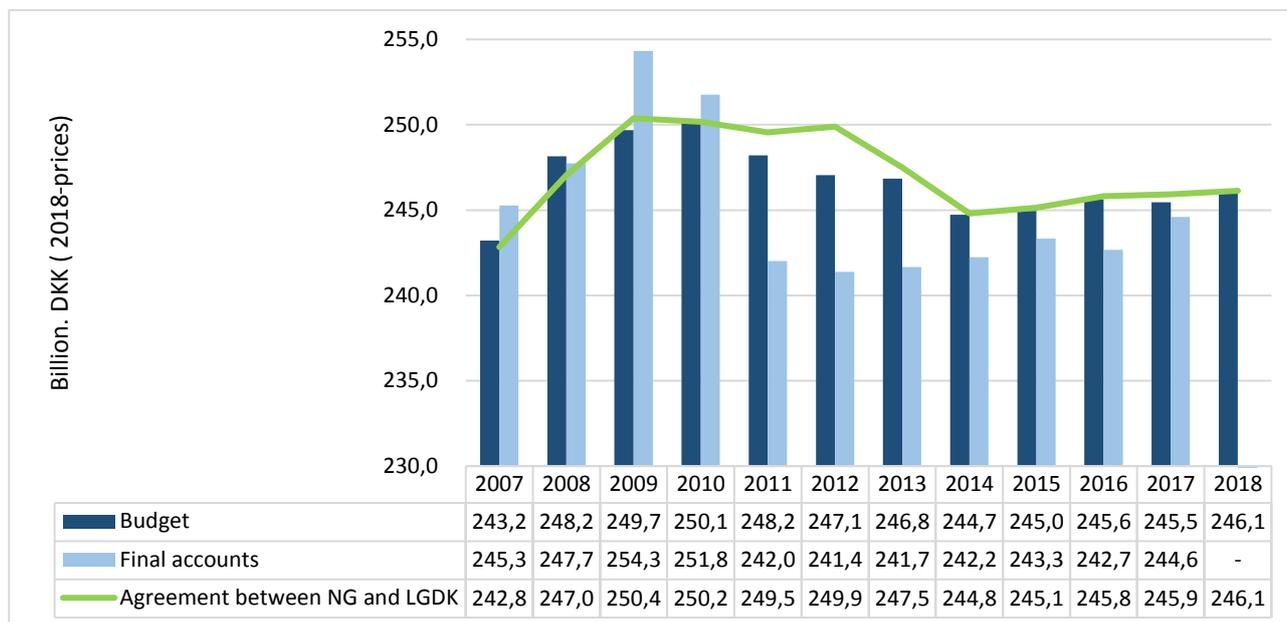
<sup>1</sup> Furthermore, there are relatively restricted options for loans as sources of municipal income (Andersen 2010).

<sup>2</sup> Until 2007: The Association of County Councils (ACC)

when a national sanction regime was implemented and the coordination of LGDK have evolved into a phase divided budget process involving an increasing frequency of meetings and consultations with all or parts of the municipal mayors, CEOs and/or head of finances.

Until 2010 the municipalities at large were typically overrunning the agreed levels of taxes or expenditures, often in the approved budgets and even more often in the final accounts (Serritzlew and Blom-Hansen 2014; Houlberg 2018). Until 2010 the partners however had an implicit common understanding, that the approved budgets were the basis for evaluating whether the agreements were kept and though the possibilities of sanctioning the local governments were articulated by the national government, the national government in practice rarely used the parliamentary channel to actually sanction violation of the agreements (Houlberg 2018). National government policy dramatically changed in the wake of the financial crisis and historically large municipal budget overruns in 2009. In 2011 the national parliament implemented a law-enforced sanction regime on the municipalities, which was later integrated in the so-called “Budget Law” (Houlberg 2018; Suenson et al. 2016). The sanction regime implies that economic sanctions are by law enforced if the municipalities (and regions) are not keeping the economic agreements in both the approved budgets and the final accounts. Eventual sanctions will be implemented by cut in general grants by up to 3 billion DKK in the year preceding the violation. In addition, the law stipulates that if the budgets are overrun, the sanctions will be directed by 60 percent on the individual violating municipalities and 40 percent collectively on the municipalities at large. So far, no actual sanctions have been practised; the threat of sanctions combined with an increased crises consciousness seem to have been successful (Houlberg 2018; Suenson et al. 2016). Budget overruns usually characterized the municipalities at large and the regions at large prior to the Budget Law, whereas budget *underruns* seems to be a permanent feature after the implementation of the sanction regime in 2011 (Houlberg 2018). Figure 9.2 illustrates this.

Figure 9.2. Municipal service expenditures 2007-2018



Source: LGDK

In the years prior to the implantation of the sanction regime in 2011, the municipalities at large were typically overrunning the budgets, ie. the light blue pillars in figure 9.2 are higher than the dark blue pillars. However, since 2011 the budgets of the municipalities at large have been underrun by 1-6 billion DKK each year and the municipalities each year end up realizing expenditures well below the spending ceiling set by the agreement (from 2014 by the Budget law). As a by-product of the increased focus on keeping the budget, the economic policies of municipalities have partly moved away from performance management in favour of expenditure control (Sørensen og Foged 2015) and the political influence on agenda-setting and decision-making in the municipal councils is redistributed from the councillors not on the finance committee towards members of the finance committees (Houlberg et al. 2018).

A similar pattern as in figure 9.2 applies for the regions, albeit the level of the agreed expenditures in general have been increasing as a reflection of the high policy prioritisation of

health care in the national parliament. In addition to expenditure limitations, the economic agreements at regional level since 2002 have included a demand for 2 percent yearly hospital efficiency gains. Within the same level of expenditures, the hospital in other words have been obliged to produce 2 percent more activities each year. Otherwise, state activity grants are not released for the regions not fulfilling the demanded efficiency gains.

Over the years from 2003 to 2015, the hospitals on average increased efficiency as demanded (Højgaard et al. 2018:172). However, not without feedback consequences for the budget cooperation system. According to ADR the continuous efficiency demand implies that hospitals are not always delivering the best possible service for the citizens and that the hospital staffs are too busy – and in the agreements for the regions for 2018 and 2019 the efficiency demand has been suspended. In addition, a significant share of the efficiency gains have been realized by switching activities more towards ambulant/outpatient treatment and LGDK accuses ADR of having realized efficiency gains by shifting costs to municipalities as the costs of rehabilitation of patients is a regional responsibility whereas the costs of rehabilitation of citizens is a municipal responsibility. The exact functional and financial interface between regions and municipalities thus continuous to be challenging and disputed. Though the agreements between the national government and LGDK and ADR are principally two separate pillars of the budget cooperation system, the agreements are chronologically synchronous and in practice connected and interwoven.

A tax stop has been a core element of national tax policies since 2001 and unchanged tax levels for the municipalities and regions at large have correspondingly been an integral part of the yearly agreements. From 2007 the regions have no right to levy taxes and accordingly this

element is no longer part of the regional agreements, but continues to be a core element of the municipal agreements. This has reinforced a tendency that less and less municipalities are actually deciding to change their tax rates (Blom-Hansen et al. 2012). The system thus loses flexibility, as municipalities are only allowed to raise taxes if other municipalities similarly lower the taxes – and municipalities having the economic possibilities and the political ambitions to lower taxes may refrain to do so as they fear they will not be allowed to raise taxes again if the economic situation worsens. At present, it can therefore be questioned whether the municipalities can raise taxes independently due to the restrictions placed on the individual municipality through the budget cooperation (Andersen 2010). Put in other words, the local income taxation right, which has traditionally been considered a cornerstone of Danish local self-government, is losing its vitality and in reality mainly exists on paper (Blom-Hansen et al. 2012).

Besides a tighter economic steering regime in central-local relations, a setting of tighter norms and the centralisation by the national level has occurred since the mid-1990s. Central regulation of the municipalities is increasingly a regulation of the administrative processes in the municipalities, that is, process regulation (Andersen 2010). Process regulation refers among others to regulation on user involvement, requirements to produce plans of actions, visitation and requirements on applying specific methods, follow-up actions, free choice or applying standards of quality (KL et.al. 2005). Within specific sector areas such as health and basic education, the national government has interfered more and more emphasis is put on the results achieved within these areas (Andersen 2010). Municipalities and regions are subject to demonstrating their achievements through such things as benchmarking, publicising waiting lists or exam results. This process has been supplemented by national legislation introducing free choice into various public services areas (Andersen 2010).

In addition, the impact of EU-policies affects the discretion of local government in Denmark (Andersen 2010). As a supra-national unit, EU primarily affects the national level of government. However, given the position of municipalities in the Danish public sector, the EU also has consequences for the discretion of local government, e.g. particularly in such areas as the environment, outsourcing and call for tenders, regional development and the labour market. The municipalities are either bound by EU-regulation in these areas or responsible for administering EU-regulation. In sum, the steady decentralisation of tasks has on one hand increased the discretion of the municipalities for the past decades. However, the decentralisation has subsequently been accompanied by process regulation that on the other hand restricts the discretion of the municipalities. The 'national mood' may also have changed in the sense that less emphasis is put on local diversity (Andersen 2010). However, as pointed out below considerable diversity still exists.

## **Expenditures and Revenues**

### *Expenditures*

Table 9.2 shows the distribution of municipal and regional expenditures by main functional categories. In line with the task portfolios set by the 2007-reform, health care is the by far most important task of the regions. Hospitals account for the majority of the health expenditures, but primary health care by general practitioners etc. is also included. National regulations and standards delimit the regional autonomy substantially, and basically leaves the regional councils with fairly little discretion for prioritizing and organize *within* the hospital sector. As a consequence of the nearly single-purpose status of the regions, discretion for prioritizing *across* policy areas is almost non-existing.

### **Table 9.2: Gross current and capital expenditures of municipalities and regions (budget 2018)**

<b>Municipalities</b>	DKK		<b>Regions</b>	DKK	
	billions	%		billions	%
Urban and environmental affairs	17,4	3,9	Health care	128,0	93,4
Public utilities	9,5	2,1	Social affairs	4,1	3,0
Traffic and infrastructure	15,4	3,4	Regional development	3,3	2,4
Education and culture	77,8	17,4	Administration	1,7	1,2
Health care	31,0	6,9			
Social affairs and employment	250,9	56,1			
Administration	45,1	10,1			
<b>Total</b>	<b>447,1</b>	<b>100,0</b>	<b>Total</b>	<b>137,1</b>	<b>100,0</b>
<i>Hereof:</i>					
Capital expenditures (gross)	19,1	4,3		7,8	5,7
Service expenditures (net current)	246,0	55,0			
Social benefits and employment (net current)	80,7	18,1			
Co-financing of regional health care (net current)	21,9	4,9			

Source: Statistics Denmark.

At municipal level the most important main category of task is social affairs and employment. This includes a number of policy areas like day care, elder care, specialised services for children, youth and adults with special needs, social benefits and employment activities for unemployed. In addition, expenditures for education account for a substantial part of the budget. In fact, running primary and lower secondary schools is the economically single most important policy area – and along with day care and elder care also the most politically salient areas (Bækgaard et al. 2015; Houlberg et al. 2016). In contrast to the regions, the municipalities are entitled a high level of local decision-making autonomy with respects to allocate resources according to local needs and preferences. Within the framework of national legislation and the yearly economic agreement between the Government and LGDK, the municipal councils have autonomy to decide the allocation of resources across policy areas and have a large degree of discretion in setting the standard and quality of services (Andersen 2010). This discretion is reflected in substantial differences in the level of expenditure between the municipalities, cf. table 9.3.

**Table 9.3. Variations in selected municipal expenditure and taxation levels budget 2018**

	Mean	Minimum	Maximum	Standard deviation	Coefficient of variation
<b>Expenditures (DKK)</b>					
Daycare per 0-5 year old	69079	51999	89810	6428	0,093
Schools per 6-16 year old	78818	66264	109814	8425	0,107
Elder care per 65+ year old	38910	24694	58999	5948	0,153
Children and youth with special needs per 0-22 year old	10419	3838	24918	3446	0,331
Adults with special needs per 18-64 year old	9082	6428	15942	1630	0,180
Culture per inhabitant	1745	831	3055	449	0,257
Road maintenance per inhabitant	1160	450	3106	406	0,350
Administration per inhabitant	6394	4549	14210	1358	0,212
<b>Selected tax rates</b>					
Income tax rate (%)	25,3	22,5	27,8	0,967	0,038
Land tax rate, farm buildings (‰)	6,8	1,2	7,2	1,029	0,151
Land tax rate, other buildings (‰)	26,1	16,0	34,0	4,602	0,176

Source: Statistics Denmark.

The differences in expenditures do not necessarily indicate similar differences in the quality of service. They may reflect differences in expenditure needs and municipal wealth and for most policy areas in fact 50-80% of the inter-municipal variations may be explained by differences in fiscal environment (Houlberg et al. 2018) indicating that the municipalities are adapting policies to local needs and preferences. However, the difference between the municipalities with the highest and lowest expenditures within a number of sector areas is considerable, especially in such areas as elder care, culture and road maintenance. Though national regulation through the budget cooperation system has been strengthened and become more detailed, considerable variation in the level of expenditure across the municipalities remains and reflects the autonomy and discretion entitled at municipal level.

Furthermore, some delegation of functions and financial responsibility from the municipal level to the service producing institutions has been implemented in most municipalities since the beginning of the 1990s (Andersen 2010). In this way, we find a decentralised system not

just between the state and the municipalities, but also within the municipalities. Though many municipalities in the wake of the budget law seem to have restricted the access of transferring budgets from one budget year to another, the managers at schools, day care centres and elder care centres still have a large degree of discretion with regard to finance and organisation.

### *Revenues*

Municipal and regional expenditures are financed by different income sources. The regions are not allowed to levy taxes and state grants is the by far most important revenue source. General grants account for 75% of the revenues and are distributed to the individual regions by demographic and socioeconomic criteria. Besides these activity-independent grants, the regions are financed by activity-dependent grants from the state (depending on assessment of the 2 percent efficiency demands) and by activity-based co-financing from municipalities for citizens' treatment at hospitals and general practitioners.

At the municipal level, taxes are the main source of revenue (Blom-Hansen and Heeager 2011). Taxes account for nearly two thirds of the revenues of the municipalities at large (see table 9.4). The most important tax source is local income tax. In addition, municipalities levy land taxes and corporate taxes, but these generate far less revenue. The second most important revenue source is grants from the central government in form of a general block grant and conditional grants for expenditures mainly for income transfers to recipients of unemployment benefits, social benefits, sickness benefits etc.. Third, municipalities levy fees and user charges within the utility area and the social area. Finally, borrowing is generally forbidden, but exemptions are granted for a number of capital goods specified by central government regulation (Blom-Hansen and Heeager 2011).

**Table 9.4. Municipal revenue sources budget 2018**

	Billion DKK	Per cent
Taxes	283,8	63,5
General grants and equalisation	78,3	17,5
Conditional grants	25,9	5,8
Fees and user charges	61,0	13,6
Net borrowing	-1,7	-0,4
Other	-0,3	-0,1
<b>Total</b>	<b>447,1</b>	<b>100,0</b>

Source: Statistics Denmark. 'Other' includes sale of capital assets, net interest payment and use of liquid assets.

The figures in table 9.4 however represent the average revenue profile and considerable variation exists across municipalities due to variations in local fiscal environments and local policies. In some municipalities general grants account for 35 per cent of the revenues, in other municipalities *minus* 30 per cent of the revenues. These differences reflect the importance of the equalisation scheme, which aims at evening out the differences in the economic situation in the municipalities and give the municipalities approximately the same financial basis on which to solve their tasks (The Ministry of Economic Affairs and the Interior 2014).

The equalisation scheme is complex and includes a set of special subsidies and equalisation schemes. However, the main elements are a national equalisation scheme covering all municipalities and an additional capital equalisation scheme for the municipalities in the capital area. In the national equalisation scheme, 58 per cent of the difference between a municipality's estimated expenditure needs and its tax revenue based on an average tax rate are equalised. In the capital equalisation scheme, an additional 27 per cent of the differences are equalised. Estimations of expenditure needs are based on two set of indicators (The Ministry of Economic Affairs and the Interior 2014):

- Demographic expenditure needs. This includes the population's distribution in a number of age groups and an indicator of the dispersal of settlement
- Socio-economic expenditure needs. This includes a number of socio-economic criteria like 25-49 year olds without vocational training, families in certain types of housing, children in families where the parents have little or no education, the number of individuals with low income, number of immigrants and descendants and number of children with single parents.

The level of equalisation in the national equalisation scheme was increased as part of the 2007-reform and the new tasks transferred to municipalities. This combined with subsequent redistribution of conditional grants and less flexibility in the economic agreements to adjust taxes has turned general grants and equalisation a more important and viable part of municipal revenues. In line with the increased economic importance of the equalisation scheme, the content of the scheme is increasingly being politicised both at national and local level. An increasing number of municipalities or groups of municipalities question the level of equalisation and/or the criteria of the equalisation scheme, the relative weights of the criteria or the measurement of the individual criteria – and call for a more 'just' equalisation scheme. However, the scheme is inherently a zero-sum game and what one group of municipalities argue to be more 'just' other municipalities argue to be the opposite. As stakeholders often evaluate losses higher than gains (Kahneman and Tversky 1979), any national reform of the equalisation scheme is likely to produce more local opponents than proponents. Potential political costs of reforming the scheme thus contributes to explaining why reforms of the equalisation scheme is not high on the national political agenda and the national government for instance in 2018 gave up settling an political agreement of reforming the equalisation scheme.

### **Challenges and Opportunities**

[fortsat snitfladeproblemer]

[manglende fleksibilitet i aftalesystemet/fastlåste skatter]

[rigid udgiftsstyring/øget risiko for benzinafbrænding]

[stigende betydning af tilskuds- og udligningssystemet -> øget politisering]

[fortsat lokal omstillings- og tilpasningsevne, fx rehabilitering og "sverigesmodel"]

## **Conclusion**

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