

The Economy Report.

ON SWEDISH MUNICIPAL AND COUNTY COUNCIL FINANCES
- OCTOBER 2013



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).

As was the case for 2012 non-recurring revenue from the AFA Försäkring insurance company is expected to contribute to positive net income for our sector in 2013. We expect net income for the sector to be a surplus of about SEK 10 billion, corresponding to 1.3 per cent as a share of taxes and transfers. Thereafter things look tougher; demographic change and major investment needs lead to increased costs. To achieve net income of SEK 9 billion in 2017, which corresponds to 1 per cent of taxes and transfers, the tax rate must be increased by 0.31 percentage points, and government grants by almost SEK 18 billion.

This is an abridged version of the report. It contains the Summary (supplemented with some diagrams from the main report) 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 people 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 Jessica Bylund, Elisabet Jonsson and Anna Kleen. We are very grateful to the municipalities and county councils that have contributed basic data to our report.

Stockholm, October 2013

Annika Wallenskog
Section for Economic Analysis

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The Chief Economist's summary

Municipalities and county councils have reported good net income for a number of years. The reason is that tax revenue has developed relatively favourably, despite the economic situation, and local authorities have received additional finance in the form of repayments of AFA insurance premiums and cyclical support. This has been positive at the same time as a false sense of security may have been created when net income has been given such a strong lift. Despite the high aggregate level of net income, many municipalities and county councils are in an extremely difficult situation. If the balance target for the public sector is to be met in coming years, the scope for increased government grants to the sector will be limited. Without higher government grants municipalities and county councils will have to increase the tax rate by almost one percentage point up to 2017 so as to be able to develop schools, social services and health care at the same pace as up to now.

An upturn in the international economy

More than five years after the financial crisis became acute, it seems as if the world economy is slowly beginning to get back on the right track. The US economy is growing steadily, albeit at what is a mediocre rate in historical terms. We assume that the Senate and House of Representatives will manage to agree on the debt ceiling before the consequences become too extensive.

Recently it has also been possible to note signs of life in the Eurozone, which is paralysed by the debt and bank crisis. Even though it is mainly Germany that is showing some strength, it seems as though the worst is also over for Spain and Portugal. However, major question marks have still to be resolved for Greece and Italy, which are suffering from social tensions and political chaos, respectively.

There has been a considerable reduction in the risk of a new bout of acute financial and economic crisis linked to the problems in Europe since the ECB promised in summer 2012 to take all the measures needed to avoid a systemic crisis. The risk of an acute collapse for the EMU must now be viewed as minimal. So we can thank monetary policy for the stabilisation of the situation in the EMU. The same also applies to the US and UK, where the central banks have filled up the tanks of their economies with high-octane monetary fuel. We will have to see whether the realignment of Japanese economic policy in a similar direction can get the Japanese economy to recover after a 20-year period of lethargy.

Even though the world economy is slowly picking up, the financial crisis has left lasting traces. In addition, many countries are still in a situation where both public and household balance sheets must be slimmed: the debts must be reduced. This means that there is reason to expect the global economy to grow much more weakly than we are used to for a number of years to come.

Another consequence of the financial crisis, which may create problems in the coming years, is associated with the fact that sooner or later the central banks must start to remove the enormous monetary stimulus. There is a great risk that they will either do this too quickly and suffocate an incipient recovery in its cradle, or wait too long and release new financial bubbles or inflation. This time this task is more difficult than ever.

So, to sum up, we can note that many countries are still wrestling with weak growth or recession and that the emerging economies are developing more slowly. However we expect the economy to turn round, towards the end of the year and to gain strength in 2014. We expect GDP in the euro zone to fall by 0.4 per cent this year and to rise by 1.1 per cent in 2014.

The Swedish economy will not pick up real speed until 2014

The slow rate of growth in the world economy and the relatively strong krona have a very great impact on the Swedish economy. We expect exports to decrease this year – which is very unusual. The continuation of the relatively weak growth internationally means that the recovery here at home will be more protracted. Nevertheless, next year we expect the better international prospects and a stable SEK exchange rate to have a positive impact on Swedish exports. However, the net outcome of exports and imports is expected to make a mainly negative contribution to growth in the next few years. We expect GDP growth to be a moderate 0.8 per cent this year and 2.7 per cent next year.

While Swedish households have large loans, which are very much linked to high property prices, they have an unusually high level of savings at the same time. This is because real incomes and lower taxes have had a positive impact on incomes while household expenditure on consumption has grown quite slowly. As a result there is scope for households to increase their consumption, and this will influence growth in a positive direction.

Even though we expect international growth to remain relatively slow in 2015 and thereafter, the situation will still get brighter for Sweden as the prospects for Swedish growth are relatively favourable. Households, companies and public finances have such good prospects that this bodes well for the coming years, and we expect growth to be well over 3 per cent per year after 2014.

Gradual rise in employment leads to rapid tax base growth

Despite the weak economic growth in recent years both the number of people employed and the labour force have continued to increase, resulting in an extremely weak decrease in unemployment. We expect the number of hours worked to be largely unchanged for the rest of the year so that unemployment will remain at the level of around 8 per cent until the end of 2013 and then fall slightly next year. The weak labour market will continue throughout 2014, after which a recovery moving towards balance will begin. As the labour market approaches balance, pay will also rise more quickly. In 2017 we expect nominal pay rises to be around 4 per cent.

The slow increase in the number of hours worked this year and the moderate pay rises mean that pay will make a relatively limited contribution to tax base growth. However, pension incomes are rising, leading to a rise of 3.7 per cent in the underlying tax base. Next year the brake will come into operation at the same time as the labour market will not pick up any real pace. Then the underlying tax base will only increase by 3.3 per cent.

Thanks to low price and pay rises the increase in tax revenue will still have a fairly good effect in municipalities and county councils. In real terms the tax base will grow by 1.7 per cent this year and 1.0 per cent next year.

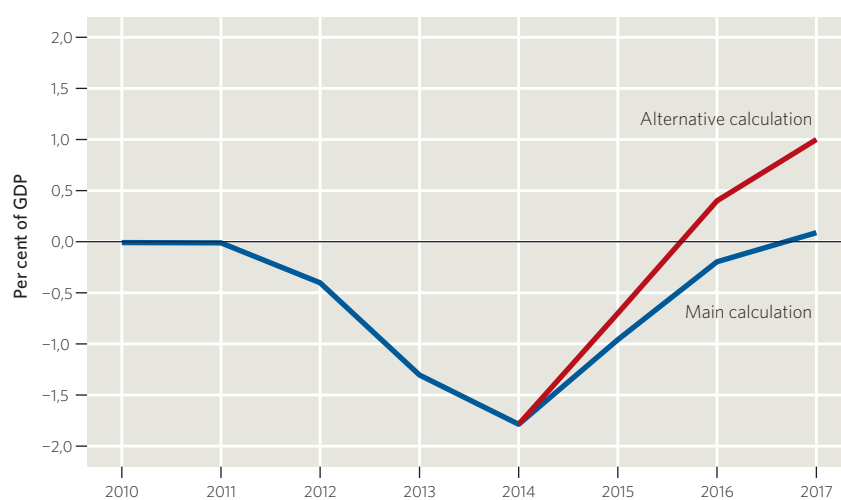
When the labour market moves towards balance in the years after 2014 and pension incomes rise more rapidly, the tax base will increase by an average of 5 per cent per year. Because the overall price and pay increases in the local government sector will average just under 3 per cent per year, the tax base will also continue to provide substantial additional resources in these years.

The public sector will not reach the surplus target; debt as a share of GDP is stable

In our calculations we assume that, as of 2015, local government consumption will rise in line with demography and the historical trend and that municipalities and county councils will adjust the tax they levy so as to achieve net income of 1 per cent of taxes and transfers. This corresponds to half of the rule of thumb for healthy finances. To achieve such a level of net income the county councils would have to raise their tax rate by 0.31 percentage points, from the present level up until 2017. Then the level of government grants to municipalities and county councils must also rise by SEK 18 billion, which is a real increase of 2 per cent per year from 2015 to 2017.

At the same time the public sector only shows a surplus of 0.1 per cent of GDP. This is well under the surplus target for the public sector of a surplus of 1 per cent of GDP on average over a business cycle. We therefore make an alternative calculation in which we assume that the Government and the Riksdag stick to the surplus target and achieve a surplus of 1 per cent of GDP in 2017 by taking measures to strengthen the budget that correspond to SEK 38 billion. In this calculation we assume that central government will let the government grants to the local government sector be unchanged in nominal terms and increase its income, or reduce other expenditure, by a further SEK 20 billion. The absence of the index-adjusted government grants corresponds to a revenue loss of SEK 18 billion. If this is to be offset by higher taxes, this corresponds to a tax rate increase 0.60 percentage points.

Diagram 8 • General government net lending, main and alternative calculation
Per cent of GDP



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

The deficit in general government net lending deteriorates until and including 2014. Then the recovery of the economy leads to balance being achieved in 2017. In the alternative calculation the surplus target is also achieved.

Even though the surplus target is not achieved in the main calculation, our assessment is that the financial position of the public sector is strong, as consolidated gross debt as a share of GDP in 2017 has returned to the 2012 level of just over 38 per cent. Without an upwards adjustment, government grants will be eroded in real terms, which means that municipalities and county councils will have to make savings at a time when demographic change is making increasing demands on the sector. Alternatively, tax increases must be made in municipalities and county councils, which will negate part of the effect of the earned income tax credit and lower tax for pensioners.

After some extremely good years:

Falling net income for municipalities and county councils

Net income in municipalities and county councils has been strong for some years, mainly as an effect of temporary factors, such as the repayment of premiums from the AFA Försäkring insurance company and cyclical support from central government. As a result many municipalities and county councils may have been lulled into a false sense of security as net income had improved at the year-end in each year. We expect a net income level this year of SEK 10 billion. Net income for the sector has been doped by a repayment of insurance premiums from AFA Försäkring amounting to SEK 10 billion. However, the county councils will have a deficit of SEK 2 billion, partly as a result of a revaluation of pension liabilities.

In 2014 net income will fall substantially, to only SEK 5 billion. Many municipalities and county councils are having difficulty in drafting their budgets for next year, but despite this many municipalities are choosing not to raise their tax rate. However, we expect that the county councils will not be able to withstand a tax increase, and the average tax rate will therefore increase by 0.06 percentage points, compared with this year. We expect to see a lot of savings made in the sector ahead of 2014, and therefore judge that the cost increases will be moderate. Yet net income will still be low in 2014, and this is

because tax revenue increases relatively slowly, the government grants stay at an unchanged level, i.e. they are eroded in real terms, investment needs demand attention and we have not included any additional resources in the form of repayments of insurance premiums.

In the years after 2014 population changes in the form of a higher share of old people and children start to make greater and greater demands on the sector's finances.

As a result of increasingly outdated and run-down facilities and a high rate of urbanisation, the level of investment needs to increase further, and with it the loans taken by municipalities and county councils.

If the sector as a whole is to achieve net income of half the level regarded as healthy finances, SEK 9 billion, the county councils must raise their tax by a further 0.25 percentage points, up until 2017. We judge that the municipalities will be able to achieve this net income and still have an unchanged average tax rate. We expect certain municipalities to raise their tax rate while others lower their tax rate. We calculate that government grants will increase by SEK 18 billion between 2015 and 2017.

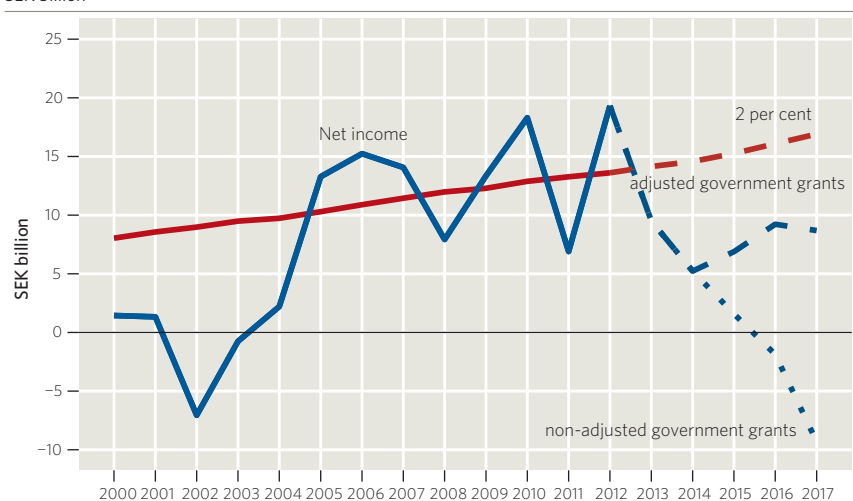
In the alternative calculation we have done, in which the public sector reaches a surplus of 1 per cent of GDP, the government grants stay unchanged at the same level and are therefore eroded in real terms. According to this alternative calculation the municipalities would need to raise their tax rate by 0.43 percentage points, and the county councils by 0.48 percentage points, compared with the present level to achieve net income of 1 per cent of taxes and transfers. Otherwise net income would fall to minus SEK 9 billion in 2017, if municipalities and county councils are to be able to afford to adapt their services to the coming, ever greater demographic needs and cost increases following the trend.

Factors affecting net income

In our forecasts we have not included any further factors affecting net income. In several years recently AFA Försäkring has repaid previously paid premiums. If AFA Försäkring was also to repay premiums paid in 2004, net income would improve by SEK 5 billion in 2014.

Diagram 1 • Net income in municipalities and county councils

SEK billion



Source: Swedish Association of Local Authorities and Regions.

In 2013 we expect an aggregate net income of SEK 10 billion for municipalities and county councils, which is the same level as the premium repayment from AFA Försäkring. In 2014 we do not assume any temporary additional finance, which means that net income falls to SEK 5 billion, even though we assume that the county councils raise their average tax rate by 0.06 percentage points. If there is no upward adjustment of government grants after 2014, the level of net income will fall to minus SEK 9 billion, or municipalities and councils will need to increase their tax rate by 0.91 percentage points. With the upward adjustment of government grants, by 2 per cent per year in real terms in 2015–2017, and a level of net income that corresponds to half the target for healthy finances, SEK 9 billion, a tax rate increase in the county councils of 0.31 percentage points is required compared with the present level. However, with this scenario the balance target for the public sector is not achieved.

How much are the municipalities in debt?

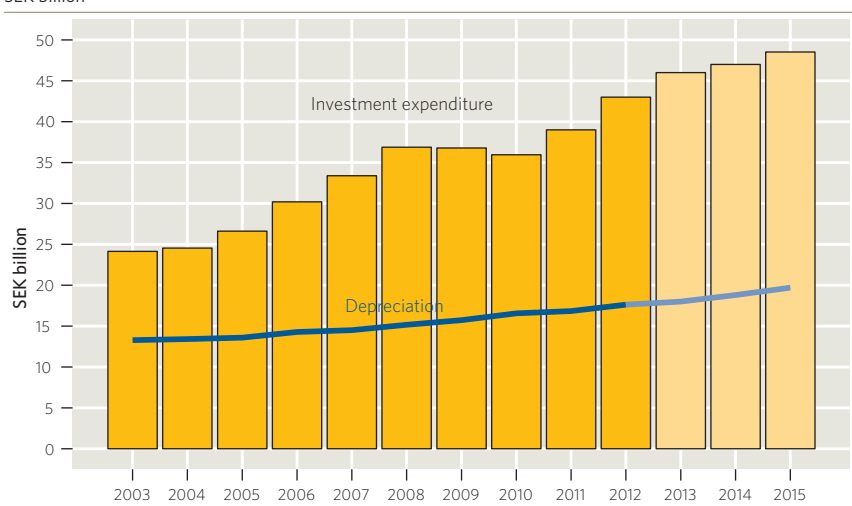
The municipalities' debts have increased in recent years. One reason for this increase in indebtedness is a higher rate of investment in many municipalities, and also in municipal companies. On average municipalities' non-current liabilities amounted to SEK 18,700 per inhabitant in 2012. Including municipally owned companies non-current liabilities amounted to more than SEK 40,400 per inhabitant. The rate of increase of group debt is not as high as in the municipalities, but both have increased substantially since 2010.

Over and above liabilities and equity, municipalities also have assets on their balance sheets, for example in the form of land, shares in their own companies and municipal properties such as schools, elderly homes and infrastructure. These assets often have a low valuation, while their sales values may be higher. In 2012 the value of non-current assets excluding financial assets amounted to SEK 36,100 per inhabitant on average in the municipalities and SEK 92,900 including the municipal companies.

Why are municipalities increasing their borrowing?

At present the municipalities are investing more than the equivalent of their depreciation and net income. This is largely because a substantial part of their infrastructure and non-residential properties were built in the 1960s and 1970s and it is now beginning to be time to build anew. The strong urbanisation also requires investments. Municipalities that are growing need to build new schools and infrastructure for growing and newly built housing areas. But municipalities that are shrinking may also need to restructure their services, leading to investments. Demographic change also requires the expansion of properties, such as homes for the elderly. This means that during a period with a high rate of investments municipalities must either report high net income, sell assets or borrow funds.

Diagram 16 • Investment expenditure and depreciation
SEK billion



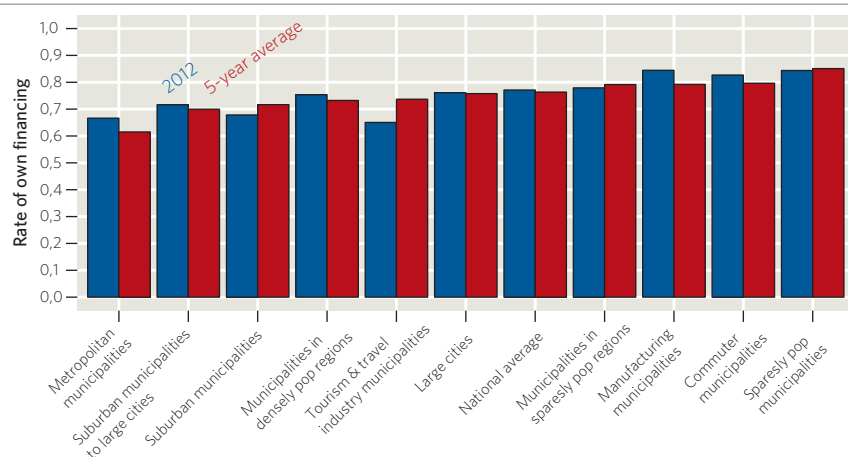
Investment needs in the municipalities remain high. The ever higher investment expenditure will mean that more resources will be needed for depreciation and financing costs in the future.

Source: Swedish Association of Local Authorities and Regions.

Investing requires liquidity when the investment is to be made and scope in future budgets for operation, maintenance, depreciation and any financing cost such as interest expenses or a lower return on capital. In the last five

years the municipalities have financed 76 per cent of investments from own resources. In terms of municipality groups, the metropolitan municipalities have the lowest level of own resource financing, on average 62 per cent, for 2008–2012, and the sparsely populated municipalities have the highest level, 85 per cent. The main reason is the rapid rate of investment in the metropolitan municipalities.

Diagram 17 • Financing of investments from own resources, 2012 and average for 2008–2012
Per cent



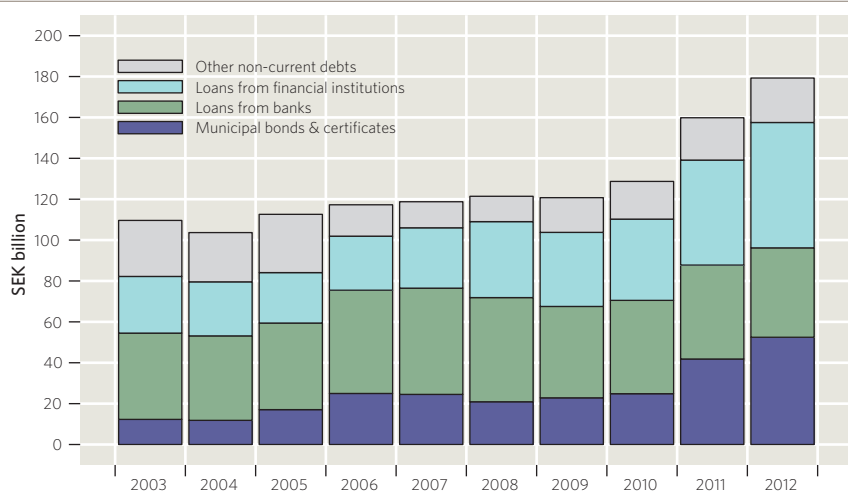
Source: Statistics Sweden.

Financing from own resources is calculated as net income after extraordinary items plus depreciation as a proportion of net investment expenditure. Sales of assets can also affect municipalities' borrowing needs.

Own funding programmes instead of traditional bank borrowing is a new trend

A few years ago traditional bank loans were the most common way for municipalities to increase their borrowing. During the years of financial unrest in connection with the financial crisis the banks' willingness to lend to the municipalities decreased and loans in Kommuninvest with a direct recourse guarantee became increasingly common. Recently municipalities have increasingly raised finance via their own funding programmes and bond loans.

Diagram 18 • Non-current debt per financing solution
SEK billion



Source: Statistics Sweden.

The municipalities' non-current debt has increased strongly in recent years. Traditional loans from banks have decreased while loans from financial companies, primarily Kommuninvest, have increased, as have bond loans and municipal certificates.

The increased share of borrowing via municipalities' own funding programmes can be a manifestation of a more advantageous interest rate than from banks and Kommuninvest, as new regulations in the form of higher capital adequacy requirements are being introduced. To cope with the higher capital adequacy requirements banks and other financial institutions must raise the margins on their lending and this then makes it more interesting for municipalities to find alternative financing solutions, such as issuing their own municipal bonds or using municipal certificates.

The increase in municipalities' debt can be an indicator of how high their financing of investments from own resources is at present. While the growth rate for lending to municipally owned companies has tailed off, the municipalities' non-current liabilities have increased sharply, by almost 40 per cent, over the past three years.

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 *Ämnen, Ekonomi, Sektorn i siffror*.

An aggregate picture of municipalities and county councils

Table 26 • Key indicators for municipalities and county councils, 2012–2016
Per cent and thousands of people

	Outcome	Forecast		Calculation		
	2012	2013	2014	2015	2016	2017
Average tax rate, %	31.60	31.73	31.79	31.88	31.94	32.04
municipalities, incl Gotland	20.59	20.62	20.62	20.62	20.62	20.62
county councils*, excl Gotland	11.07	11.17	11.23	11.32	11.38	11.48
No of employees**, thousands	1,065	1,076	1,085	1,101	1,119	1,139
Municipalities	804	812	819	831	845	861
County councils	261	264	266	270	274	278
Volume change, %	1.4	1.8	1.3	2.0	2.1	2.2
Municipalities	1.0	1.4	1.0	1.7	1.9	2.0
County councils	2.1	2.4	1.9	2.5	2.4	2.4

Note: As regards the average tax rate, the calculations for the municipalities assume an unchanged tax rate as from 2012. For the county councils an increase of the tax rate is included.

*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 27 • Aggregate income statement for the sector, 2012–2017

SEK billion

	Outcome	Forecast		Calculation		
	2012	2013	2014	2015	2016	2017
Income of activities*	166	171	169	176	185	195
Expenses of activities	-803	-834	-868	-905	-950	1,001
Depreciation	-26	-26	-27	-28	-30	-30
Net expenses of activities	-663	-689	-726	-757	-795	-837
Tax revenue	561	585	602	631	668	703
Gen gov grants and equalisation	120	122	127	132	136	142
Net financial income	2	-8	2	1	0	0
Net income before extra-ordinary items	19	10	5	7	9	9
Share of taxes and grants, %	2.9	1.4	0,7	0.9	1.2	1.0

Note: Consolidation has taken place by purchases between sectors.

*The non-recurring effect of a repayment of AFA premiums of SEK 11 billion is included in Income of activities for both 2012 and 2013.

**The non-recurring effect of the reduction of the RIPS-rate of SEK -10 billion is included in Net financial income.

Table 28 • Income statement for the municipalities, 2012–2017

SEK billion

	Outcome	Forecast		Calculation		
	2012	2013	2014	2015	2016	2017
Income of activities*	123	127	123	128	134	141
Expenses of activities	-533	-554	-573	-597	-626	-660
Depreciation	-18	-18	-19	-20	-21	-21
Net expenses of activities	-428	-445	-469	-490	-513	-540
Tax revenue	365	380	390	408	431	453
Gen gov grants and equalisation	74	76	80	83	87	91
Net financial income	3	1	2	2	2	2
Net income before extra-ordinary items	14.4	11.5	3.6	4.2	6.4	5.6
Share of taxes and grants, %	3.3	2.5	0.8	0.8	1.2	1.0

*The non-recurring effect of repayments of AFA premiums of SEK 8 billion is included in Income of activities for both 2012 and 2013.

**The non-recurring effect of the reduction of the RIPS-rate of SEK -2 billion is included in Net financial income.

Table 29 • Income statement for the county councils, 2012–2017

SEK billion

	Outcome	Forecast		Calculation		
	2012	2013	2014	2015	2016	2017
Income of activities*	44	46	48	50	53	55
Expenses of activities	-271	-282	-296	-309	-325	-343
Depreciation	-8	-8	-8	-9	-9	-9
Net expenses of activities	-235	-244	-257	-268	-282	-297
Tax revenue	196	205	212	223	237	251
Gen gov grants and equalisation	46	46	47	48	50	52
Net financial income	-1	-9	0	-1	-2	-3
Net income before extra-ordinary items	5.0	-2.0	1.7	2.7	2.8	3.1
Share of taxes and grants, %	2.1	-0.8	0.6	1.0	1.0	1.0

*The non-recurring effect of repayments of AFA premiums of SEK 2.9 billion for 2012 and of SEK 2.8 billion for 2013 are included in Income of activities.

**The non-recurring effect of the reduction of the RIPS-rate of SEK -8.3 billion is included in Net financial income.

Source: The Swedish Association of Local Authorities and Regions.

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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 2017.

In 2013 non-recurring revenue from the AFA Försäkring insurance company is expected to contribute to positive net income for the sector. We expect a surplus of about SEK 10 billion, corresponding to 1.3 per cent as a share of taxes and transfers. Thereafter things look tougher; demographic change and major investment lead to increased costs. To achieve net income of SEK 9 billion in 2017, which corresponds to 1 per cent of taxes and transfers, the tax rate will have to be increased by 0.31 percentage points, and government grants by almost SEK 18 billion. To achieve the surplus target for the public sector of 1 per cent of GDP, taxes need to be raised by a further 0.60 percentage points, compared with 2013.

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-English-Publications-and-reports).

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