The Economy Report.

ON SWEDISH MUNICIPAL AND COUNTY COUNCIL FINANCES
– APRIL 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).

In 2013 we expect net income for the sector to be around zero. Net income in the sector is being weakened because pension liabilities must be revalued, reducing net income for the sector by SEK 11 billion. To achieve net income of just under SEK 8 billion in 2016 we assume that the tax rate will be increased by SEK 0.44 and that government grants will increase by almost SEK 12 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, April 2013

Annika Wallenskog
Section for Economic Analysis

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The Chief Economist's Summary

Despite a slow recovery of the economy after the financial crisis, real tax revenue in the local government sector is rising at a relatively good rate. Net income is nevertheless being weakened in the municipal and county council sector. This year we expect net income to be zero, mainly because the low interest rate makes it necessary to revalue local government pension liabilities. Next year we expect zero net income in the county councils and a small surplus in the municipalities.

In succeeding years the ever increasing demographic challenges and the major infrastructure needs will mean that the sector will be unable to achieve positive net income without tax increases and higher government grants.

A growing calm has settled following the turbulence in financial markets in 2011 and the first half of 2012. World stock markets have risen substantially at the same time as interest rates in the crisis-hit countries in southern Europe have fallen sharply. A further sign of stabilisation was rising interests rates in 'safe havens' such as Germany and Sweden. Shrinking interest rate spreads between 'weak' and 'strong' economies largely reflected decreasing concern for the countries in crisis.

Alongside stabilisation in financial markets we could also note in the autumn and winter that leading economic indicators stabilised and began to rise in Europe. There was also a growing optimism in the US that the weak close to 2012 was mainly a temporary effect of slow-downs in public expenditure linked to the discussion of the fiscal cliff during the autumn. These developments were taken as evidence that the global economic downturn had now bottomed out.

In recent months, however, doubts have again begun to grow about the sustainability and vigour of the global economic upturn. The leading indicators have stopped rising and in parts of Europe they have even begun to fall back to the bottom levels of the autumn. All the signs are that the Eurozone economy has continued to decline in early 2013, and at present there are no indications of a rapid turn for the better. The fundamental problems for the Eurozone are far from over. In the US the upturn in leading indicators has also stopped, at least temporarily. At the same time, however, there are also other, more positive signals from the US in the form of a relatively rapid recovery in the real estate market and good willingness to invest among companies, which indicate that the economic upturn is continuing, but at a moderate pace.

The overall effect of the economic news in recent months has been that the global rise in interest rates has turned into a decline at the same time as there has been a substantial fall in cyclically sensitive raw materials prices. Recently we have also been able to see signs that the strong stock market growth from the start of the year is beginning to lose some of its vigour.

Our overall conclusion is that there is no reason to dramatically alter our view of the global economy compared with our previous forecast. An unprecedented monetary policy stimulus all over the world presages a gradual but weak recovery even though there are still major underlying problems in the wake of the financial crisis

Sweden is standing up quite well

For Sweden's part the mediocre international picture means that we cannot hope for any strong growth impetus from exports in the coming years. At the same time the financial situation of Swedish households is good: even though indebtedness is high, households are relatively wealthy since the savings ratio is high, most people still have jobs and income growth has been good while interest rates are expected to remain low.

Moreover, Swedish households do not need to fear severe fiscal austerity in the form of cuts and/or tax increases in the coming years since Sweden's public finances are in relatively good shape. With the assumptions we make the public sector will have a surplus of 0.6 per cent of GDP in 2016, which does, however, mean that the surplus target of 1 per cent will not quite be attained. Even if the economy takes a weaker than expected path, there is still some scope for fiscal stimulus, an option not open to most other countries. The security of knowing that the economy is not at risk of being devastated by austerity helps households to feel secure, thereby making them more willing to consume than are households in many other countries. One source of uncertainty in this context is, of course, the approaching Riksdag elections in 2014 as there is still no clarity as to what stimulus measures the parliamentary alternatives may propose. Obviously, this uncertainty also applies to measures that may be of importance for the economy of the local government sector.

We expect that the outcome of a weak international situation but with good conditions for Swedish households will be mediocre economic development in Sweden in the coming years. GDP is expected to grow by 1.5 per cent in 2013 and then accelerate to 2.5 per cent in 2014. In the subsequent years we expect a gradual normalisation with macroeconomic balance being reached in the course of 2016.

The relatively weak GDP growth in 2013 means that employment will only rise marginally this year and will then pick up additional pace in 2014 when production begins to accelerate. Weak employment growth, in combination with continued labour supply growth, means that unemployment will remain at around 8 per cent in 2013 and will only begin to fall in 2014.

The high unemployment rate and the low resource utilisation mean that the inflationary pressure will remain low. Even though inflation can be expected to be below the Riksbank's inflation target for a large part of the forecast period, we do not expect any further interest rate reduction. The Riksbank's focus on household indebtedness will put a stop to further stimulus measures. However, a first interest rate rise is not likely until well into 2014.

Relatively good revenue for the local government sector

Despite a relatively pallid economic situation we expect the real tax base to grow at a fairly good rate in 2011–2016. For 2013 we expect nominal growth of 3.6 per cent[1] in the tax base, with growth of 3.2 per cent for 2014. Adjusted for price and cost growth this means that the real tax base will grow by 1.5 per cent in 2013 and 0.8 per cent in 2014.

But weak growth of net income

We expect that net income for the sector this year will be about zero. The county councils are expected to show negative aggregate net income of about SEK 5 billion and the municipalities are expected report a positive figure of the same size. Net income is weakened by the fact that pension liabilities must again be revalued on account of the present low interest rates. For county councils, which have more employees with incomes above the ceiling, the impact on costs is greater and the change reduces the county councils' net income by SEK 8 billion. The reduction for the municipalities is SEK 3 billion.

For 2014 the underlying levels of net income will be weakened further in both municipalities and county councils. One reason for this development is that we have not assumed that the local government sector will receive any new government grants. This is unusual especially since 2014 is an election year. However, we choose not to make any forecast of the Government's policies. Without factors affecting net income, such as changes in pension liabilities, there will still be a small surplus of just less than SEK 4 billion in 2014, with the municipalities accounting for all of this amount. In making this assessment we still expect municipalities and county councils to show restraint and costs to only increase by 1.3 per cent in fixed prices, which is a much slower rate than the historical trend. (See the section "Government grants to municipalities and county councils" for information about our assumptions.) Despite the relatively good increase in real tax revenue in the future, they are still not sufficient to meet the cost increases expected in the sector in the coming years.

To achieve net income of just under SEK 8 billion in 2016 we assume that government grants will increase by almost SEK 12 billion and that the municipal and county council tax rate will be increased by a total of SEK 0.44 from its present level. This level of net income only corresponds to one per cent of taxes and government grants, i.e. well under the 2 per cent target regarded as the benchmark for healthy finances. However, the assessment made is that municipalities and county councils are not giving priority to the cost adjustments that would be needed to achieve a net income of 2 per cent and that many are instead content with weaker net income so as to be able to maintain and develop good welfare services during the period.

Without higher government grants but with the tax increases set out above, net income would weaken gradually and would already be negative in 2015.

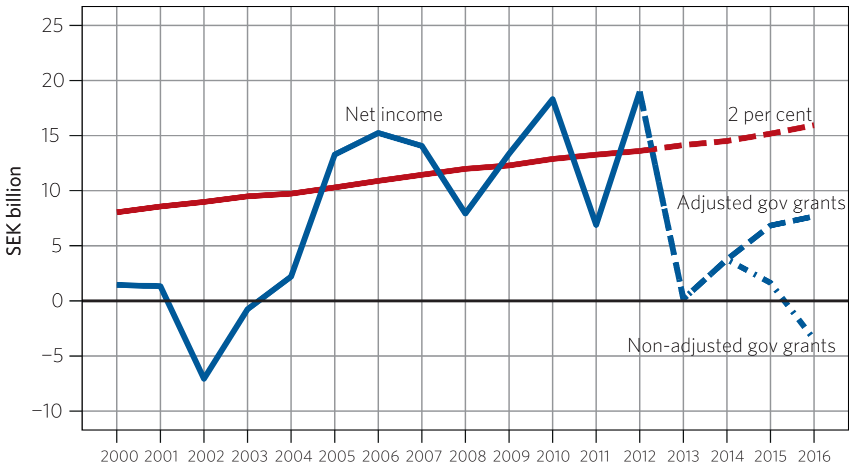
Factors affecting net income

We have not included any other factors affecting net income in our forecasts. In several years recently the AFA Försäkring insurance company has returned premiums previously paid. If AFA Försäkring were also to return premiums paid in 2005 and 2006, net income would be improved by SEK 11 billion, of which SEK 8 billion relates to the municipalities.

1. Excluding regulatory changes.

We expect that net income for the sector this year will be about zero. Net income will weaken because pension liabilities must again be revalued, reducing net income for the sector by SEK 11 billion. For 2014 the underlying level of net income will weaken further in both municipalities and county councils and, excluding factors affecting net income, there will be a small surplus of SEK 4 billion. Government grants must be increased by SEK 12 billion and the tax rate must be increased by SEK 0.38 in county councils and SEK 0.06 in municipalities compared with the present level, in order to achieve net income of SEK 7.7 billion in 2016, which is a level well under the 2 per cent target.

Diagram 1 • Net income in municipalities and county councils
Per cent and SEK billion



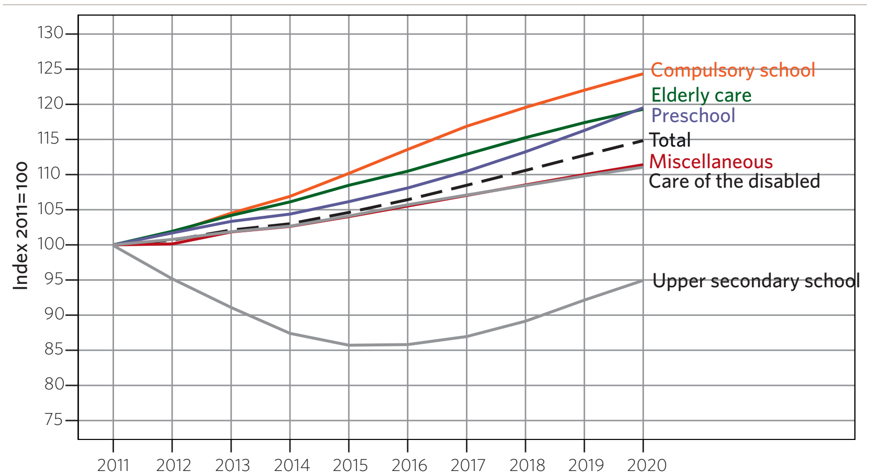
Source: Swedish Association of Local Authorities and Regions.

Increasing pressure from population change

In the future ever increasing demographic challenges await the welfare sector. While county councils have already experienced high pressure from demographic change for a number of years, the demographic pressure on municipalities has been relatively low for a long period. However, over the next few years the municipalities will need to adapt their services to a larger proportion of older and young people compared with people of working age. This is one of the reasons why costs are expected to increase at a relatively high rate in the future. In the final two years of our calculation period, 2015 and 2016, we expect costs to rise by more than 1.8 per cent per year in fixed prices

Reduced needs in upper secondary school require cost adjustments. In all other services we see increasing needs in the future, especially in compulsory school, preschool and elderly care services.

Diagram 20 • Volume changes in various municipal services
Percentage change, index 2011 = 100



Source: Swedish Association of Local Authorities and Regions.

for the sector as a whole. This means that costs will rise much faster than tax revenue.

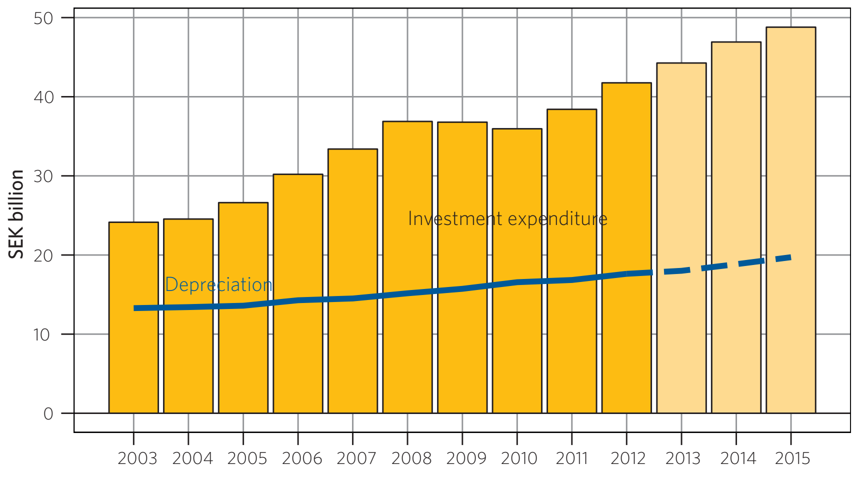
Major investments affect both costs and debt

Many schools, hospitals, swimming baths and water and sewage treatment plants were built in the 1960s–1980s and are now in need of very substantial renovation or upgrading. For a number of years investments, calculated in current prices, have increased strongly and we expect this trend to continue and even to intensify. The level of investments is therefore expected to double in a ten-year period and in 2014 we expect investments to be around SEK 70 billion.

The high rate of investments is a challenge for the sector in two ways, in the form of both higher costs and a higher debt burden. Costs in the sector will increase in the form of the deprecation of investments. We also expect depreciation to have doubled in a ten-year period to SEK 40 billion.

Since the level of depreciation is much lower than the investments made, net income must run at a level that reflects the difference between depreciation and the level of investments, i.e. around SEK 30 billion for the sector as a whole, in order to be able to finance investments from own resources. The alternative, which is the usual approach in municipalities and county councils, is to borrow money for investments or to use liquid funds. This means that the high level of investments also increases indebtedness in the sector.

Diagram 18 • Investment expenditure and depreciation among municipalities, outcome and forecast
SEK billion

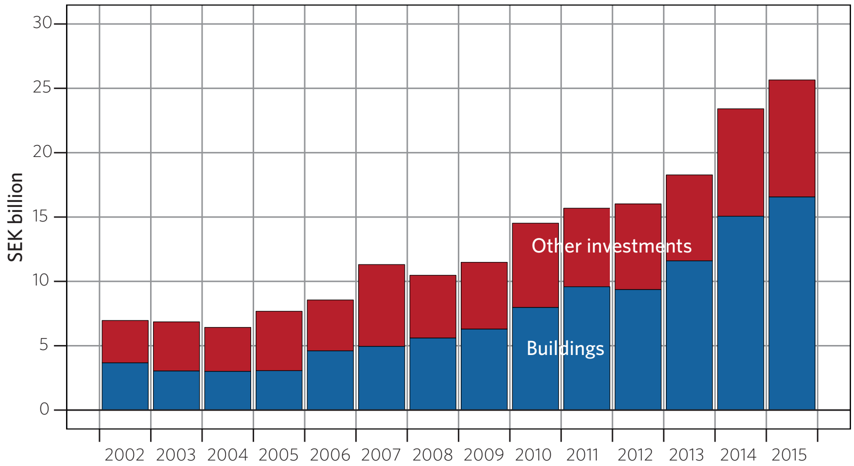


Source: Statistics Sweden and Swedish Association of Local Authorities and Regions.

Investment will increase according to the municipalities' plans for the years to come. An increase in investments means that depreciation also increases and takes up more space in municipal operating budgets. The municipalities' investment plans form the basis for the assessment in the yellow bars for 2013–2015.

Investments speeded up in 2010. Since then investments have remained at the same high level and have even increased slightly from year to year. Our assessment, based on county council budgets and plans, is that investments will speed up again this year and next year. The main increase is in investments in buildings.

Diagram 28 • County council gross investments, outcome and forecast 2013–2015
SEK billion, current prices



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

Payments of old pension liabilities will continue for a few years

A third major challenge for the sector in the coming years is the continued payment of old pension liabilities at the same time as there are also pension costs for current employees. The costs for payments of old pension liabilities will almost double in the sector, from SEK 9.5 to 17.5 billion, between 2003 and 2013. The good thing about these pension costs, unlike the other costs described above, is that they will decrease gradually in a few years.

ANNEX

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

	Outcome	Forecast		Calculation	
	2012	2013	2014	2015	2016
Average tax rate, %	**31.60**	**31.73**	**31.76**	**32.03**	**32.17**
municipalities, incl Gotland	20.59	20.62	20.62	20.68	20.68
county councils*, excl Gotland	11.07	11.17	11.20	11.41	11.55
No of employees, thousands**	**1,060**	**1,070**	**1,084**	**1,099**	**1,115**
Municipalities	802	811	822	833	846
County councils	258	259	262	266	269
Volume change, %	**1.5**	**1.6**	**1.3**	**1.8**	**1.9**
Municipalities	0.7	1.4	0.9	1.5	1.6
County councils	1.6	2.2	2.0	2.3	2.3

Note: As regards the average tax rate, the calculations for the municipalities assume an increase of SEK 0.06 in the tax rate in 2015. For the county councils the assumption is increases of SEK 0.03 in 2014, SEK 0.21 in 2015 and SEK 0.14 in 2016.

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

**Thousands; average number of people in employment according to the National Accounts.

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

Table 24 • Aggregate income statement for the sector, 2012–2016
SEK billion

	Outcome	Forecast		Calculation	
	2012	2013	2014	2015	2016
Income of activities*	164	162	167	174	182
Expenses of activities	–802	–834	–864	–899	–942
Depreciation	–26	–26	–27	–28	–30
Net expenses of activities	**–663**	**–698**	**–724**	**–753**	**–790**
Tax revenue	561	584	602	632	664
Gen gov grants and equalisation	120	123	123	127	133
Net financial income	2	–9	2	1	0
Net income before extra-ordinary items	**19**	**0**	**4**	**7**	**8**
Share of taxes and grants, %	*2,8*	*0,0*	*0,5*	*0,9*	*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 2012.

Table 25 • Income statement for the municipalities, 2012–2016
SEK billion

	Outcome	Forecast		Calculation	
	2012	2013	2014	2015	2016
Income of activities*	122	118	122	126	132
Expenses of activities	–533	–552	–569	–592	–619
Depreciation	–18	–18	–19	–20	–21
Net expenses of activities	**–428**	**–452**	**–466**	**–485**	**–508**
Tax revenue	365	380	391	408	427
Gen gov grants and equalisation	74	76	77	79	83
Net financial income	3	1	3	3	3
Net income before extra-ordinary items	**14.0**	**5.0**	**3.7**	**4.2**	**4.8**
Share of taxes and grants, %	*3.2*	*1.1*	*0.8*	*0.9*	*1.0*

*The non-recurring effect of a repayment of AFA premiums of SEK 8 billion is included in Income of activities for 2012.

Table 26 • Income statement for the county councils, 2012–2016
SEK billion

	Outcome	Forecast		Calculation	
	2012	2013	2014	2015	2016
Income of activities*	47	46	48	50	53
Expenses of activities	–274	–284	–297	–309	–326
Depreciation	–8	–8	–8	–9	–9
Net expenses of activities	**–235**	**–246**	**–257**	**–268**	**–282**
Tax revenue	196	205	211	224	237
Gen gov grants and equalisation	46	46	47	48	50
Net financial income	–1	–9	–1	–1	–2
Net income before extra-ordinary items	**4.9**	**–4.8**	**0.1**	**2.7**	**2.8**
Share of taxes and grants, %	*2.0*	*–1.9*	*0.0*	*1.0*	*1.0*

*The non-recurring effect of a repayment of AFA premiums of SEK 3 billion is included in Income of activities for 2012.

Source: The Swedish Association of Local Authorities and Regions.

The Economy Report. April 2013

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 2016.

Municipalities and county councils are facing ever increasing demographic challenges with the need for welfare services rising as the proportion of older and young people rises. Moreover, the sector needs to make major investments that will result in both higher costs and a higher debt burden. Our assessment is that both tax increases and higher government grants will be needed to generate the financing require.

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.

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