

restrictions on municipal decision-making, which ear-marked and matching grants do. Fewer restrictions on municipal decision-making make local accountability easier. Fourth, general grants are more in accordance with the idea of local self-government than ear-marked and matching grants.

#### *Decentralization of services*

There is a large amount of tasks that are decentralized to the municipalities in Finland. A reasonable question to ask is which services are suitable to decentralize? Are all welfare services appropriate? It is not obvious that it is a good idea, for example, to decentralize primary schools and welfare. Research shows that decentralization of social welfare (welfare assistance) might lead to welfare competition among the municipalities, which in turn might lead, from a societal point of view, to a sub-optimal level in the welfare generosity (a “race to the bottom”). Research on decentralization of schools in Sweden indicate that decentralization might lead to an, from the society’s point of view, undesirable large variation over students in school resources.

### **6.4 Comments on the Finnish model: Lars-Erik Borge**

The Finnish model of local government has the same main characteristics as the other Nordic models. The local government level is the main provider of welfare services within education, health, and social services. Total revenues amount to a substantial part of GDP and a proportional income tax is the cornerstone in the financing. A block grant system has been in place since 1993, with the purpose of equalizing service provision throughout the country. On the other hand, the Finnish model differs from the other Nordic models in two important and related aspects. It has no middle tier and relies on extensive cooperation among municipalities.

In this comment on the Finnish model I will concentrate on (i) municipal structure and municipal cooperation, (ii) the middle tier, and (iii) tax financing and tax equalization.

#### *Municipal structure and municipal cooperation*

In terms of municipal structure Finland is facing the same challenge as Norway. Many municipalities are considered to be too small to achieve efficiency and quality in service provision. In addition, both countries have relied on voluntary mergers instead of a national reform. Turning to the outcomes, Finland has clearly been more successful than Norway in terms of reducing the number of municipalities. Since 2005 the number of municipalities is reduced by 90 in Finland, compared to only 5 in Norway.

Why has Finland succeeded, while Norway has not? Both countries have applied economic incentives to stimulate mergers, but I think the Finnish design has been more effective by limiting the merger grant to the period 2008-2013 and by making the grant more generous for mergers early in the period. In addition a merger grant may in general be less effective in Norway where most small municipalities have above average fiscal capacity – the carrot becomes less tempting when they already are well off.

In the Norwegian context I have expressed skepticism towards the principle of voluntariness, arguing that it is unlikely to result in a coherent reform in all parts of the country. In some parts of the country small municipalities will merge, in others they will not. Then there is no national solution with respect to the organization of welfare services. However, in Finland the lack of a coherent reform is less of a problem given the tradition of extensive municipal cooperation. Areas where small municipalities do not merge must simply rely on cooperation.

However, I must admit that the extensive reliance on municipal cooperation in Finland is a bit of a puzzle to a Norwegian observer. Extensive cooperation makes the system less transparent and may create unclear responsibilities and little accountability. That joint municipal authorities run hospitals is particularly puzzling. Specialized medical care is a large, growing, and increasingly complicated activity where most countries are struggling with organization and financing to control costs. Municipal cooperation is seldom an alternative that is considered. Still the Finnish system seems to produce pretty good results. Is that because or despite municipal cooperation?

### *The middle tier*

All Nordic countries are discussing reforms of the middle tier. Finland and Norway seem to be the two countries that are discussing the most drastic changes. In Finland there is a discussion to establish a middle tier, and in Norway a move to a two-tier system is on the agenda. For both countries the experience of the other are obviously of relevance.

I think the main message from the Norwegian experience is that it is difficult to build up sufficient political legitimacy for a new middle tier. The establishment of the county level as a separate political level in 1976 was expected to strengthen local democracy, but the counties were never able to live up to these expectations. The citizens are far more attached to municipal and national politicians than to county politicians. And after the central government took over the responsibility for the hospitals, the county level became even weaker and more marginalized. For Finland I will argue against establishment of a middle tier of the present Norwegian type, i.e. county governments with own tax base,

directly elected councils and with responsibility for regional planning, transportation, and other minor issues. Responsibility for hospitals must be a precondition for establishment of a middle tier with own tax base and directly elected councils.

The main message from the Finnish experience is that decentralized provision of welfare services and no middle tier require extensive municipal cooperation, in particular when there are many small municipalities. When a move to two-tier system is considered in Norway, it is important to think through how municipal cooperation will work.

#### *Equalization grants*

The Finnish equalization system consists of costs equalization and revenue equalization. There are three cost equalization grants related to health and welfare services, education, and general grant (capturing rural and urban cost factors). For health and welfare services and education a formula defines a calculatory cost per capita for each municipality. The per capita grant received equals the calculatory cost in excess of 65 percent of the country average. The cost equalization scheme could be revised in two ways. First, since the cost equalization grants are block grants (non-earmarked), it may be confusing to have sector specific cost equalization grants. The formulas should be merged into a single formula producing a single cost equalization grants. Second, the cost equalization could be made self-financing by letting contributions from municipalities with below average calculatory costs finance the transfers to municipalities with above average calculatory costs. The amount of money in the present cost equalization grants could be transferred into a flat per capita grant. The legitimacy of the cost equalization should be improved by publishing the analyses that have generated the formulas.

The revenue (or tax) equalization scheme guarantees all municipalities nearly 92 percent of average per capita (calculatory) tax revenue. This implies that municipalities with tax base below 92 percent of the average have weak incentives to develop the local tax base. A successful development policy has little impact on municipal revenues since higher tax revenues are counteracted by a reduction in the revenue equalization grant. To improve incentives the compensation rate should be below 100 percent also for the municipalities with tax base below 92 percent of the average.

### **6.5 Comments on the Finnish model: Anwar Shah**

Globalization and the information age calls for empowered local governments that can work as catalysts for national economic growth and international