

Chapter 7

Basic Services Case Study

Objectives and characteristics of the Basic Services Programme

As discussed in Chapter 2, the elderly dependency rate in Finland is relatively high compared to other OECD countries, and it will become higher as the population ages. Between 40% and 50% of current municipal employees in Finland's regions are expected to retire by 2020, which might present particular problems for remote areas where both retirement rates and public employment shares are higher. In addition, the ageing population will create new needs for welfare services. Finally, there are internal migration trends towards urban centres in Finland; population growth is concentrated in urban regions in central and southwest Finland, and even within remote regions the population growth in cities is significant.

In light of these demographic trends – and the challenges connected to intense global economic competition – Finland has taken collective action to sustain its public services, with the involvement of both the state and sub-national governments. Key basic services – such as primary and vocational education, primary healthcare, and basic social services – are the focus. Basic services are a common responsibility in Finland: they are funded in part by state government, national-level legislation mandates a minimum standard service level for certain services, and municipalities are responsible for determining the best mix of services and mechanisms for delivery to the public. Effective management of basic services is important from a fiscal sustainability standpoint, but their importance goes much further. They are one of the most important, and personalised, interfaces between government and citizens, and their mode of delivery (*e.g.*, local schools and clinics) can have a significant impact on the life of local communities, particularly in rural and isolated areas.

Programme objectives: three characteristics of the Basic Services Programme

The Basic Services Programme was introduced to secure effective local public service delivery in the coming decades. It aims both to facilitate the management and financing of local government services, and to strengthen linkages across lines of service delivery to encourage innovation and build local capacity. As such, the Basic Services Programme is linked to a wider discussion on the sustainability of the Nordic welfare state: in all Nordic countries, rising costs of welfare services and increasing demands for these programmes present challenges to the public sector.¹

The Basic Services Programme in Finland is at once: a government document, a governance procedure and a central government grant reform effort. These elements are highly inter-related. The Basic Services Programme document is produced using the Basic Services Programme process and relates to funding streams that will be consolidated into one central government grant for basic public services. Despite these connections, it is important to distinguish the three elements, which present different challenges and implementation issues.

Government document: The Basic Services Programme was introduced in 2003, and includes an annual budget review and service assessment. The central document provides

an overview of the state of basic local government services, evaluates changes in the demand for services, and analyses trends in local government revenue and the measures required to balance local government expenditures and revenues. Basic services are defined as the services that local governments provide and fund, based on special legislation. The programme emphasises statutory services funded through government transfers for social welfare, healthcare, education and culture. These services account for more than three-quarters of total local government expenditure. The basic public services budget, which provides an overview of local government finances including central government grants, is submitted in parallel with the national government's budget proposal.

Governance procedure: The Basic Service Programme forms part of a statutory consultation procedure between central and local government. The programme is prepared by a ministerial working group including the most relevant ministers (such as Finance, Public Administration and Local Government, Health and Social Welfare, and Education), as well as the President and Director General of the Association of Finnish Local and Regional Authorities. Through the Basic Services Programme, this ministerial group works to align policy across ministries responsible for designing and implementing delivery of key basic public services by local government. The Basic Services Programme also forms part of a negotiation procedure between central and local government to discuss legislation on local authorities, matters of municipal administration, and finances; this process is enshrined in the *Local Government Act*.

Central government grant reform efforts: The third element of the Basic Services Programme is a promised and ongoing reform of central government grants. In 2010, the government introduced an overhaul of central government transfers to local governments, replacing three large block grants with one general government grant for basic services, allocated by the Ministry of Finance. These three block grants cover: social services and healthcare, education (which covers pre-school, primary education and libraries), and the general (equalisation) grant. They were previously administered by the Ministry of Health and Social Services, Ministry of Education and Ministry of Finance, respectively. The basic services grant totalled EUR 7.8 billion in 2010 and represented about 80% of total government grants to sub-national governments. This grant covers 34% of total expenditures on basic services; the rest is covered by municipal revenue sources. The new grant will be allocated using the same criteria as the block grants, which guarantees that no municipality will lose grant revenues due to the reform.

The Basic Services Programme is related to a wider set of public administration reforms. It forms one part of the *Act on Restructuring Local Government and Services*, which also includes elements aimed at strengthening municipal and service structures through mergers and co-operation (PARAS), and transferring planning obligations in urban regions and other tasks (such as reporting on sexual abuse of children) from local to central government. Two other laws are directly relevant to the Basic Services Programme: the Act amending the *Act on Local Authority Boundaries*, and the Act amending the *Asset Transfer Tax Act*. The Basic Services Programme is ingrained in the strong tradition of multi-level government reforms in Finland.

Initiatives similar to Finland's Basic Services Programme can be found in other OECD countries. For example, annual documents summarising the state of local service provision and finance are relatively common in OECD countries, as are annual central-local budget negotiations (which occur in Denmark, the Netherlands, etc). Grant reform, in which specific

grants (also called earmarked grants) are consolidated into block grants, also takes place in other OECD countries. These reforms have resulted in declining shares of earmarked grants in local governments' revenue over the last decades. However, recently some OECD countries have started to re-orient their grants systems, for both welfare services and other services, towards more earmarked grants in order to compensate local authorities for the costs of complying with legislation creating new roles for local authorities.²

Challenges of the reform

The Basic Services Programme will be assessed based on its effectiveness in achieving the two key goals of efficiency and equity. For the purpose of this report, these two objectives will be considered in terms of: *efficiency* of public service provision, and *equity* between territories in the level of public services provided. These two goals intersect and could potentially present policy trade-offs. Efficient public service provision can contribute to regional development by strengthening underlying drivers of regional economic growth, such as human capacity, infrastructure and amenities, and enabling territories to become more competitive. At the same time, public service provision could be inefficient in some territories because limited population or remoteness do not allow for economies of scale; however, these services still need to be provided (regardless of cost) from a territorial equity perspective.

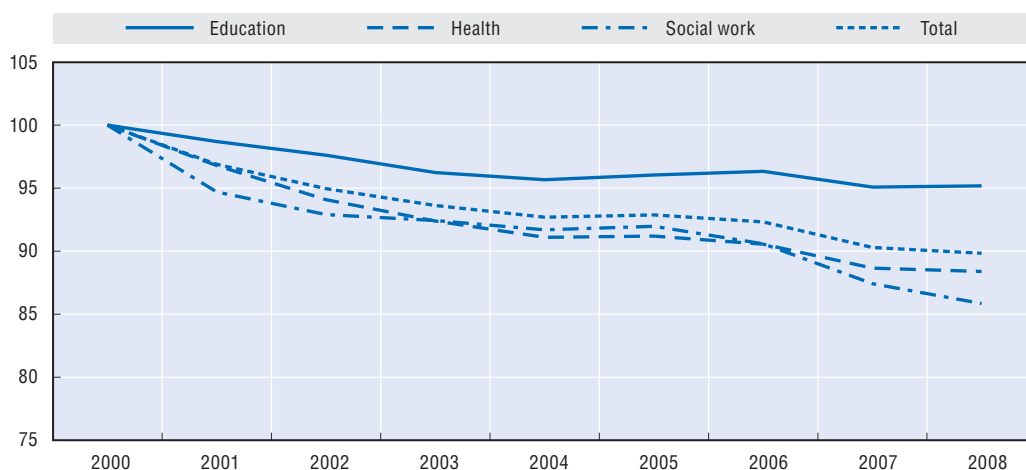
Achieving efficiency

Although the overall efficiency of Finnish local public services has not been assessed, studies indicate that some programmes might be very efficient.³ Municipal health services, for example, appear successful: per-capita health expenditures in Finland have been lower than in other Nordic countries, which is attributable to relatively low wages for healthcare personnel and particularly effective cost management by municipalities.⁴ In addition, Finland has long been one of the best-performing countries in the OECD/PISA study, which compares student performance in a variety of subjects (*e.g.*, language, mathematics, science) across countries, and which indicates a high quality of education provided by Finnish municipalities. However, studies by Statistics Finland indicate that overall productivity levels in local public services declined over the period 2000-08, especially in social work and health, and to a lesser degree in education (see Figure 7.1). Although the relationship between productivity and efficiency in public services is not straightforward, this might indicate that the efficiency of public services is an increasing concern. Studies on the outcomes of local public services in Finland do not exist.

There is no clear consensus on how much the efficiency of local public services varies among localities. Some studies indicate that there is considerable variation in cost efficiency of providing basic services including education, culture, social services and health services. Efficiency appears to be one factor that explains differences in municipal spending on these services, in addition to factors such as incomes, demographics and political variables.⁵

Comprehensive school education, for example, appears to be efficient across municipalities. Studies comparing education production and cost functions in Finnish municipalities during 1998-2004 show very small efficiency differences among municipalities.⁶ Most differences were due to environmental variables and pupil characteristics, which cannot be directly influenced by schools or municipalities. Spatial and social segregation in Finland are limited, as illustrated by one of the lowest Gini

Figure 7.1. **Productivity growth in local public services, 2000-08**
(index 100 in 2001)



Source: Own calculations based on Statistics Finland (2009), Statistics on local government productivity, 2008.

co-efficients in OECD countries with regards to income inequality and inter-regional inequality.⁷ However, these circumstances still impact local governments' ability to efficiently deliver educational services.

A variety of factors has been found to impact the efficiency of municipal service provision. Lower efficiency of municipal service provision is associated with peripheral location, high-income inhabitants (i.e., high wages), large population, high unemployment, diverse service structure and a large share of services bought from other municipalities. Factors associated with higher efficiency include a high number of municipal workers aged 35-49 years, high population density and a high education level of inhabitants. The 10 municipalities identified as most efficient in local service provision were rather small and mostly located in southern Finland. Peripheral municipalities scored mostly below average, whereas the 10 biggest cities showed a varying performance, ranking between 65 and 317.⁸

No study has linked the Basic Services Programme (or its elements) to more efficient local service provision. The Basic Services Programme evaluation, which will be released in March 2010, is expected to provide some information on the impact of the Basic Services Programme on efficiency of local basic services. These indications will be on the macro-level, but the methodology provides a tool that could be applied to measure public service efficiency by individual municipalities. One committee of the ministerial working group on the Basic Services Programme, the Committee for the Municipal Economy, is currently building such a methodology using inputs from ministry representatives and researchers.

Evidence from reforms in other OECD countries suggests that programmes such as the Basic Services Programme can increase the efficiency of local public services when they go hand-in-hand with the following elements:

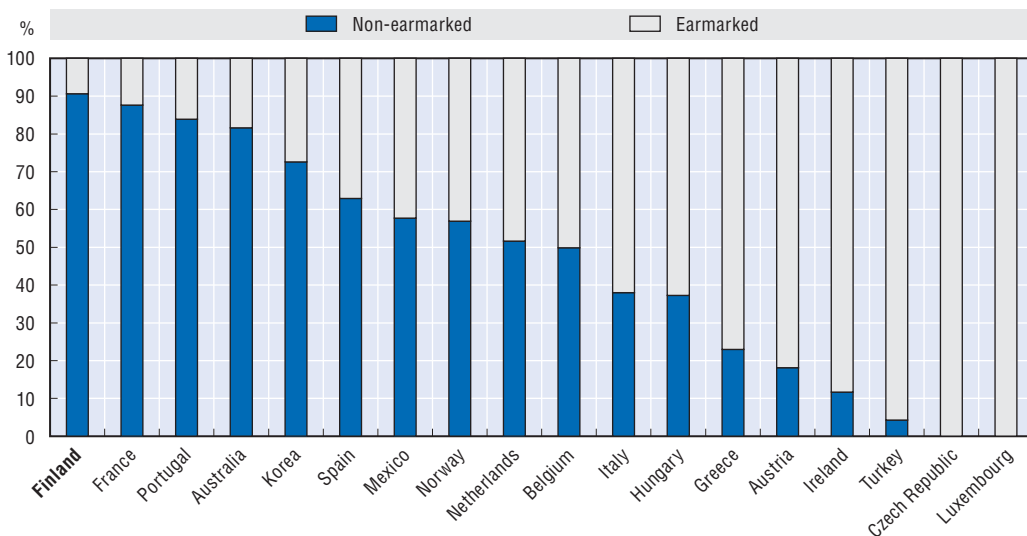
- a) local autonomy and capacity, which clears local governments to actually use the freedom that comes with a general grant to make more efficient local allocation decisions;
- b) policy alignment and co-ordination among levels of government, which ensures that central government involvement (via sector requirements, for example) does not constrain the autonomy of local governments to build on relevant complementarities among policy fields to provide a specific local policy mix;

- c) monitoring efficiency and yardstick competition (i.e., competition among local governments using benchmarks that enable citizens to evaluate the performance of their municipality vis-à-vis other municipalities), which allows citizens to compare the performance of their local government against other municipalities and press their government representatives for more efficiency.

Local autonomy and capacity

Within the Basic Services Programme, the grant reform will have the largest consequences for local autonomy and capacity. Consolidating block grants into one general grant will give local authorities more possibilities to adapt funding to local preferences, taking into account local circumstances. Finland's 1993 grant reform paved the way for most of the current effort. Before 1993, over 90% of central government grants were specific matching grants. The 1993 reform reduced this number by consolidating specific grants into block grants. As a result, a very large share of government transfers to local governments was non-earmarked in 2006: 90% in Finland, compared to an OECD average of 48% (see Figure 7.2). The potential benefits of further reforms depend on the extent of local autonomy and capacity. If local authorities have only limited autonomy or capacity in terms of instruments, revenue sources or staff, they will not be able to reap benefits of the further consolidation of specific grants into a block grant.

Figure 7.2. **Earmarked and non-earmarked grants for local governments in OECD countries (2006)**



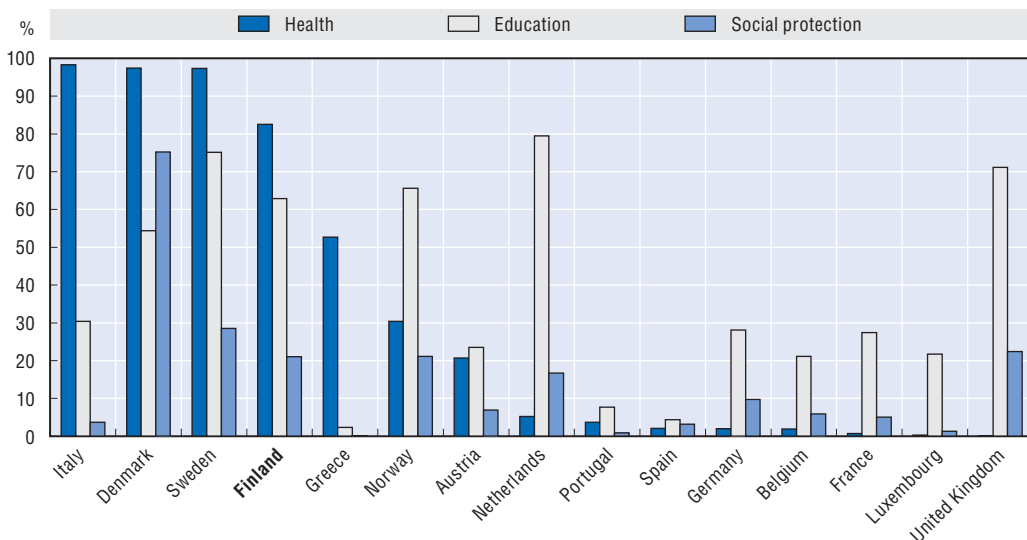
Source: OECD Network on Fiscal Relations Across Levels of Government Database.

The new municipal grants system implemented in 1993 reduced the sector-specific supervision of municipalities and gave them more independence in providing services. Studies have shown that specific cost-related grants were more expensive for municipalities than general grants. Additionally, grant lobbying was a common and widespread phenomenon under the old system. The new system has made it easier for the central government to co-ordinate macro-economic policy, and to cut grants. The reform significantly impacted the operations of joint authorities of municipalities whose finances depend more than ever on whether they can sell their services to member municipalities

and other buyers.⁹ This incentive, combined with reduced grant lobbying, suggests that the grant reform has had a positive effect on the efficiency of local public service provision.

A variety of indicators show a high degree of autonomy among local governments in Finland. They have a broad range of responsibilities and policy instruments, as compared to counterparts in other OECD countries. Finland's local governments provide services that are not administered locally in most other OECD countries, or are to a lesser extent; local shares of government spending on public services such as health (83% in 2003), education (63%) and social protection (21%) are among the highest of OECD countries (see Figure 7.3). In addition, Finnish local governments have significant local fiscal autonomy including discretionary powers over several tax resources. Local tax revenues in Finland represented 20.7% of total tax revenues in 2005 (see Figure 7.4), and local governments have full discretion over tax rates for 90% of these revenues (compared with an unweighted OECD average of 73% in 2004). Local governments have more discretion over tax rates in only five OECD countries, and only Sweden's local governments generate more local tax revenues as share of GDP than Finland's.¹⁰ Finland is one of the few OECD countries without numerical (quantified) constraints on local government borrowing or debt.¹¹

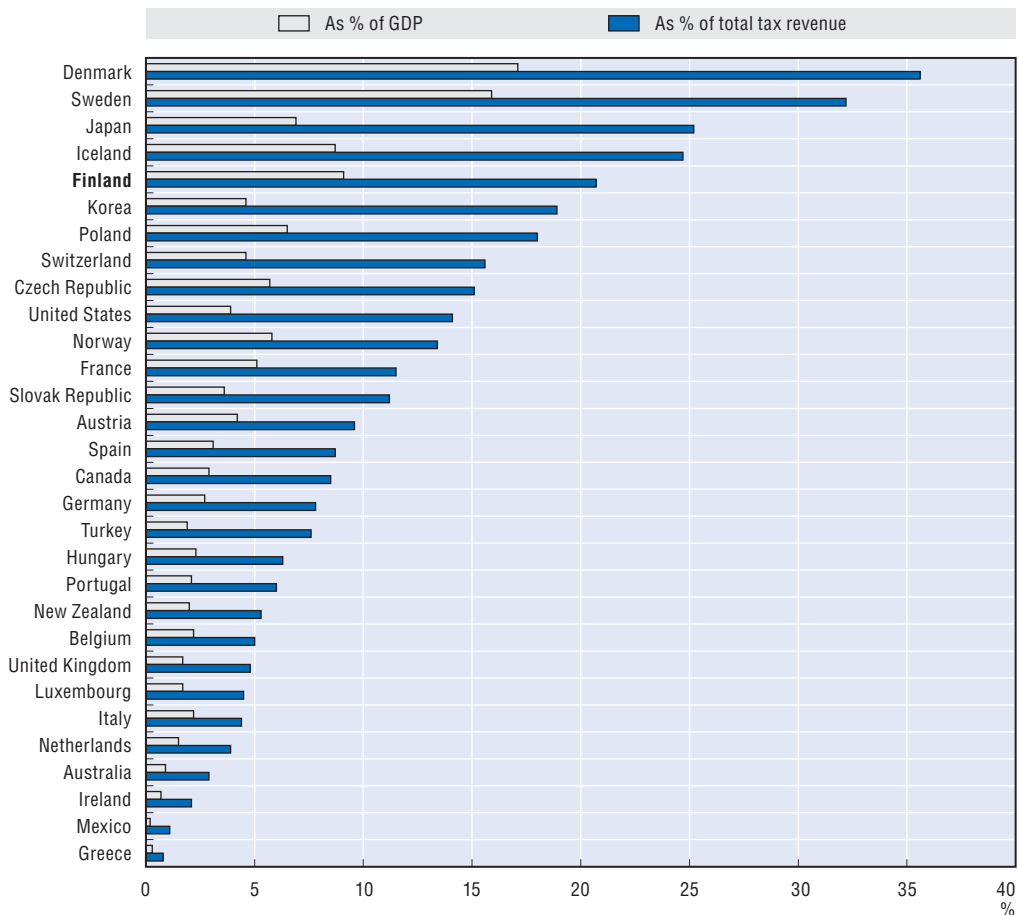
Figure 7.3. **Sub-national shares of public services expenditures in OECD countries (2003)**



Source: OECD Network on Fiscal Relations Across Levels of Government Database.

The grants reform in the Basic Services Programme will stimulate local autonomy to a certain extent. Sector ministries have considered their specific and block grants as a steering instrument, which will be reduced under the reform programme. For example, whereas the educational grant provided remote and rural areas with additional resources to fund (more) schools, the new basic services grant will provide the same resources based on location but without obligation to spend this money on schools. At the same time, sector ministries will continue to develop legislation and regulation for basic services. The Basic Services Programme has broadened the local tax base by transferring certain deductions from the local to the central level.

Figure 7.4. Local tax revenues as share of total tax revenues

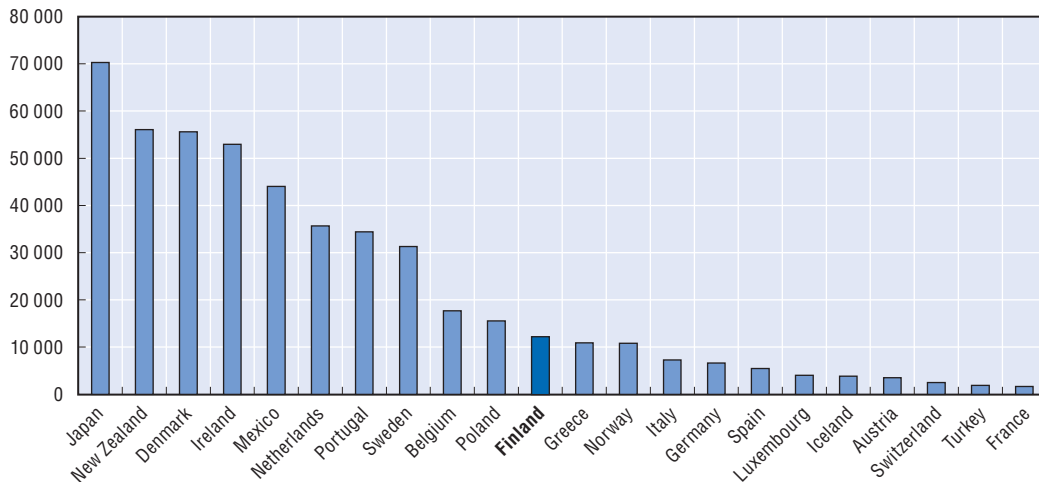


Source: OECD (2008), *Revenue Statistics 1965-2007*, 2008 Edition.

Local capacity, as measured by size of municipalities, is relatively limited in Finland. The average municipal size is around 11 600 inhabitants, which is small in comparison to other OECD countries (see Figure 7.5). The average number of sub-national staff, however, is higher than in other OECD countries. The public sector made up about 26% of total employment in Finland in 2007, and roughly four-fifths of public employees in Finland work at the local level (in local administrations and to deliver different local services); the remaining one-fifth work at the central level. Although federal states within the OECD tend to have similar or higher shares of sub-national public employment, the Finnish level of public employees working sub-nationally is relatively high for unitary OECD countries (see Figure 7.6).

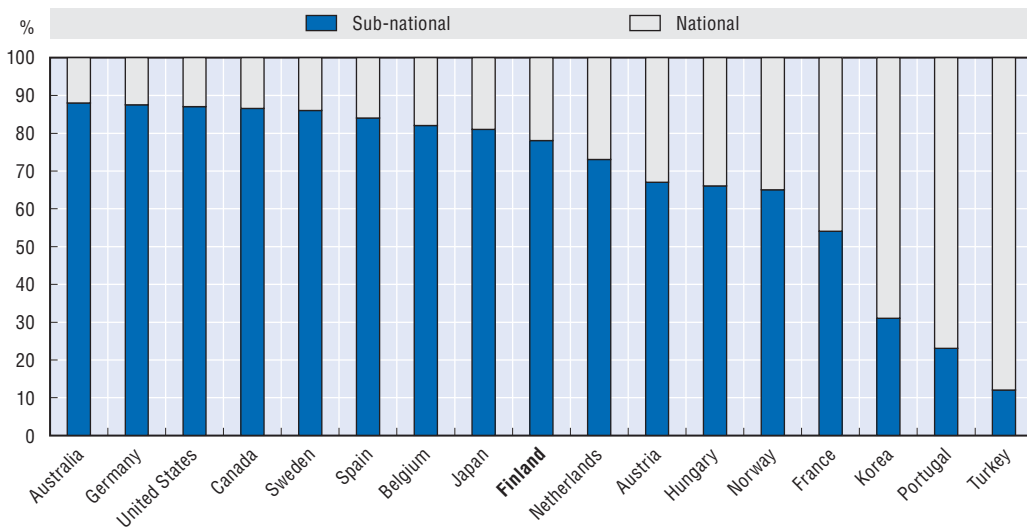
This limited municipal size might have consequences for the efficiency of local public services in Finland, although it has proven difficult to find an optimal size to maximise performance. While studies on the efficiency and productivity of Finnish comprehensive schooling found that both the size of the municipality and the average school size had a non-linear impact on costs, optimal municipal size was determined to be approximately 24 000-37 000 inhabitants and optimal school size was 690 students.¹² In the health sector, very small municipalities have experienced increasing difficulties in securing enough skilled healthcare professionals to provide services.¹³ There are, however, many reasons to be cautious about these figures. Most studies find different optimal size for different public

Figure 7.5. **Average number of inhabitants per municipality in OECD countries (2005)**



Source: OECD Network on Fiscal Relations Across Levels of Government database.

Figure 7.6. **Share of sub-national employees in total public workforce (2006)**



Source: Based on OECD (2008), *Challenges of Human Resources Management for Multi-level Government*.

services (e.g., education, health, social services). It is therefore unlikely to determine one optimal size for a local government that can most efficiently provide services across all the sectors for which it is responsible.

In order to increase efficiency of local basic services, the reforms aim to increase local capacity by reaping economies of scale from larger municipal size and shared services provision (see Chapter 6 for a description of the PARAS reform). Municipal structures will be reinforced by merging municipalities and incorporating parts of some municipalities into other municipalities. Service structures are reinforced by forming larger catchment areas and increasing co-operation among municipalities. This reform assumes that the population base required for primary healthcare and associated social services is about 20 000 inhabitants, whereas the population base desirable for vocational education would

be 50 000 inhabitants. Local governments are free to decide whether they would like to merge, but are stimulated by merger grants. In order to create larger catchment areas for service provision, they form co-operation areas led by a joint municipal organ or board, and with decision making power based on the municipal population (unless otherwise agreed by the participating municipalities). Joint municipal boards are obligatory for specialised medical care and special care for the mentally handicapped. Consolidating service delivery in larger catchment areas will allow medical professionals to perform specialised procedures in order to maintain their skills. Joint municipal authorities are voluntary within the fields of vocational training and regional enterprise development support. For some services, such as waste management, municipalities create common limited companies. Co-operation by agreement takes place for a variety of services, such as libraries, music schools and vocational high schools.

All forms of co-operation and common service delivery could stimulate the sharing of administrative capacity such as data entry and case work, across sector areas like education, health and social services. As such, it is important that both the conditions for structural change (*e.g.*, mergers, co-operation, joint services boards) and the incentives for making necessary underlying process changes (*e.g.*, truly sharing administrative capacity, rather than simply reducing municipal staff without improving efficiency) are in place. Both the central government and the Association of Finnish Local and Regional Authorities could play a role in these efforts. Similar associations of sub-national governments elsewhere in the OECD are engaged in building local capacity (*e.g.*, Denmark and Norway).

The reforms also aim to clearly establish the responsibilities of local governments. Tasks transferred from local to central government in 2009 include consumer advice guardianship measures and tasks related to the *Security of Child Maintenance Act*. Funding responsibilities that have been transferred to the central government include reporting on sexual abuse of children, forensic psychiatric reports, and healthcare and medical treatment for people under the direct responsibility of the government of Finland (*e.g.*, under EU legislation or international agreements).

The municipal merger reform has reduced the number of municipalities from 415 in 2008 to 348 in late 2009, improving the conditions for effective grants reform. However, most mergers have been taking place in the less remote areas of the country. The margin for economies of scale is limited in isolated areas with large distances, especially in the North of Finland. Despite relative effectiveness in increasing economies of scale, these efforts will therefore not help municipalities located in the most remote areas in Finland.

Alignment and policy co-ordination: Gaps and tools

Horizontal alignment. The Basic Services Programme has improved policy alignment across ministries. When the ministers concerned with service provision (*i.e.*, Finance, Public Administration and Local Government, Health and Social Services, Social Affairs and Health, Education, Migration and European Affairs and Justice) come together with the Association of Finnish Local and Regional Authorities to prepare the Basic Services Programme document, they have an opportunity to share and co-ordinate ideas. The reform of the transfer system in 2010 centralises grant allocation within the Ministry of Finance; this move was facilitated by the transfer of the Directorate of Municipal Affairs from the Ministry of the Interior to the Ministry of Finance in 2008. Barriers among sectors will be reduced; less specific grants will require more strategic vision on public service provision at the local level, which might stimulate horizontal co-operation within

municipalities. The Basic Service Programme fits in with wider inter-ministerial policy co-ordination initiatives such as inter-ministerial re-organisations (*e.g.*, merging the Ministry of the Economy and Employment) and horizontal programmes (*e.g.*, the Government Programme) and horizontal processes like the Productivity Programme.

As the grant reform creates more strategic local debate on public services, further policy alignment among municipalities may be necessary. This is particularly the case for public services with significant external impact, *i.e.*, “externalities”. Because externalities are not taken into account in local decisions, local governments tend to under-invest (in case of many positive externalities) or over-invest (in case of negative externalities). Specific matching grants make sense for services with large externalities.¹⁴ An example of a positive externality is higher education; when educated people move away from the places where they were educated, the benefits of the investment in higher education spill over to the new communities. Several local services in Finland could be considered to have externalities: in some cases, people use schools, health services and other social services that are not located in the municipality where they live and pay taxes. General grants leave more freedom to the local level of government, which might ignore externalities and thus increase the need for policy alignment among municipalities at the regional level. Specific interventions could include uniform standards, regulations and budgets that follow users. In order to promote the use of services across municipal boundaries, data definitions and standards could be improved and harmonised.

In fact, the recent reforms require that urban regions align their local plans to address externalities. The new *Act on Restructuring Local Government and Services* requires 17 urban regions to create a plan to improve the reconciliation of land use, housing, and transportation, as well as the use of services across municipal boundaries. The main city and its neighbouring municipalities – which make up the urban region as defined in the law – must work together on the plan, unless the municipalities in question decide unanimously that it is not necessary. Special initiatives have been put in place to increase metropolitan co-ordination in the Helsinki metropolitan region. Because most externalities take place in urban regions and remote areas have fewer spillovers to neighboring areas, it makes sense to focus horizontal policy alignment on urban centres. However, horizontal co-ordination among remote municipalities could to some extent create economies of scale for services where daily face-to-face contact is not crucial and where relatively long travel distances might be justified (such as specialised medical care).

Vertical alignment. The Basic Services Programme is embedded in vertical policy alignment mechanisms: negotiations between central and local government representatives, in which regional and local governments are represented by the Association of Finnish Local and Regional Authorities. (This association also participates in the ministerial working group on the Basic Services Programme.) Direct relations between central and local governments take the form of efficiency incentives initiated by the central government such as quality standards, overview mechanisms, service delivery agreements, reporting requirements and the Productivity Programme. A new vertical dynamic is being developed in Kainuu, where the regional level has taken over some local tasks, which it funds through part of its tax revenue – the regional/local dynamic was previously absent from Finnish policy making.

One goal of the vertical alignment mechanisms is to better balance sub-national responsibilities and resources. Although the Finnish Constitution obliges the central government to make sure that new sub-national responsibilities are matched with sufficient

resources, sectoral ministries have generally been more concerned with government grants for their programmes than with the resources that individual municipalities have to fulfil their responsibilities in these areas. This has led to a vicious regulation circle: sectoral ministries tend to increase regulation in sectors where gaps emerge in sub-national service provision due to insufficient resources (such as elderly care), ensuring that resources are prioritised towards these sectors but creating new policy gaps where resources are withdrawn, provoking a new round of more intense regulation. A more holistic approach to basic services by the central government, building on complementarities among policy areas, can stop this cycle. Despite improved policy alignment among ministries, substantial sectoral regulation complicates service provision across sectoral domains and prevents service connections among social services, child care and education. Both harmonizing the regulation of local basic services and limiting new service obligations for municipal governments could create needed policy complementarities. Such an approach could help the government to ensure basic services for all Finns, regardless of where they live, and to find a balance between national and local concerns.

Monitoring efficiency and yardstick competition

Competition among local governments provides an important incentive for more efficient public services provision. This competition can take different forms. Good public services or low tax rates could attract mobile citizens and firms. However, when citizens judge the performance of their municipality by comparing their outcomes with their neighbours, tax mimicking and policy mimicking could lead to more subtle competition. There are indications that such competition takes place in Finland. For example, Finnish municipalities behave strategically in terms of tax setting; when the average tax rate of a neighbouring municipality is raised by one point, a Finnish municipality will generally raise its tax rate by 0.303 point.¹⁵ This is a tax-mimicking rate similar to those found in other OECD countries.¹⁶

In order for such competition to generate efficiency gains, transparent information on the performance of local governments must be made accessible to the public. Greater autonomy (in the form of reduced regulation and earmarking of funds) will have to go hand-in-hand with greater accountability and more transparent information about outcomes. Although the Basic Services Programme document provides some basic financial information for municipalities by region, it does not give indications on performance of local public services. Outputs on public services per municipality – such as the number of graduated pupils, patients treated and operations fulfilled – are available through the sectoral ministries, which are working to develop more sophisticated outcome information. However, this information is not publicly accessible. Initiatives to create more transparent, comparable and publicly accessible performance information on local public services should be stimulated.

The Norwegian KOSTRA model could be a useful reference for such initiatives. The KOSTRA system, introduced in 2001, includes uniform standards which have enhanced the comparability of municipalities and service sectors. KOSTRA has helped the central government to determine if municipalities are complying with national standards and regulations, and facilitated a common assessment of the local economic situation. This report is used as the basis of a parliamentary discussion on the transfer of resources to municipalities. For municipalities, KOSTRA lessened the administrative burden of reporting and provided a tool for internal planning, budgeting and communication at the local level. In

addition, it facilitated the sharing of knowledge among municipalities, which are able to use indicators for the purpose of benchmarking performance¹⁷ (see Box 5.8 in Chapter 5). Norwegian sub-national authorities (19 counties and 431 municipalities) account for approximately 50% of public spending. However, the de-centralisation of expenditure does not accurately reflect the role these entities play in resource allocation. In some areas, earmarked transfers constrain their ability to use funds as they wish. Municipalities also have limited room for raising revenue through taxes. This means that the central government plays a large role in the transfer and allocation of public funds, and that it requires substantial amounts of information (indicators) in order to execute this role effectively.

Reinforcing regional equity and competitiveness

Despite regional-equity principles underlying Finnish policies, there are major differences in basic service provision among municipalities. Per-capita healthcare expenditures are an example; very small municipalities have faced growing financial difficulties in addressing the economic risks of hospital care expenditures, which are relatively higher for them than for the bigger municipalities.¹⁸ The municipal fiscal revenue base is one possible explanation for the differences: local tax rates have been used to finance local services and compensate for disparate municipal financial capacities.¹⁹ Another possible cause is differences in grant allocations among municipalities; the choice of criteria can impact fund allocation. For example, the indicator that local governments use to express the rate of illness is the share of people outside the workforce, which only gives a rough indication. More precise indicators, such as data on people with diseases in municipalities, are available at the national level in Finland, but not used for the allocation of grants. Expenditure-needs measurement is considered a challenging task,²⁰ and allocation criteria for government grants need to be refined.

A strong revenue equalisation system exists to even out tax-base differentials between rich and poor municipalities. This is particularly relevant in Finland, as the bulk of municipal revenues are raised through municipalities' own sources (grants represent only about 12% of total local tax revenues in Finland). The state grants system might have to pay more attention to reinforcing municipalities' revenue bases and financial capacity to secure funding and provision of public healthcare. The 2010 grants reform intended to improve and refine allocation criteria, but within the context of the economic downturn the government decided to keep current allocation criteria to ensure that no municipality would lose grant revenues due to the reform (*ceteris paribus*).

As the equalisation system attempts equity in basic services provision, other programmes are in place to increase regional competitiveness. The Regional Development and Cohesion (Coco) programme builds on existing regional endowments, targeting successful development efforts and forming inter-regional networks for greater learning, innovation and co-operation as a means to promote competitiveness (see Box 5.5 in Chapter 5). Coco is multi-disciplinary and involves different line ministries around themes that are relatively unconnected to basic services provision: innovation environments, well-being, creative sectors and culture. On the other side, local basic public services will arguably have an impact on regional competitiveness and attractiveness, even if they are considered necessary conditions rather than determining factors.

Implementation of the reform

The success of any reform is critically dependent on its implementation. Several elements of the implementation process are crucial in helping to address political economy of reform challenges: timing and sequencing, informational strategies, incentives and the enforcement of reforms.

Time considerations

The Basic Services Programme can be considered the consequence of reforms implemented since the 1990s. The Basic Services Programme as a document and procedure was created in 2003; it was integrated into the *Act on Restructuring Local Government and Services*, implemented in 2007, and embedded in a set of other Acts (on municipal boundaries, etc.) that were also implemented in 2007. The grants reform piece of the Basic Services Programme is envisaged for 2010. Consolidating the block grants that remain into one large basic services grant (including the 2008 transfer of the Department of Municipal Affairs from the Ministry of the Interior to the Ministry of Finance to allow for a more holistic approach to basic services²¹) will complete the reform process kicked off in 1993. Most of the municipal mergers and the creation of co-operation areas took place in 2009; the incentives for such mergers were higher in 2008 and 2009 than in 2010 and 2011, in order to ensure quick implementation by local governments.

The sequencing of the reforms has been logical. The full reform package was rolled out over the course of a few years, allowing well-informed debate on each element. However, there is a limited time period during which government administrations can be subject to reforms. An option might have been to introduce the grant reform at the same time as the restructuring of the municipal boundaries, which would have reduced the transition period for local governments. The resources made available, such as incentives for municipal mergers, create a window of opportunity to both change institutional structures and reform processes so that efficiency gains are actually realised. The sequencing of reforms does not guarantee that these reforms take place simultaneously.

Informational strategies

The main stakeholders of this reform have been central government departments (including political leadership) and local government representatives. In fact, the current package of local government reforms has been the outcome of political compromise, which could explain its heterogeneity; this is a positive factor, as it leaves room for local preferences and experimentation with different models. At the same time, however, it leaves local governments with uncertainty about the course of developments in the longer term, and does not allow for clear messages about the reform package. Municipal mergers, increased inter-municipal co-operation, the creation of a regional-level government in one region (Kainuu) and strengthened regional de-concentration (via the ALKU reform) all take place more or less simultaneously.

Local government representatives have been actively involved in the formulation of the reforms. The Association of Regional and Local Authorities has officially been consulted, and informal discussions with large municipalities have informed the policy making process. The Basic Services Programme has gone hand-in-hand with an increased focus on evaluation. On the other hand, neither citizens nor union leaders have been involved. Considering that the future sustainability of Finnish basic services provision

would depend on either controlling rising costs or dedicating additional public resources – and more generally on reforms within the field – there appears to be a need to explain this situation to citizens. Presenting possible approaches could stimulate societal acceptance of current and future reforms.

Incentives

The grants reform that is part of the Basic Services Programme foresees compensation for municipalities. The reform will be cost-neutral for municipalities concerned. In addition, the Basic Services Programme 2010-13 will consolidate EUR 30 million over this period into the basic services grant to solve structural problems caused by low population density for eight archipelago municipalities and 20 municipalities with population density lower than two inhabitants per square kilometre. The economic slowdown and subsequent weakening of tax bases have complicated some elements of the grants reform, such as plans to re-vamp allocation criteria. In addition, the municipal share of corporate tax revenues has been temporarily increased, and public investments have been advanced.²² These provisions facilitate the reform by lowering possible resistance from local governments.

Financial incentives have helped to stimulate municipal mergers, and to counteract disincentives in the regular grant system; part of the grant is a basic lump sum that every municipality receives irrespective of its size, but a merged municipality only receives one such lump sum. Another example is the allocation criterion for population density. Currently, municipalities with lower population density receive relatively higher grants, and as a result, municipal mergers (especially those between smaller scarcely populated municipalities and larger densely populated areas) result in net loss of government grants. Some of these disincentives still exist, even after the grant reform. The central government has worked to balance these factors by guaranteeing municipalities that they will not receive fewer grants than before the merger for a period of five years – and it provides a merger grant during three years if the merger starts between 2008 and 2013 (with higher incentives for efforts begun in 2008 and 2009 than those that will take place in 2010 and 2011). The merger grant is based on two components – number of inhabitants, and number of municipalities – multiplied by a factor of 1.8 in 2008 and 2009, and by 1.4 in 2010 and 2011. Although these incentives definitely ease local merger decisions, the structural disincentives in the grant system will need to be addressed in order to sustain the tendency to reap economies of scale through amalgamations.

There is no explicit roadmap for sustaining the reform when a new government comes into power. Several elements would need to be developed beyond the current reform: revision of the grant-reform allocation criteria (including those for health services and solving structural disincentives for mergers), harmonisation of regulations for basic services, and improving performance information on local basic services. The elements that were included in the original reform proposals but delayed due to the current unfavourable economic climate might be expected to be introduced as soon as the economic climate improves. This would require leadership, and these and other elements of a reform package might be underlined in a new government's Government Programme. This could be made explicit now.

Enforcement of reforms

Although there is political commitment to the principles of the Basic Services Programme, it is weak in comparison to sectoral engagements. The main policy document

of the central government, the Government Programme, has a strong sector bias and contains limited indications for implementation of a holistic local Basic Services Programme. Political actors tend to identify with sector interests, rather than an inter-sectoral approach that brings together several ministries (Social Affairs and Health, Education and Culture) to deal with basic services. Many public actors and stakeholders are also organised on a sector basis, which reinforces sectoral responses from political leaders. These elements contribute to limited *de facto* engagement or pressure on public actors to enforce reforms within the Basic Services Programme. In order to successfully implement the aims of the Basic Services Programme, political involvement and commitment towards inter-sectoral co-ordination and citizen consultation would need to be strengthened.

Conclusions

A variety of changes to the Basic Services Programme could be suggested. Greater clarity is needed in the government document, along with stronger tie-ins to the Government Programme that forms the basis for every new national government. Although the Basic Services Programme has improved horizontal co-ordination among ministries in government procedures, more could still be done. For example, the Government could work to harmonize regulations concerning basic services, and strengthen vertical coherence. The central government grant reform makes sense, but the allocation criteria for the basic services grant should be improved over the longer term.

It is clear, however, that the Basic Services Programme is broadly in line with international practice, and that it has been well-conceived and well-executed. To achieve its full benefits, however, the government will have to put conditions in place that allow municipalities to take advantage of increased freedom and ensure that they have the capacity to do so. As the state moves away from earmarking funding and regulating services, many more tough decisions will have to be made at the municipal level – including whether or not to amalgamate with other municipalities, create service co-operation areas, or otherwise co-ordinate horizontally with other municipalities and regional authorities. Maintaining quality services, especially in sparsely populated areas, will also lead to some difficult choices. Increasing the role of citizens on the one hand, and improving performance information on the other, will provide some of the tools for municipalities to innovate and to improve their performance in order to meet these challenges.

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