

Summary

Efficiency in Swedish municipalities varies greatly, where services of different quantity or quality are provided for similar amounts of money. This has been demonstrated in a number of studies in recent years, including in our previous report to ESO (2016) where we estimated an efficiency potential of 10–15 per cent in primary and secondary schooling and elderly care.³ The differences in efficiency are also well known among the municipalities themselves. From several quarters, not least from within the municipal sector, it has been pointed out that increased efficiency is necessary to deal with the financing problem that will arise in years ahead, when costs of municipal services will increase as a result of demographic change.⁴ If inefficient municipalities learn from more efficient ones, more municipal services can be provided for the same amount of money.

For several decades, comparisons between municipalities have been encouraged as a tool for streamlining. The conditions for comparisons are also being continuously improved by the development of new indicators for resources, quality and performance. However, despite often ambitious benchmarking and improving conditions for analysis, significant differences in efficiency remain between municipalities. There is therefore much to suggest that calls for benchmarking are not enough to achieve a more efficient use of resources in many municipalities. It is likely that the incentives for streamlining need to be further strengthened. The question is how this should be done.

In this study, we have explored the possibilities of strengthening municipalities' efforts to increase efficiency by introducing a financial incentive based on systematic benchmarking in preschool, primary and lower secondary school and care for the elderly. In

³ Arnek, M., T. Melin and A. Norrlid, (2016), and *Vårdanalys* (2013).

⁴ Mörk E., G.O. Erlingsson and L. Persson (2019).

concrete terms, the idea is to introduce a new government grant, the size of which is determined by how a municipality performs compared to other municipalities with similar conditions. By increasing efficiency, either by achieving a better result at the same cost or by achieving the same result at a lower cost, a municipality should be able to improve its economic situation – thereby creating an economic incentive for efficiency.

Introducing an efficiency grant raises a number of questions that are of a both principle and practical nature and which need to be adequately answered before practical application can be considered. In order to answer these, we have reviewed previous studies of efficiency in the municipal area, analysed the incentives currently used to influence municipalities and analysed the availability of data and how differences in structural conditions between municipalities can be taken into account. On this basis, we have concluded that an efficiency grant of the kind we are presenting here must meet the following basic requirements: that the efficiency on which the grant is based is measured in a fair way, that the grant creates incentives for individual municipalities, and that unintended negative consequences do not occur. In addition, the grant must fit into the existing system of municipal self-government, the system of economic equalisation between municipalities and other existing state subsidies. In the following, we will explore how to meet these requirements.

Fair calculation of efficiency

The basis for the efficiency grant is an estimated efficiency potential for each municipality. This refers to the relationship between the degree of achievement of the targets for each service – for example, the number of pupils in comprehensive school who reach the educational goals or, for elderly care, that the objectives of the Social Services Act are met – and the resources used. In order to calculate efficiency, outcome measures are needed that capture both volume and quality for the current activity. However, good quality measures for municipal activities are often lacking, and in these cases only productivity can be calculated. As the availability of quality data increases, the calculations could increasingly apply to efficiency.

Sweden has a well-functioning system for measuring structurally contingent cost differences within the part of the municipal equalisation system related to cost equalisation. The purpose of cost equalisation is to give municipalities equal financial conditions to carry out mandatory municipal activities through the redistribution of money between municipalities. This requires accurate calculations of costs. We have therefore used data from the cost equalization system to calculate structurally adjusted costs for different activities as the central input component. On the output side, we have endeavoured to measure the achievement of targets as much as possible, but we note that there are no reliable performance measures that particularly relate to preschool and care for the elderly.

With this reservation, as a first step we calculated the relative efficiency of each municipality in the three activities. As a second step, we adjusted these estimated values for structural differences that have not been adjusted in the cost equalization system, so that we end up with an efficiency value that is fully adjusted in structural terms. Efficiency has been calculated by municipality and activity, and weighted into a total efficiency score per municipality, which then forms the basis for the calculation of the efficiency grant.

Accurate and effective incentive

The second requirement is that the efficiency grant should be accurate and have the intended effect. Efficiency differences can be viewed as scope for manoeuvring, where the right choice of measure entails greater efficiency. Financial incentives for increased efficiency should be linked to activities where the differences are large and relate to resource-wide activities, so as to provide real scope for improvement. This will allow resources to be released for other purposes, such as savings or to improve services.

Financial incentives are usually linked to certain pre-specified measures and their desired effects. Due to the complexity of the matter, it can be difficult to create an incentive for increased efficiency in this way. It is rare that a single specific approach increases the efficiency of all municipalities, since their conditions differ in so many ways. For this reason, we prefer an incentive connected to an overall target value for efficiency, allowing different

measures in different municipalities. In-depth benchmarking, so-called ‘process benchmarking’, generally aims to identify the right measure in the right place. A financial incentive can strengthen municipalities’ search for – and the implementation of – the right measure by distributing a profit based on a target value. In addition, an incentive that allows for budget reinforcement might also increase local residents’ interest in the results that their own municipality produces.

In economic theory, people’s need for goods and services is assumed to be infinite, while the resources to meet them are limited – a description that also fits the situation that municipalities face. Demand for municipal services is increasing and changing for many reasons, mainly demographic, but also due to increasing expectations among local residents. How well municipalities can meet this demand varies along with economic fluctuations and thus the resources available. In better times, it is easier to invest more in both scope and achievement of goals, since resources generally increase and trade-offs between different purposes can be perceived as less necessary. In times of economic hardship, there is normally more pressure for increased efficiency.

The fact that the focus of municipalities tends to vary with the general economic conditions is natural but not optimal in terms of efficiency. An order that continuously keeps the relationship between results and resources on the agenda would be preferable. Through the benchmarking-based efficiency mechanism that we have studied, we see the potential to contribute to a more constant focus on efficiency.

The way in which the efficiency grant will be financed also has an impact on how it should be constructed. In principle, there are two ways of financing – either through redistribution between municipalities or through a transfer from central government, ultimately with local or national tax effects. Financing through redistribution could provide an argument for including the incentive for efficiency as a new component of cost equalisation. This would probably increase interest and lead to significant inter-municipal pressure. At the same time, this would interfere with the basic principles of the municipal equalisation system, which we do not consider desirable.

As a transfer from central government, the efficiency grant would take the form of a conditional state grant to municipalities, outside

the municipal equalization system. There would involve less inter-municipal pressure, while the pressure from central government would increase.

Avoiding unintended consequences

The third requirement is that the efficiency grant should not give rise to unforeseen negative consequences. After all, the municipal economy is not free from financial incentives. On the contrary, municipalities face a number of different incentives that interact in ways that are not always transparent. The most basic incentive for efficiency comes from municipal taxation along with the statutory requirement of a balanced budget. The taxation of local residents can be seen as a balance between the amount of services and support that local residents need and require, and their willingness to pay for access to them. Finding this balance will improve the possibilities of municipal politicians being re-elected.

Most of municipalities' activities are mandatory by law. The right to tax income can therefore be regarded as a delegated obligation to collect sufficient funding for mandatory activities. Municipal self-government is therefore not entirely free, but must remain within the limits of what has to be done and how much taxation is required for this. There is some room for differing ambitions as to what service levels municipalities wish to provide, but also for different degrees of efficiency. Central government intervenes in this area with conditional grants, trying to steer municipalities in certain directions. This may increase costs but can also increase efficiency. The problem is that many state subsidies, both targeted and general, entail a jumble of often diffuse and sometimes contradictory objectives that, taken together, can make measures difficult to reconcile.

Of course, adding an additional incentive to this environment is not trivial. An incentive for greater efficiency of the kind we are trying to formulate can in itself have unintended consequences, e.g. municipalities, in order to receive the grant, may tend to improve their performance in what is measured, or even to report false results. We believe that such a development can be counteracted by the fact that the efficiency grant is not based on any single measure,

but rather several measures in various municipal activities. This makes it more difficult to manipulate the basis for the grant, while not compromising the autonomy of municipalities. In addition, the risk of undesirable effects must be weighed against positive effects in terms of the more efficient use of resources that the grant could lead to.

Conclusions and proposals

Our conclusion after studying the possibilities of stimulating municipalities' efficiency efforts through an efficiency premium based on systematic benchmarking is somewhat positive. It is possible to meet the requirements of fair efficiency comparisons and an accurate and effective incentive to improve efficiency without a serious risk of undesirable side effects, at least once better performance measures are available. Through a premium on efficiency based on the relationship between resources used and the outcome of the activities, the focus on improving efficiency can be increased. Streamlining need not be tantamount to cutting expenses. Although expenditure cuts can lead to increased efficiency, municipalities may also increase efficiency by improving the output without reducing costs. Such a development would be rewarded by the efficiency grant, as well as when the quota is improved by reducing resource consumption at the same outcome. The efficiency premium that we have calculated can thus also help to maintain efficiency targets in both better and more difficult times.

By designing the efficiency premium as a government grant independent of the municipal equalisation system, efficient municipalities are given a general budget contribution. This can be used where necessary with little risk of undesirable effects on municipal services. In the report, we have calculated a maximum premium of SEK 1 000 per inhabitant for the most efficient municipality/municipalities. In total, the cost of the proposed premium for central government would amount to just over SEK 1 billion per year.

The financing of the premium must of course be done while taking account of the cost of other measures. The best argument for the premium could be that it is a cost for central government that

can be seen as an investment in future lower costs or better results in municipal operations than would otherwise be the case. According to the preliminary calculations we have made, relatively small efficiency improvements in the municipalities are required to generate a socio-economic gain, i.e. that the benefits of the grant in the form of improved results or reduced costs exceed the cost of financing. For example, total expenditure on preschool was just under SEK 79 billion in 2018. If more than the 150 municipalities that showed efficiency below the average reduced their costs by 5 per cent, just over SEK 2 billion could be saved or used for other purposes.

On the basis of these conclusions, we think there is much to suggest that, in the long term, an efficiency premium based on systematic benchmarking of the kind we suggest here is a good investment. We propose a step-by-step process, in which systematic benchmarking with increasingly robust performance measures is developed and gains legitimacy among municipalities. Once a solid system is in place, an efficiency premium may be introduced.