

Chapter 3

Decentralisation at sectoral level: developing the role of local government on labour market oriented benefits in Denmark

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Abstract

Danish local governments' share of public expenditures has been gradually increasing, especially the share towards social protection expenditures, which is now very high compared to other countries. An increasing part of social benefit expenditures, i.e. redistributive income transfers, counted as local in official statistics explains this development. This contributes to the fact that Denmark scores very high on international indexes of the most decentralised countries. An analysis shows, however, that decentralisation in this area is not only a matter of what level incurs the expenditures but also what level of government determines the size of and entitlement to benefits. Moreover, it matters what level provides the funding. It shows that for more than half of the so-called decentralised income transfers there is virtually no local autonomy. For the rest, i.e. the labour market oriented benefits, local autonomy is limited but developing over time when it comes to entitlement and

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financial responsibility. We identify four characteristic stages of development starting from the 1970s and ending up with the latest and comprehensive employment reform of 2015. The reform supports local competencies and streamlines central government reimbursement systems, which also implies the challenging task of solving equalisation needs without jeopardising the incentives for efficiency being a main motive of decentralisation and recent reform.

3.1. Introduction and purpose

A motivation for this article has been to get a nuanced picture of the process and content of decentralisation of labour market oriented social benefits in Denmark. Our method is comparative, i.e. to characterise the Danish situation seen against other countries and especially to identify and compare different stages of development over time.

Labour market oriented benefits – as part of social benefits – may or may not be seen as suitable for decentralisation. On the one hand, we usually assign social benefits to the redistribution branch of the public sector⁵⁵, emphasising the national, legal rights to receive benefits in certain well-defined situations and taking into accordance the mobility of recipients between local governments. On the other hand, social benefits may be seen in close connection with other social expenditures on e.g. job creation, rehabilitation, continuing education /re-training, social arrangements etc., where local governments used to have a more important role, stressing factors such as cost-minimisation, effectiveness and taking into account local preferences and conditions.

In Denmark those last-mentioned factors seem to have been attached importance since – according to Statistics Denmark – the major part of social benefits, including the labour market oriented benefits, are assigned to the local government sector. We observe that this may be one of the reasons why a World Bank paper lists Denmark – out of 182 countries – as number 1 according to the degree of decentralisation.⁵⁶ In this paper, we will investigate how the time-series figures of public expenditures on sectoral/functional level mirrors decentralisation and make some simple cross-country comparisons (section 3.2).

⁵⁵ Musgrave (1959) and Oates (1972).

⁵⁶ Ivanyna & Shah (2014).

The international data and key figures on decentralisation is only crude indicators of the central-local relationship, and is only a first step for a more comprehensive picture of the situation. To get a more detailed understanding, we therefore discuss decentralisation, focusing on social benefits/income transfers, where Denmark seems to deviate from most other countries (section 3.3).

To get deeper into this issue about decentralising labour market oriented social benefits in a Danish context, we will study the decentralisation process of local governments in Denmark seen over a longer period of years. In this historical view (section 3.4), we will try to sort out different periods of decentralisation which mark progressive steps in the process. We are curious to find out how decentralisation has developed, having in mind that decentralisation of income transfers may have another character than decentralisation in other expenditure areas, i.e. areas dominated by local consumption. We expect to disclose some dilemmas or challenges in this connection. Especially, we note that cost-minimisation seems to be an important motive behind decentralisation of labour market oriented social benefits, but alongside those benefits also play an important role in Denmark in national redistribution policy.

Next we discuss the most recent financial reform of labour market oriented social benefits (section 3.5), including some of the motives and perspectives of the reform – and their implications on the need for improving the equalisation system.

Finally, we conclude in section 3.6.

3.2. Decentralisation at the sectoral level – development and international comparison

Table 1 illustrates for the local governments in Denmark the development of expenditures by economic functions (sectors) in a period covering the last 25 years.

Table 1: Danish local governments' (=municipalities and regions) expenditures by economic functions, local governments' share of total general government expenditures for each function.

Pct. Economic function	1989	1996	1999	2003	2007	2013
1. General public services	28	30	29	30	20	16
2. Defence	1	-	-	-	1	1
3. Public order and safety	12	11	12	12	9	10
4. Health	93	98	98	98	99	99
5. Education	54	51	52	54	45	41
6. Social protection	72	71	74	74	79	80(90)
Total¹	52	54	56	59	62	62(66)

¹ Including other functions, i.e. economic affairs, environmental protection, housing and community amenities, recreation, culture and religion.

Note: 1989, 1996, 1999, 2003: economic functions and modified COFOC-classification, 2007, 2013: COFOC-classification. Note for 2013 that the recent major revision of national accounts may itself have changed distribution marginally.

Source: Jørgensen et al (1992), Knudsen et al (1998), Larsen et al (2015).

It is in accordance with the standard model of allocation of tasks that the central government is the primary responsible level for *General public services*, *Defence* and *Public order and safety*. In Denmark, the *Health* sector is predominantly a regional and partly a municipal responsibility, while municipal primary schools, central government secondary schools, higher education institutions, etc. carry out *Education*.

The transfer in 2007 of secondary schools from regions/counties to independent institutions controlled by the central government explains the local governments' decreasing share of Education. In the opposite direction for *Social protection*, the importance of local governments seems to increase gradually, i.e. to around 4/5 of total expenditures in this area in 2013. Taking into account that the unemployment funds (social security funds) pay out 10 pct. of government expenditure, but are partly financed by the local governments, it may even be argued that local governments' share is up to 90 pct.⁵⁷

⁵⁷ In the official guide to national account systems, an 'alternative method' of sub sectoring the general government sector is mentioned, where social security funds are included in the other subsectors of general government (central government, state governments and local government), European Commission et al (2008, 80).

From *table 2*, it becomes more evident that tasks in connection with *Social protection* especially characterise the Danish local government sector. Denmark allocates 56 pct. of expenditures to this function with only 12 pct. and 20 pct. for OECD- and EU-countries in general. No. two on the list is Germany (33 pct.) and then UK (30 pct.), Norway (27 pct.) and Sweden (27). It seems to indicate that Denmark deviates in accordance to (measured) decentralisation of the social protection sector.

Table 2: For local governments (=municipalities): share of local governments' expenditures for each economic function, Denmark, OECD and EU, 2012

Pct.	Denmark	OECD27	EU28
1. General public services	4	15	17
2. Economic affairs	4	13	12
3. Health	22	18	13
4. Education	10	26	20
5. Social protection	56	12	20
6. Other	4	16	18
Total	100	100	100

Source: OECD (2015).

The economic function of *Social protection* includes social services, i.e. public consumption expenditures such as kindergartens, elderly homes, care for disabled persons etc., and social benefits, i.e. mainly income transfers to households.

For *Social protection*, the main explanation for the economic significance for Danish local governments compared to the central government seems to be the expenditures for social benefits/transfers to households. That is what the figures from Denmark and some neighbouring countries clearly indicate, cf. *table.3*.

Table 3: Social benefit expenditures by level of government, 2012

Pct. of GDP	Denmark	Netherlands	Germany	Korea	Norway	Sweden	Switzerland	Finland
1. Central government ¹	5.2	22.2	20.3	6.6	14.3	14.0	9.0	19.5
2. Local and other levels of government ²	13.1	1.8	3.8	0.0	1.1	4.2	2.3	2.1
Total	18.3	24.0	24.1	6.6	15.4	18.2	11.3	21.6

¹ Including social security systems, agencies etc.

² Calculated residually

Source: IMF (2015), table W09.

3.3. The character and degree of decentralisation of social benefits

3.3.1. General considerations

As mentioned in the introduction in international comparisons, Denmark appears as one of the most decentralised countries. A recent study from the World Bank ranked Denmark as number 1 according to an aggregate decentralisation index – with Sweden and Switzerland as number 2 and 3. Other studies/indexes also rank Denmark among the most decentralised countries.⁵⁸ The studies try to cover several aspects of decentralisation, but one of the findings is that Denmark deviates from most other countries by having a large share of public expenditures allocated to subnational governments, and especially social benefits expenditures, cf. section 2.

However, decentralisation can take many forms. When OECD and the World Bank (Ivanyna and Shah, 2014) focus on which level of the public sector is accountable for the expenditures, i.e. incur expenditures vis-a-vis the citizens, it is only a crude measure of decentralisation, which in practice is not necessarily congruent with autonomy or freedom to prioritise these expenditures. The World Bank is fully aware of this, cf. remarks from Ivanyna and Shah about measuring the relative importance of local governments by the share of local government expenditures in consolidated general government expenditures. Ivanyna and Shah

⁵⁸ Ivanyna & Shah (2014) and Rodden (2014). Moreover, Strohner (2016), figure 1.

(2014, 10): “This is obviously an imperfect measure of relative importance of local governments as a significant part of local government expenditures may simply be in response to higher level government mandates with little local discretion. However, data on autonomous local government expenditures are simply not available”.⁵⁹

It *is* a complex task to estimate the degree/substance of decentralisation. According to common standards, the essence of a decentralised community is that each municipality can match the local needs and preferences with the local expenditures and services. In line with this, a high degree of decentralisation means municipalities have a degree of freedom to decide the level of service and expenditures. For instance, a variation in the use of resources across municipalities suggests that the municipality has autonomy in prioritising the resources.⁶⁰

In Denmark (and other countries), the degree of decentralisation varies from one area to another. For instance, primary schools have been subject to closer regulation than day care for small children, while regulation of care for the elderly has been in-between.⁶¹

The central government control of the local governments can take many forms and involve varying degrees of control and management tools, ranging from regulation by law of standards and production processes to establishing economic incentives for motivating certain desired local behaviour. In addition, more soft instruments may come into play, like proposing local governments to compare results and learn from each other. In the next section, we discuss decentralisation and control instruments in relation to social benefits.

3.3.2. Decentralisation of social benefits

As mentioned, the expenditure area of social benefits in the form of income transfers to households serves as an instrument of redistribution. Redistribution according to the classical view should be a central government task, cf. section 1. Nevertheless, in Denmark these expenditures appear as decentralised, municipal expenditures. However, can we get closer to what we really mean by decentralisation here? Moreover,

⁵⁹ See also OECD/KIPF (2013), chp. 2 about Denmark.

⁶⁰ Grønnegård Christensen, Munk Christiansen, Ibsen (2011)

⁶¹ Grønnegård Christensen, Munk Christiansen, Ibsen (2011)

what indications about the degree of decentralisation do we get from the financial system?

For this use, we identify four factors/ dimensions characterising centralisation/decentralisation of social benefits.

First, as a starting point, it is relevant to observe if the central government or local government level incurs the expenditures. This is the piece of information that we track down from the national accounts, and the various indexes mentioned in section 2 make use of this. It tells us which level pays out the expenses to the citizens and has the responsibility of budgeting and accounting the expenditures. However, it does not necessarily imply autonomy or degrees of freedom in the decision-making about those expenditures.

Second, we ask which level determines the size of the benefits to entitled recipients. As an example: is it the central government or the local government that decides the level of social pension or cash allowance when the person in question has been entitled to these transfers?

Third, what is the relevant authority for entitlement of social benefits? The criteria for awarding benefits may be defined by a central government law or be a matter of local government discretion. Alternatively, it may be somewhere in-between, where the municipality might be able to affect the number of persons entitled to the benefits through preventive policies in other fields.

In addition, as the *fourth* factor: is it the central or local level of government that has the financial responsibility – or are the responsibilities shared in some kind of co-finance system?

Box 1 summarises the above-mentioned relevant factors or dimensions characterising decentralisation of social benefits.

Box 1: Dimensions of decentralisation of social benefits (income transfers)

- 1) What level incurs the expenditures?
 - Local government (1b)
- 2) What level determines the size of the benefit to entitled recipients?
 - The size of payment is centrally regulated (2a)
 - The size of payment is not regulated, i.e. depends on local government discretion (2b)
- 3) What level determines who is entitled to receive benefits?
 - Entitlement is centrally regulated and local governments cannot influence the potential number of recipients (3a)
 - Entitlement is centrally regulated but local governments are able to influence the potential number of recipients (3b)
 - Entitlement is not regulated, i.e. depends on local government discretion (3c)
- 4) How is the net expenditure financed (indirect measure of autonomy)?
 - Full reimbursement from central government (4a)
 - Co-financing by earmarked reimbursement from central government (<100 pct.) and partly by general grants and/or local taxes (4b)
 - Solely by general grants and or local taxes (4c)

According to the above dimensions, we identify four combinations characterising Danish social benefits, cf. *table 4*.

Table 4: Four combinations of dimensions of decentralisation

	1 Expenditures	2 The size of payment	3 Influence on entitlements	4 Finance
A	Local	Centrally regulated	No local influence	Full reimbursement
B	Central	Centrally regulated	Local influence	Co-financed local/central
C	Local	Centrally regulated	Local influence	Co-financed local/central
D	Local	Centrally regulated	No local influence	Co-financed local/central

Table 4 joins *table 5*, which categorises the different Danish social benefit schemes according to the combinations. Moreover, the table shows the economic significance of the single schemes.

Table 5: Municipal/partly municipal financed social benefit expenditures (income transfers), 2013, by scheme

Scheme	Bn. DKK	'Local autonomy'
Old-age pensions	112.6	A
Early retirement pensions	42.8	C
Personal pension supplements	1.4	A
Unemployment benefits	19.7	B
Social assistance	20.4	C
Other cash benefits	5.1	C
Unemployment allowance	3.0	B
Working capacity allowance	0.1	C
Gross rehabilitation allowance	1.8	C
Sickness benefits	12.8	C
Maternity benefits	9.2	A
Holiday benefits	1.0	A
Child and youth allowance	0.1	A
Contribution to free places in day care institutions	2.7	C
Rent subsidies and rent allowance	13.3	D
Total bn. DKK	246.1	(A: 124,3/B: 22,7/ C: 85,7/D: 13,3)

Source: Danmarks Statistik (Statistics Denmark). DST, October 2014, OFF10, and own estimates.

From *table 4* it appears that it varies at what level the expenditures are incurred (dimension 1), what level has influence on entitlement (dimension 3) and what level has the financial responsibility (dimension 4). However, for the size of the benefits, it is clear that only the central government level has the decision power (dimension 2), which may – in a Danish context – support what was formerly called the classical view of assigning the task of redistribution policy to the central level.

Combination A (in 2013124 bn. DKK = 7 pct. of GDP) consists of income transfers, such as old age pensions, maternity benefits and child and youth allowances, counted as municipal but with no discretion and underpinned by full reimbursement. These income transfers are genuine “agency functions”, i.e. the local governments are only paying-offices, so

to speak.⁶² It seems obvious to correct negatively for these expenditures when estimating the degree of decentralisation in Denmark.⁶³

Similarly, the local autonomy for *combination D-expenditures* (in 2013 13 bn. DKK = 1 pct. of GDP) is rather limited. Under this heading, we find rent subsidies and rent allowance. The municipalities after all have some channels of influencing the number of recipients. However, the municipalities can only carry out this influence in a very indirect manner, by encouraging the constructing of new social housing usually inhabited by relatively high numbers of people receiving rent subsidies and allowance.

Overall, we think it is fair to conclude that both category A and D payments should not be counted as local expenditures in e.g. a decentralisation index, since local autonomy does virtually not exist.⁶⁴

In the discussion about decentralisation, we find *combination B* and *combination C* as the most interesting categories. Category B expenditures are unemployment benefits (in 2013 23 bn. DKK = 1 pct. of GDP) counted as central government/social security funds expenditures, but partly and increasingly financed by local governments. Category “C” expenditures are primarily early retirement pensions, social assistance and sickness benefits (in 2013 86 bn. DKK = 5 pct. of GDP) counted as municipal/local government and partly financed by local governments.

For combination B and C, it is obvious that the local autonomy is limited but the designs assume some local influence on education, job training, employment agency functions, job creation and rehabilitation.

⁶² From 2013, “Udbetaling Danmark” administers all payments from those schemes. A board consisting of municipal representatives (majority) governs this relatively new organisation. In the national accounts, the organisation however is assigned to the central government; cf. Larsen et al (2015), p.77. Udbetaling Danmark also administers rent subsidies, rent allowance and early retirement payments.

⁶³ This will account for major revisions of statistics, see Lotz p. 43 in OECD/KIPF (2013).

⁶⁴ In the index mentioned in Ivanyna & Shah Denmark would then move from number 1 to number 2-4, of course assuming that other countries do not have similar relevant corrections.

Another aspect of decentralisation – not accounted for in the factors above – is the intensity of process regulation and use of performance management. This will also affect the autonomy of the local government, but it is very difficult to measure the intensity of e.g. process regulations.

In the rest of the paper, we will discuss how decentralisation has evolved for the most important category, B and C payments schemes, which mainly consist of the labour market oriented benefits. We will concentrate on benefits like early retirement pension, sickness benefit, unemployment benefit and social assistance.

3.4. A historical view on decentralisation of labour market oriented social benefits

This section gives a brief overview of the development in employment policies and the role of the municipalities. We give special attention to changes in competencies and especially the financial system for labour market oriented social benefits, and we touch upon some links to the broader social protection area.⁶⁵ To help distinguishing the factors of motivations and tendencies, we sort out different periods of decentralisation.

3.4.1. The 70s and 80s: a stronger municipal sector after 1970 structural reform – the municipalities as the main entrance for social services

Concerning the organisation and tasks of local governments, in a Danish context there are especially two important dates to be aware of. They are the local government reform of 1970 and the structural reform of 2007. These were the times of two major local government reforms that also involved labour market oriented social benefits.

The process of decentralisation began before the 1970 reform and was parallel to the development of the Danish welfare society in the 1960s. To begin with, the process spread out local responsibilities to public utilities, roads, schools, culture and care for elderly. In the years to follow – and with basis in the reform of 1970 – the local responsibilities were ex-

⁶⁵ Sources: Finansieringsudvalget (2004), chp. 7-8, Finansieringsudvalget (2012), chp. 3, and memorandum to Socialministeriet (1990).

tended continuously, not least of all in the social areas like day care, certain social benefits, etc.

The reform in 1970 was also background for a change in the financial system between the state and municipalities. Until then, state earmarked grants in the form of reimbursements primarily financed the tasks of the municipalities, and the central government reimbursed a certain part (e.g. 50 pct. or 100 pct.) of local government expenditures. The reform replaced a major part of the reimbursements schemes with a general grant, which was free of bindings to certain expenditures. At the same time, the central government expanded the financial equalisation scheme between municipalities.⁶⁶

In 1976, the Parliament passed the Social Assistance Act. The Act was based on the 1970 reform and decentralised social competences from central government to municipalities. The municipalities became the main “entrance” for applications for social assistance and most other social assistance schemes. The Act allocated the responsibility for awarding and payment of social assistance and sickness benefits for the needy without unemployment insurance to the municipalities. The rate of reimbursement for social assistance for uninsured unemployed was 50 percent. Persons who were members of the unemployment insurance remained the responsibility of the state and the unemployment insurance funds.

1987 saw new changes in the financing of local governments’ social benefits.⁶⁷ Social expenditures on wages and services, which used to be financed partly through reimbursements, became fully financed by the municipalities. These changes covered the areas of care for elderly and day care institutions. Now, only social cash benefits (e.g. social assistance and sickness benefits) and some services in specialised social areas like services for handicapped, vulnerable families and children, drug addicts etc. applied to the “old” system of reimbursements.

It also was under consideration to change the financing of early retirement pension towards more financial responsibility for the municipali-

⁶⁶ Grønnegård Christensen, Munk Christiansen, Ibsen (2011).

⁶⁷ Ministry of Social Affairs (1985): Bill number 262 6/6 1985.

ties, but there was yet no political will to do so.⁶⁸ The economic importance of early retirement was increasing, however, since in 1983 it became possible to receive early retirement pension based on a broad assessment of needs and not solely on the health situation.

The purpose of the change from reimbursement to general grants was to increase financial consequences for the municipalities failing to take steps to avoid the need for social help.⁶⁹ The intention was that the cost-consciousness of the responsible authorities would increase. Moreover, it was deemed important to insure economic neutrality between overlapping services so the most suitable service was carried out – without considering the financial “advantages”, a factor that would later be stressed even more, cf. below.

3.4.2. Decentralisation in the 90s: more local own finance of social benefits and macroeconomic protection of the municipal sector⁷⁰

In the aftermath of the change in 1987, there were ongoing discussions and considerations whether to change the “old” finance system regarding social benefits towards lower reimbursements and more general grants.

One of the discussions was the possible effect of the finance system regarding the amount of benefits. Would a change of the reimbursement system increase the local incentive to help an (uninsured) unemployed person to find a job quickly so that person would be able to support himself – instead of receiving social benefits? Following the economic argument advocated by the Ministry of Finance, it would contain the increasing amount of benefits when the local municipality financed a greater part of the benefits – instead of receiving 100 percent reimbursement. The municipalities would be more aware about the money spent on benefits, i.e. the costs for the society, and would have more focus on getting unemployed people a job quickly and thereby save money.⁷¹ If the options for the municipalities were over-estimated, the re-

⁶⁸ Ministry of Social Affairs (1990): Bill number 64 7/11 1990.

⁶⁹ The changes were prepared based on Finansieringsudvalget (1985).

⁷⁰ Sources: primarily Finansieringsudvalget (2012), Arbejdsmarkedskommissionen (2009), KL et al (2009) and memorandum to Socialministeriet (1990).

⁷¹ Cf. Christiansen (2000).

form would lead to inequalities between the spending need of the municipalities, so the changes implied serious challenges to the equalisation system.

At this stage, the discussions of the role of local governments relative to the unemployed solely concerned the uninsured persons, i.e. people eligible to social assistance. Later, the municipalities also played a role in relation to the insured unemployed, see below.

Another consideration was to uphold the classic principle in decentralisation: competences and finance should go hand in hand⁷². Decentralisation of competences should follow more direct financing by municipalities so that the municipality was also entitled to allocate benefits like early retirement pensions. The competency to award early retirement pension was at that time (around 1990) a county responsibility (county boards – “Revaliderings- og Pensionsnævn”)⁷³. The rationale was to make the municipalities acting responsible by increasing their autonomy in this field. In other words, to encourage them to be the entrance for a more coherent employment policy, including the autonomy to award and (co)finance benefits and to assist and help people get back to work.

Generally, the thinking of labour market policy was changing towards a more active approach and active employment policies aiming to qualify and motivate the individual person to seek and obtain employment. At the time the active employment measures were not very used, as only 1/5 of the total employment expenditures were spent on activating and rehabilitation schemes, education etc., while 4/5 were spent on passive benefits, i.e. income transfers.⁷⁴ The argument was that reduced reimbursement and more general grant financing would stimulate municipalities to prioritise the active employment policy. By prioritising the active employment policies, it would be possible for the forward-looking municipalities to reduce the amount of income transfer benefits in the end and thereby save money and improve employment in general.

⁷² The slogan – intensively used in this period – was in Danish: “Ansvar og kompetence bør følges ad!” which is translated to “Finance and competence should go together!”.

⁷³ The county boards/“Revaliderings- og Pensionsnævn”, were independent boards for awarding rehabilitation and pension, administered by county council personnel.

⁷⁴ Ministry of Social Affairs (1990): Bill number 64 7/11 1990.

It was not only an economic argument. Due to studies⁷⁵, income transfers were not a suitable solution for social problems, and social assistance or early retirement pension did not necessarily help persons with reduced working capacity. The studies argued⁷⁶ that even to receive social benefits in a limited period could involve a risk of making the unemployed person more passive and helpless than before. It was important that the municipality – quickly – assisted those people that needed help to find a job. It was serious that these active measures were carried out immediately so the period with passive benefits was as short as possible.

There were also talks about a uniform reimbursement across (some of) the different social benefits, i.e. the same rate of reimbursement would apply for different social benefits schemes. Uniform reimbursements should ensure a choice among the different benefits based upon the correct relative cost – expressed as “the principle of neutrality”⁷⁷. The size of the reimbursement rate and who should pay would not affect the choice. Instead, it was found that focus would be on the jobseeker and the measures needed in order to find a job.

All these considerations by subsequent governments led to the decision *first* to reduce the size of the reimbursements so the municipalities should finance more themselves, and *second* to uniform the co-financing system so municipalities would make a neutral, non-distorted comparison between the different benefits.

These changes placed much emphasis on the local ability to shape their own social landscape. However, the legislators would later face that the accompanying deepening of differences in objective local spending needs between municipalities would be very difficult to equalise between them.

In 1990, an agreement⁷⁸ reached by the central government and Local Government Denmark (LGDK) lowered and uniformed the size of the

⁷⁵ Ministry of Social Affairs (1990): Bill number 64 7/11 1990.

⁷⁶ Ministry of Social Affairs (1990): Bill number 64 7/11 1990.

⁷⁷ Pedersen (2007), p. 273 and Lotz (1998), p. 392f.

⁷⁸ Ministry of Social Affairs (1990): Bill number 64 7/11 1990.

reimbursement for social assistance, sickness benefits and early retirement pension. The Parliament passed the following law in 1991 and thereby implemented the principle of neutrality between different measures – as considered back in the 70s. Moreover, the parties agreed to increase the competence of the municipalities, so municipalities also had the competences to award early retirement pension and administering the national set of rules for eligibility. At first, in 1992, the county boards transferred the competence concerning certain kinds of early retirement pension to the municipalities. Later, in 1994, the municipalities could take over the full competency of awarding early retirement pensions if the individual municipality deliberately asked for it.

The future general level of reimbursement rates for these benefits should be 50 percent – assuming that with this lower rate it would be more attractive for the municipality to invest more money in the active measures. Formerly there had been 100 percent reimbursement on early retirement pension and 75 percent reimbursement on sickness benefits. The new 50 percent reimbursement rate did not apply fully, however. For early retirement pensions, it only applied to persons under the age of 60 and only for those pensions allocated by the municipality. For sickness benefits, it only applied after the first 13 weeks of illness.

Nevertheless, the reform changed economic conditions markedly. A person that got sick or was in another way hindered from working would now more directly affect the municipal economy. Conversely, by assisting this person in finding a job, the municipality could save money – and of course improve the welfare of the person. The government and municipalities agreed that this change would give the municipalities the right incentive to prioritise active measures instead of passive measures. Since then the side effects of this reform in terms of inequalities between the municipalities have become visible and has intensified the debate about the equalisation needs and especially the needs criteria.⁷⁹

In 1992, the so-called *budget guarantee scheme* was also implemented; its purpose was to compensate the municipalities for changes in cyclical activity-related expenditures, for instance social assistance for the unemployed, early retirement pensions, etc. The (co)finance social benefits

⁷⁹ Finansieringsudvalget (2004), chp. 7 in fine.

would expose the municipalities more to macroeconomic conditions. Therefore, it was deemed fair that central governments compensated these expenditures. The general grant system (the annual block grant) compensated the municipalities, and some new inequalities cropped up here as the general grants did not compensate those hit hardest by the cycle.⁸⁰

Further changes along the same lines followed the 1992 reform. The financial system was changed in 1997 where the 50 percent reimbursement on early retirement pension was expanded to pensions of persons over the age of 60, and for sickness benefits, the 50 percent reimbursement now began after 8 weeks of illness. Then, in 1999, the reimbursement to municipalities for early retirement pension expenditures for “new” persons was lowered from 50 pct. to 35 pct. Moreover, the changes abolished reimbursement for sickness benefits totally after one year of illness. Further, in 2001 the 50 percent reimbursement for sickness benefits started after 4 weeks of illness – instead of 8 weeks in 1997. *Table 6* shows the development of the reimbursement rate system in 80s and 90s.

Table 6: Reimbursement rates (pct.) for certain municipal/partly municipal financed labour market oriented social benefit schemes, 1985-1999

	1985	1992	1997	1999
Early retirement pension	100	50 ¹	50	35
Sickness benefit	75	100/50	100/50	100/50/0
Unemployment benefits	-	-	-	-
Social assistance	50	50	50	50

¹ For persons < 60 years of age.

Note: In some instances, the rates are lowered in relation to the length of the period an individual can receive benefits. The table shows these different rates.

In conclusion, during the 90s the municipalities undertook a greater share of the direct finance of early retirement pension and sickness benefits. Several times, we saw a reduction of the reimbursement rates. This development was parallel to a general tendency in the relationship between the central and the local government sectors to move away from detailed rules and towards economic management and economic incentives. Generally, it was a time for further devolving of competence to municipalities. All in all, these changes attempted a better correla-

⁸⁰ For a description of the budget guarantee, see AKF et al (2007), p.91.

tion between the decision competences and the financial responsibility of municipalities, but there have been costs in terms of horizontal equity among municipalities that were difficult to compensate. Further, the central government had to take over the macro responsibility to guard the municipal sector against unfavourable changes in cyclical income transfers.

1.4.3. The Structural Reform of 2007 and the following years: local responsibilities for nearly all labour market benefits and differentiated reimbursement to encourage active instead of passive activities⁸¹

The active employment measures continued to be in focus and the central government underlined that the municipalities had to make an active effort to help people get back to work.⁸² The central government deliberately started to distinguish between *active* measures and *passive* benefits. This was in order to further motivate the municipalities to activate.

A new initiative followed this policy to give a higher reimbursement when municipalities used active measures instead of passive benefits. By differentiating the reimbursement rates, the government wanted to affect the incentives and behaviour of the municipalities. If municipalities “only” assigned social benefits without presenting activation offers, training or education they would get less money reimbursed. From 2006, central government reimburses social benefits by 65 percent in periods with activation and education, while reimbursing the benefits by “only” 35 percent in periods with passive payments. Before, the reimbursement was 50 percent in both active and passive periods. *Table 7* shows the development of the reimbursement rate system from the 80s/90s to the first part of 00s.

⁸¹ Sources: primarily Finansieringsudvalget (2012).

⁸² Ministry of Social Affairs and the Interior (2004): Agreement on a Structural Reform.

Table 7: Reimbursement rates (pct.) for certain municipal/partly municipal financed labour market oriented social benefit schemes, 1985-2006

	1985	1992	1997	1999	2001	2006
Early retirement pension	100	50 ¹	50	35	35	35
Sickness benefit	75	100/50	100/50	100/50/0	100/50/0	100/50/0
Unemployment benefits	-	-	-	-	-	-
Social assistance	50	50	50	50	50	65/35

¹ For persons < 60 years of age.

Note: In some instances, the rates are lowered in relation to the length of the period an individual can receive benefits and these different rates are shown in the table. Rates also vary in accordance to “active” or “passive” measures, i.e. for social assistance in 2006.

The active measures of the municipalities were only reimbursed up to a maximum amount. Expenditures over the maximum would be financed 100 percent by the municipalities.⁸³The municipalities off course wanted to apply active measures on as many unemployed as possible within the ceiling, and the possible risk was that the municipalities used the cheapest activation – without focusing on the quality.

In order to avoid “doubtful” activation, the central government defined some legislative minimum demands regarding the active measures. This we see as an example that the differentiated rate of reimbursement had unintended consequences, as it led to further legislative demands. In addition, the central government introduced legislative rules defining that the municipality could lose the reimbursement from the state if the municipality did not fulfil different process steps.⁸⁴

On 1 January 2007, the Danish Structural Reform came into force. 98 municipalities replaced the previous 271. The reform transferred a number of new tasks to the municipalities. The reform strengthened the position of the municipalities as they undertook most of the citizen-related tasks.

The reform assigned new tasks to the municipalities, and employment-policy/employment service was one of them. 91 new so-called ‘job centres’ (there are 98 municipalities) were established and should act as the access point for all the citizens and companies needing help and ser-

⁸³ Ministry of Employment: Bill number 89 21/3 2006.

⁸⁴ Ministry of Employment: Bill number 89 21/3 2006.

vice regarding employment exchange. The government and the municipalities would enter binding partnerships to join their tasks (both local and central) in these centres. The aim was to create *one* access and insure that the decisions and measures were locally grounded. The focus of the job centre was the active labour market policies and to activate and motivate the unemployed – in dialogue with the individual – to seek and obtain employment. The unemployment insurance system (“A-kasser”) still had some competencies regarding the insured unemployed persons such as interviews and job guidance and were solely financed by the central government and membership fees.

In 2009, the central government transferred some of the measures towards insured unemployed persons to the municipalities. Reimbursements and a new special employment grant to soften the equalisation problems financed this change. The joined partnership at the job centres (between municipality and government) was cancelled as the municipalities took over the full responsibility. It was argued that it would be more efficient and assure a more coherent and focused employment policy.

An important part was the decision to make the municipalities co-finance the expenditures for insured unemployed, i.e. let the municipalities pay part of the central government bill to the social security funds (“A-kasser”).⁸⁵ It was argued that this would strengthen the incentive to help unemployed people find a job, regardless of whether the individual was insured or not. At the same time, the idea to distinguish between active and passive reimbursements was expanded to other benefits.

It finally became clear that it was necessary to consider the economic burden of the municipalities from these changes and to find ways to mitigate the distribution of those burdens. In this respect, the reform was – as said – comparable to earlier financial reforms but the challenges were added to the consequences of earlier reforms and were more difficult to solve. It was complicated because expenditures to insured

⁸⁵ Formerly, when local governments co-financed social assistance benefits but not unemployment benefits, local job creation would affect the economy in a very different way, e.g. an economic premium if the employed persons were uninsured – but negatively if they were insured. The case was named after the municipality to discover the problem, the Municipality of Nakskov (now merged into Lolland Municipality), cf. PLS-Rambøll (2000).

unemployed are to a high degree influenced by the economic conditions and general activity level of society, even more than for expenditures on social assistance. Therefore, the economics of the municipalities became more “vulnerable” because of the new competences. The solution was a special employment grant. This grant was distributed to municipalities considering the past number of insured unemployed persons – a measure that reflects the unemployment in past years.⁸⁶

In 2011, the central government (again) lowered the reimbursements to local governments in general. There was still a higher reimbursement on active measures than on passive measures, but from now on the central government harmonised the reimbursement on active measures. The system thereby got simpler and the municipalities were encouraged to decide the exact measures, which had the best-documented effect on how to get an unemployed person back to work. *Table 8* shows the development of the reimbursement rate system from the late 90s to 2011.

Table 8: Reimbursement rates (pct.) for certain municipal/partly municipal financed labour market oriented social benefit schemes, 1997-2011

	1997	1999	2001	2006	2011
Early retirement pension	50	35	35	35	35
Sickness benefit	100/50	100/50/0	100/50/0	100/50/0	100/50/30/0
Unemployment benefits	-	-	-	-	100/50/30
Social assistance	50	50	50	65/35	50/30

¹ For persons < 60 years of age.

Note: In some instances, the rates are lowered in relation to the length of the period an individual can receive benefits and these different rates are shown in the table. Rates also vary in accordance to “active” or “passive” measures, i.e. for unemployment benefits in 2011 and for social assistance in 2006 and 2011.

Finally, the system of punishing local governments economically if they did not make timely job-efforts was abolished from 2013.

⁸⁶ To avoid distortions from the financial system against efforts to reduce the number of unemployed, the employment grant was calculated on the basis of historical figures in combination with figures from functional regional areas (local labor markets/commuting areas), cf. Finansieringsudvalget (2012), chapter 19.

3.5. Reform of employment policies and reimbursements 2015⁸⁷

In 2014, the political parties reached a political agreement on a new employment policy. The Parliament passed the law in August 2015. The reform implements changes by 1 January, 2016.

3.5.1. The reform

The aim of the reform is to reduce the level of structural unemployment. The focus of the reform is to promote an individual approach to each unemployed person. This means greater freedom of choice and more personal influence on individual active measures. At the same time, the reimbursement system again is reformed – in a rather radical way.

The reform has implied several changes:⁸⁸

First, it implied some changes for the unemployed. The authorities should offer the unemployed support much earlier. The municipality will have greater flexibility in the efforts so that the measures will be individual and meaningful for the unemployed and not depend on “mechanical” steps. The first six months introduces an intensive job-seeking course with relevant and differentiated interviews and job seeking activities. The job centres and unemployment insurance funds must cooperate in organising this intensive job-seeking course. Unemployed persons have a right and duty to receive one activation offer instead of repeating offers – and the offers must relate to enterprises. Education and training must be targeted at unemployed persons who are motivated to learn and in need of a skills upgrade.

Second, focus on enterprises and the needs of enterprises increases. Assistance for enterprises must be a main priority for job centres, so the enterprises can receive the necessary labour. The job centres should lead a systematic and outreaching contact to enterprises based on knowledge of the labour market, assist in recruitment of unemployed workers as well as upgrade qualifications and maintenance of existing employees.

⁸⁷ Sources: Especially Ekspertgruppen (2014, 2015) and Regeringen et al (2014).

⁸⁸ Ministry of Social Affairs and the Interior (2015), bill number L1, and Ministry of Employment (2015), bill number L4. Both bills passed through Parliament on 26 August, 2015.

Thirdly, the municipalities get increased flexibility to organise relevant courses for each individual unemployed. The job centre can freely choose between all possible measures; however, there must be a focus on those offers relevant for enterprises. Additionally, the reform intended less regulation and more simplified and efficient processes. Local Government Denmark (LGDK) however did not find the reform that ambitious when it comes to less regulation and bureaucratisation.⁸⁹

Fourth, the reform involves some changes in the overall organisation of the tasks. The 94 Local Employment Councils and 4 Regional Employment Councils are merged into a number of cross-municipal employment councils that better corresponds to geographic ‘travel to work’-areas (commuting regions). The new councils shall support cooperation between municipalities, between municipalities and unemployment insurance funds and between the job centres, Adult Education Centres and Regional Growth Fora.

Fifth, thorough changes to the finance system is a part of the overall reform of the employment policy. From 2016, the rate of reimbursement rates of municipal expenditures on labour market oriented social benefits are be the same for all sorts of benefits. Similarly, they now only vary in accordance to the total length of the period of receiving labour market oriented social benefits – irrespective of the kind of transfer (i.e. sickness benefits as well as unemployment benefits as well as early retirement benefits etc.).⁹⁰ Consequently, the rate of reimbursement is no longer be dependent on the active/passive dimension. Over the length of the period of receiving income-transfer for the individual person, the reimbursement rate declines. The aim of these changes is to support the main purpose of a more flexible and individual approach in the employment policy and to encourage employment efforts from the beginning.

⁸⁹ KL (2014): A note from the Local Government Denmark regarding the reform of employment policy.

⁹⁰ Certain other labor market schemes outside income transfers, which count as subsidies and/or public consumption, are also covered by the reform e.g. fleksjobs (jobs on certain conditions and with local government financial support), wage-subsidies (subsidies to certain jobs in the private or public sector of extraordinary character), see Ministry of Employment (2015).

Until now, a complex set of rules as the rate of reimbursement varied from one measure to another and, dependent on the actual active measures in use, characterised the reimbursement system, cf. section 3.4. The system maybe also had too many objectives. Although this system also has had its underpinnings in such a system, there is a risk of opportunistic behaviour to optimise the highest rate of reimbursement instead of identifying the best measure for the unemployed person.⁹¹

Thus, the new reimbursement system aims to strengthen the result-oriented focus of the municipalities, i.e. a performance management viewpoint. The change implies an overall reduction of average reimbursement rates and correspondingly again more weight given to financing through general grants. To a higher degree, it gives the municipalities direct economic incentives to prevent long-term unemployment and carry out an effective effort to obtain permanent employment.

As indicated, the rate of reimbursement declines over time: From 80 percent the first 4 weeks of receiving income transfers, 40 percent in week 5-26, 30 percent in week 27-52 and 20 percent in week 52 and thereafter, cf. *table 9*.

Table 9: Reimbursement rates (pct.) for certain municipal/partly municipal financed labour market oriented social benefit schemes, 2001-2016

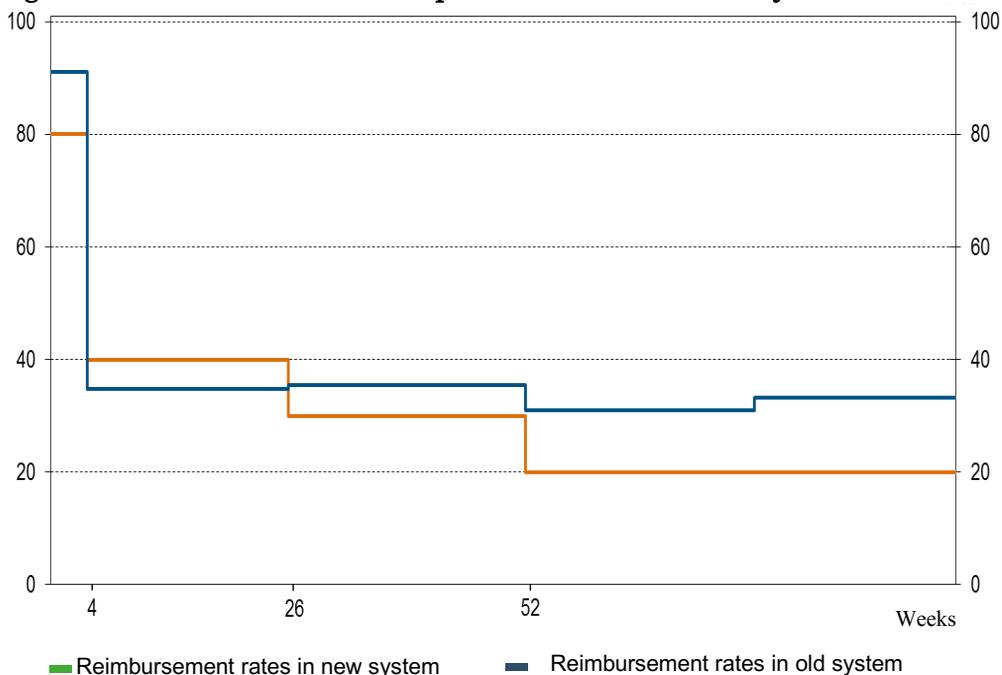
	2001	2006	2011	2016
Early retirement pension	35	35	35	80/40/30/20
Sickness benefit	100/50/0	100/50/0	100/50/30/0	80/40/30/20
Unemployment benefits	-	-	100/50/30	80/40/30/20
Social assistance	50	65/35	50/30	80/40/30/20

Note: In some instances, the rates are lowered in relation to the length of the period an individual can receive benefits and these different rates are shown in the table.

In *figure 1* the “old” and the “new” system are illustrated. The graph of the “old” system is however, an average of several different rates of reimbursement for the different schemes involved.

⁹¹ Cf. the political agreement behind the reform, Ministry of Economic Affairs and the Interior (2015).

Figure 1: Reimbursement rates (percent) in new and old system



Source: Ministry of Employment (2015).

Sixth, it is presumed that the changes in the finance system will not have unintended economic consequences for the municipalities and the economic balance between the municipalities. Therefore, an important part of the changes is a parallel adjustment in the equalisation system.

In short, so-called initial adjustments enhance the level of equalisation, which primarily will benefit the rural municipalities where the reform would otherwise tend to have a negative effect. Moreover, some temporary financial arrangements to limit some of the consequential losses and gains of the municipalities. As has been the case for the preceding reforms, it is a complicated task to repair the consequences for the municipal equity using objective criteria. Therefore, the Finance Committee (Finansieringsudvalget) of the Ministry conducts an analysis of a more permanent adjustment to the equalisation system.

3.5.2. Perspectives of the employment reform of 2015

The latest and most comprehensive reform of employment policies implies many changes with the purpose of generating an efficient system that permanently can raise the structural employment rate and limit the numbers of benefits. With the reform, the government takes an important step towards “actual” decentralisation.

The different changes are interdependent and must be seen as a whole as the increased economic responsibility follows increased autonomy and flexibility. The government gives up some control of the process and content, but instead, the economic incentives will ensure that the municipalities will make more and more effective efforts to get the unemployed in a job than before. Onward, more focus will be placed on the targeted help for each individual unemployed person, instead of measures with advantageous reimbursements. Further, it is hoped for that the changes will lead to a better political leadership locally and to professionalised policies of the municipalities.

The aim of the preliminary change of the equalisation scheme in 2016 and 2017, and the more long-sighted changes expected to come, is to ensure that the increased economic responsibility of the single municipalities will not lead to an unintended imbalance between the municipalities. It seems evident that the comprehensive changes of the reimbursement system would not have been possible if it was not for the parallel adjustments of the equalisation system. The consequences of lowering the rate of the reimbursements would have been tremendous, at least in the end, as it would have had a significant negative impact on the revenue, especially of some rural municipalities and some regions. On the other hand, it is important to base the equalisation system firmly on so-called objective criteria, which do not reduce the economic incentives to get the unemployed a job. If the equalisation system works against the intended economic incentives of the reform, the financial changes will have been all in vain. The legislators have to find a more reasonable balance between “economic equity” and “economic incentives”. This will be an important topic for further discussions and evaluations. One must also keep an eye on the temporary adjustment of the equalisation system and transitional arrangement so that it will not compensate the municipalities in a way that jeopardises the improvement of economic incentives, which is the aim of the reform.

The reform was implemented by 1 January, 2016, but the effects are of course “yet to be seen” over the following years.

3.6. Conclusions

Denmark has a very high score when it comes to comparing the GDP-share of expenditures assigned to local governments across countries. This is an explanation why investigations often rank Denmark at the top of decentralised nations. Nevertheless, we have to regard the ranking of Denmark at the top end in this respect with a pinch of salt. The reason that official statistics measure a high share of expenditures assigned to local governments stems primarily from the fact that the major part of expenditures, especially for social benefits/income transfers to households, are counted as local expenditures in Denmark.

More than half of the social benefits, i.e. old age pensions and child benefits, are “agent functions” and involve no local discretion nor local financing and consequently should not be counted as “local”.

For the rest of the social benefits, i.e. the labour market oriented social benefits, we find that decentralisation concerns the authority to award the benefits and the possibility to influence who is entitled to them, together with a degree of self-financing from local governments. The wish to improve structural employment and to contain expenditures seems to drive decentralisation.

The historical development shows that since the first local government reform back in 1970 – the several governments that have been in power have sought to decentralise labour market oriented benefits. However, the nature of that process has been different in comparison with other decentralised areas. Irrespective of the official assignment of these social benefits to the municipalities, for many years a high rate of reimbursement and bureaucratic process regulations has characterised the expenditures. Thus, the government maintained – contrary to what the official statistics may show – a high degree of regulation and inspection of the employment policies, and the degree of local autonomy was rather limited.

After all, seen over a long period of time the changes in the financial system, e.g. lowering reimbursements, have to a certain degree been going hand in hand with more competences for the local authorities

awarding the benefits. However, the central government has also used the finance system to influence the behaviour of the municipalities. We identify two partly conflicting objectives: first using the finance system to encourage certain measures and solutions, and second obtaining financial “neutrality” without distorting the process of the municipalities to make “free” decisions about the most effective measure. Legislators see changes to the reimbursement system as a possible way to affect the municipalities, however leaving a growing challenge to the equalisation system to compensate for resulting local inequalities.

In the recent 2015 reform, the reimbursement system was itself seen as a hindrance to an efficient employment policy and a more individually based employment policy. Parallel to this, the central government method of control via process regulation was criticised. Consequently, the reformed reimbursement system is clearly simplified and (some of) the process regulation has been abolished. The effects of the reform in the coming years are yet to be seen.

A condition for the municipalities to efficiently produce services is the ability to finance these services as independently as possible. In order to do so, there must be a certain level of equalisation between the municipalities so each municipality has the fiscal potential to deliver an “average” service at an “average” local tax rate. A successful decentralisation of social benefits is dependent on a solid equalisation system and “safety net” because the expenditures are vulnerable to macroeconomic fluctuations. It is also critical that the equalisation system rests on objective criteria so that it does not jeopardise the gains of improving incentives.

The solution to this is not a minor problem. In addition, to maintain the Danish system of local autonomy and responsibility intact, it should be kept in mind that this should be done without increasing – but rather reducing – the discretionary grants partly stemming from former reimbursement reforms.

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