

**Workshop on
Local Authorities' Fiscal Rules and Finances
Reykjavik January 22, 2010**

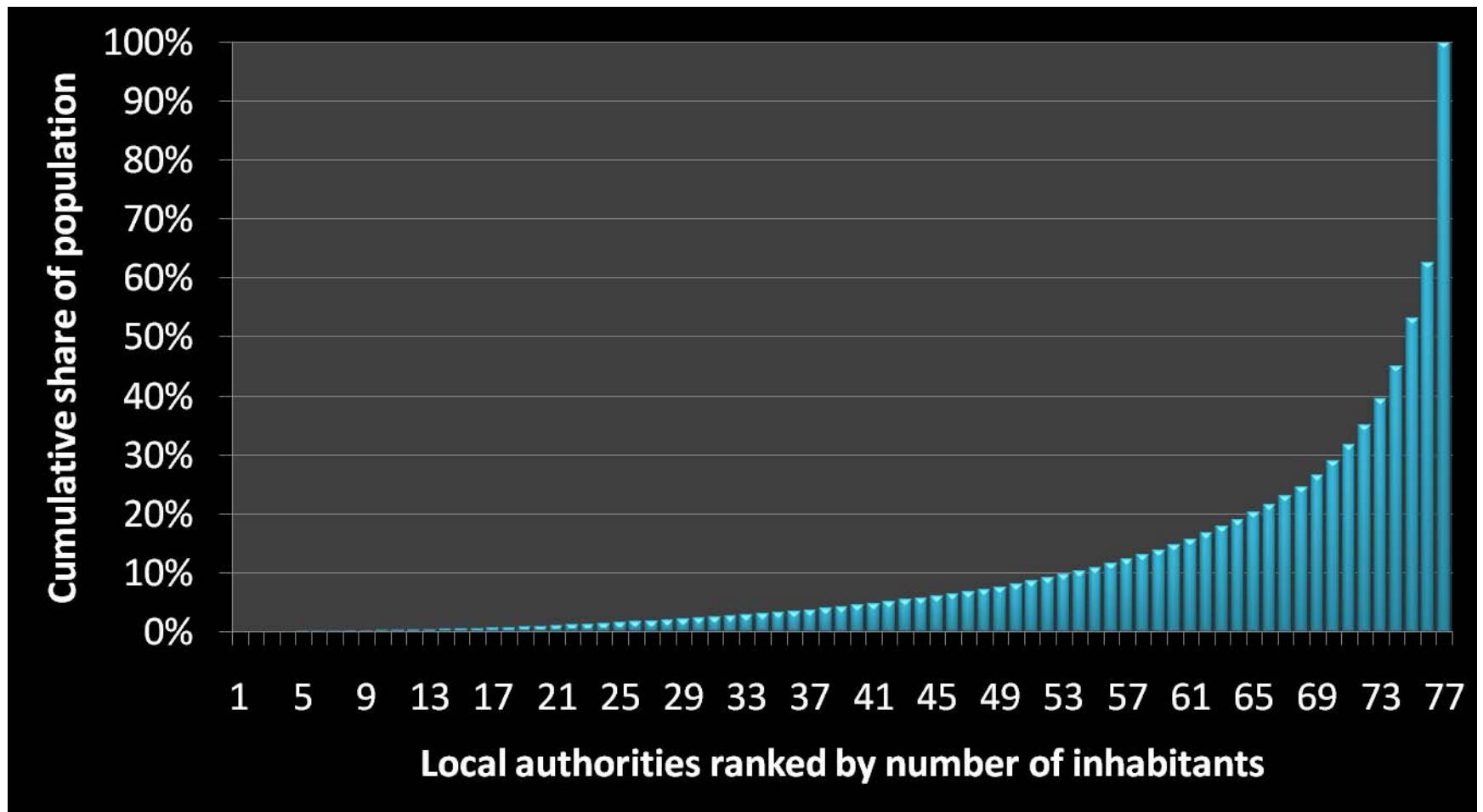
Responsibility for local government finance in Iceland

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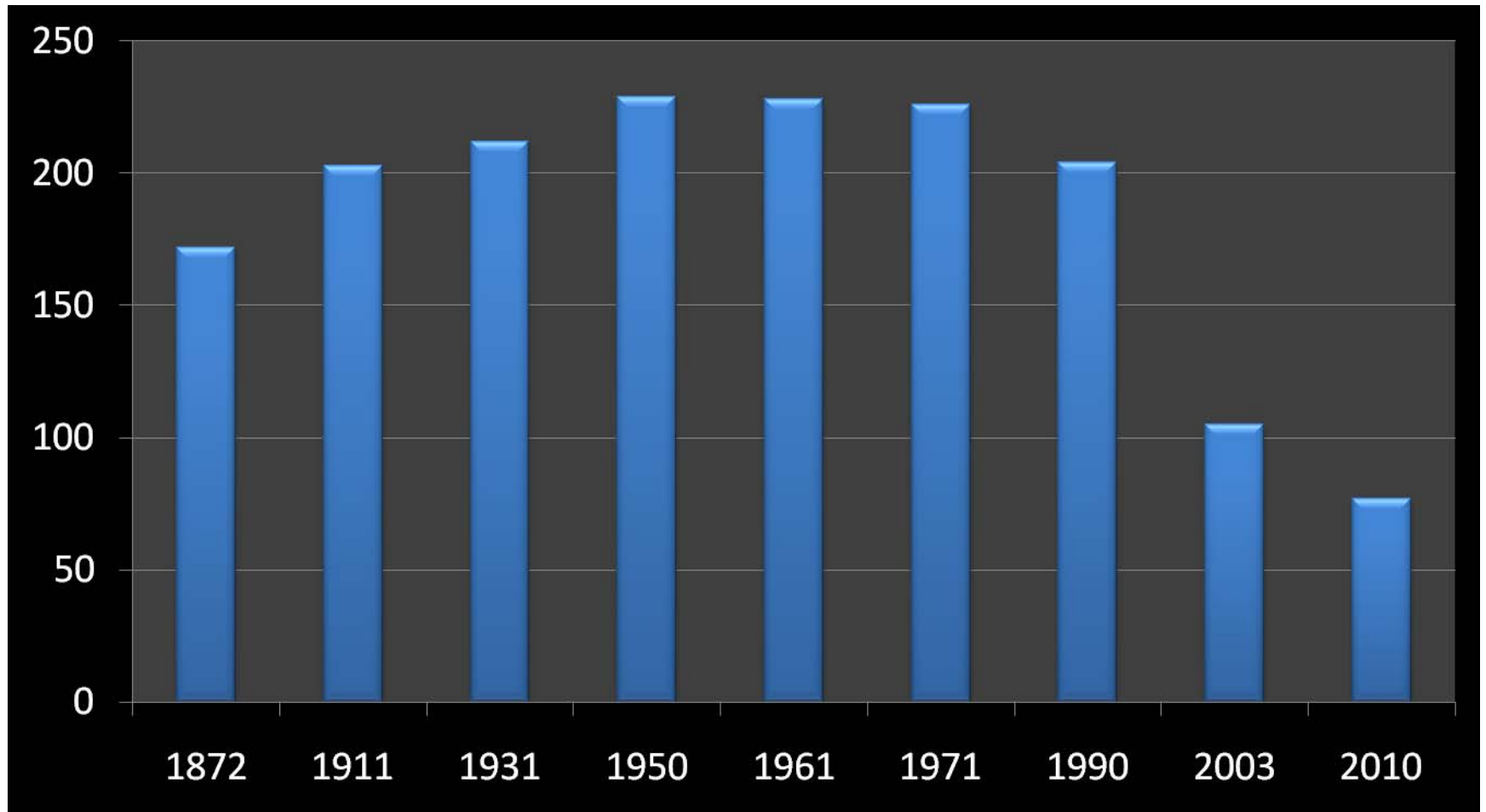
Main conclusions

- Local authorities in Iceland enjoy (suffer?) a great deal of fiscal autonomy compared to local authorities in most other countries.
- Yet at the same time, cooperation between the stages of government in this small island needs to be improved.
- In particular this pertains to underfunded assignments passed from central to local authorities.

Size distribution of municipalities



Number of municipalities 1872-2010



The role of local governments

- **Social services**
 - Social assistance
 - Child welfare
 - Rental benefits
 - Elderly care
- **Education, sport, recreation, culture**
 - Pre Schools
 - Primary schools
- **Infrastructure, technical services**
 - Streets, water, sewages
 - Fire services
 - Waste management and collection etc.

Taxation

- Taxes constitute 75% of municipalities revenues, user fees 15% and central government grants 10%.
- Local income taxes levied on non-financial personal income at a flat rate. Rates set by law, from 11.24%-13.28% (average 2010: 13,12%)
- Property taxes levied on annually assessed market value. Max rates set by law, on residential property:

The (soft) balanced budget requirement

The council shall each year ensure as far as possible that the total expenditure of the municipality, including operating expenditure, does not exceed its total revenues.

The curious cap on municipal investments

Should a council plan to embark on an investment, of which the estimated total cost, or the municipality's share in the costs, exceeds one quarter of the tax revenues for the current fiscal year, an expert opinion on the cost estimate, anticipated effects on the financial performance of the municipal treasury during the period of the project,

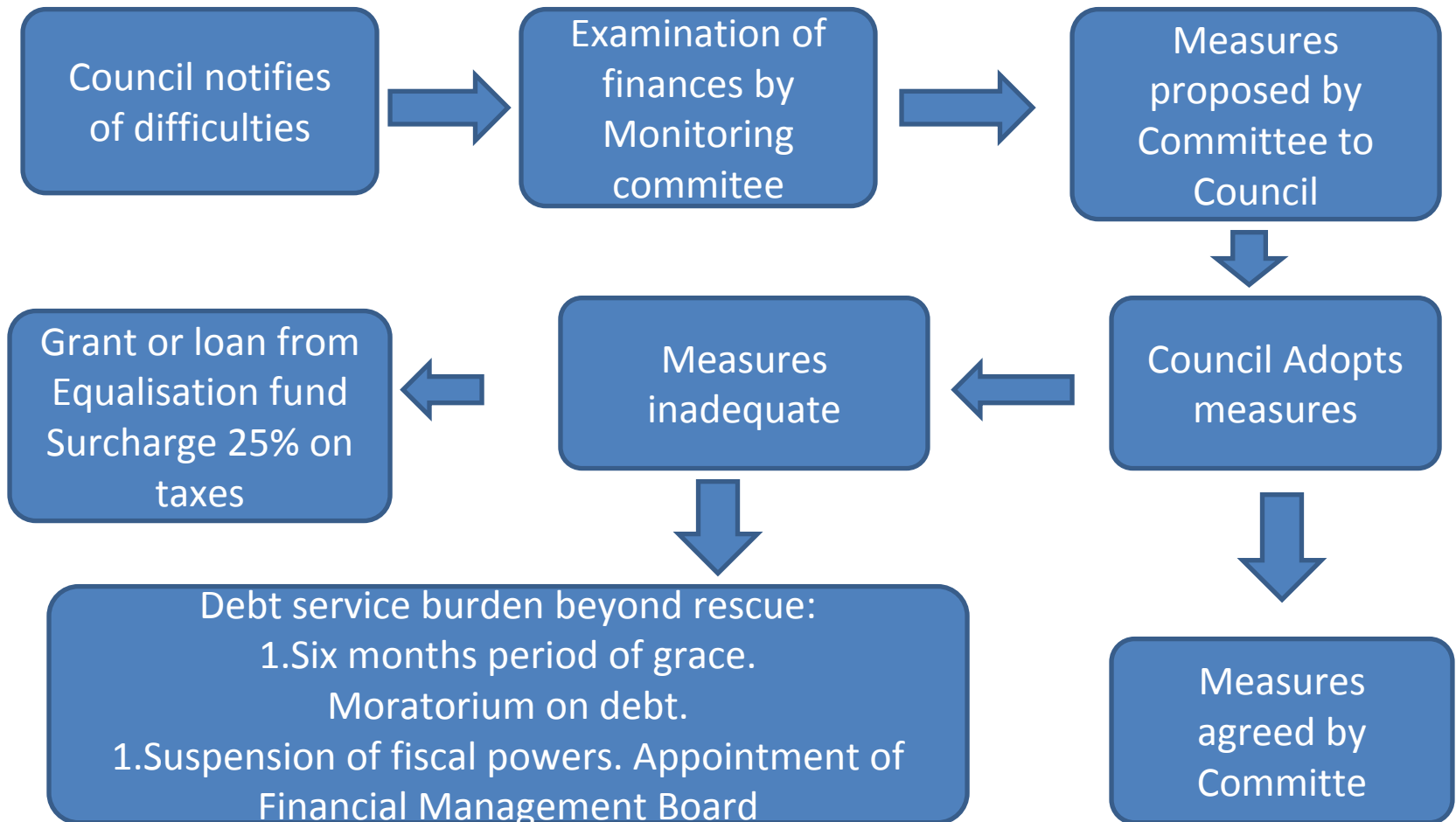
Financial difficulties

- Should the investigation reveal that the municipality's finances are such that, given normal operating procedures, it cannot meet the expenses of its mandatory tasks or other obligations, the Ministry may, on the proposal of the monitoring committee, provide the municipality a grant or loan from the Local Authorities' Equalisation Fund, in order to rectify the finances of the municipality, on conditions laid down by the Ministry. The Ministry may authorise or propose to the council, in such a case as is discussed here, on the proposal of the monitoring committee, as a surcharge of up to 25% of municipal tax and property tax.

Grave financial difficulties

- In a case where the municipality's debt service burden so far exceed its ability to pay that it is clear that no solution can be achieved in the short term, the Minister may, on the proposal of the monitoring committee, **suspend the council's fiscal powers** over the municipality, and appoint a financial management provided that the council has so neglected its duties as provided in this Act as to create difficulties, that the financial management of the municipality has been in disarray, and that measures as provided in art. 75 will not foreseeably prove effective.

The process



Fiscal rules?

- Fiscal rules are designed to place limits on public finances in order to increase fiscal sustainability and to promote economic growth and stability. Their main objective is to resist the rapid increase in public debt and reduce them over time.
- The central government's fiscal rules specify 2% real growth of central government consumption and 2½% real growth of transfers as a target in medium fiscal framework.

The time for reforms is now

- Making municipalities stronger and larger through amalgamation or through new forms of cooperation.
- Improving collection of real time financial information from municipalities. Sanctions may be needed.
- A complete rehaul of the section on finance in the Local Government Act.
- Greatly strengthening the surveillance of municipalities' finances with the aim of timely interventions.