6 The current General Purpose Grant Scheme

Local authorities' revenues from general grants and tax revenues constitute the unrestricted revenues, and amount to approximately NOK 353 billion in 2022. It is these unrestricted revenues that are distributed and redistributed through the General Purpose Grant Scheme (GPGS). The GPGS consists of several elements, the three most important of which are:

- Equalisation of tax revenues (income equalisation);
- Expenditure equalisation intended to compensate local authorities for involuntary variations in expenditure needs;
- Various grants based on regional policy.

In this chapter, we will review the various elements of the current GPGS. Section 6.4 covers the historical background of the GPGS, from its introduction in 1986 to the present day.

6.1 Tax revenues and income equalisation

The tax revenues that are currently included in the GPGS and subject to income equalisation consist of income tax and wealth tax from personal taxpayers, as well as natural resource tax from power companies. The estimated revenue generated by local authorities from these sources in 2022 is NOK 188 billion.

6.1.1 Tax share

The portion of the total revenue in the local government sector that stems from tax revenues is referred to as the tax share. Currently, tax revenues account for approximately 40% of the local government sector's total revenue. The target tax share has been 40% since 2011, but the tax share was somewhat higher before then.

The majority of local authorities' tax revenues is generated from income tax. The maximum municipal tax rates on general income are determined with the aim of achieving the target tax share. This is based on the expected development in local authorities' tax bases and is within the overarching framework for the municipal element of the national budget.

As the tax share increases, the variation in revenues among local authorities will become more pronounced in isolation, due to the disparate distribution of tax bases and tax revenues across these local authorities. Tax revenues are also a more unpredictable source of income than, for example, general grants. The higher the tax share, the greater the uncertainty related to the income level, both for the local government sector as a whole and for the individual local authority.

6.1.2 Income equalisation

Income equalisation partially evens out the variation in tax revenues between local authorities. The compensation rate indicates the degree of equalisation. Income equalisation consists of symmetric equalisation at 60%, along with additional compensation for local authorities with tax revenues below 90% of the national average. Symmetric income equalisation entails proportional reductions per capita for local authorities with revenues above a specified reference level, and proportional compensation for local authorities with revenues below that level. The reference level is the national average for tax revenues in NOK per capita.

The compensation rate of 60% and the additional compensation for local authorities with tax revenues below 90% of the national average have remained unchanged since 2011.

Figure 6.1 illustrates income equalisation. Local authorities with tax revenues above the national average, such as Municipality A in the figure, receive a deduction in income equalisation that corresponds to 60% of the difference between their own tax revenues and the national average. Local authorities with tax revenues below the national average, such as Municipality B in the figure, receive compensation through income equalisation that corresponds to 60% of the difference between their own tax revenues and the national average. Additionally, local authorities with tax revenues below 90% of the national average, such as Municipality C in the figure, receive additional compensation of 35% of the difference between their own tax revenues and 90% of the national average.

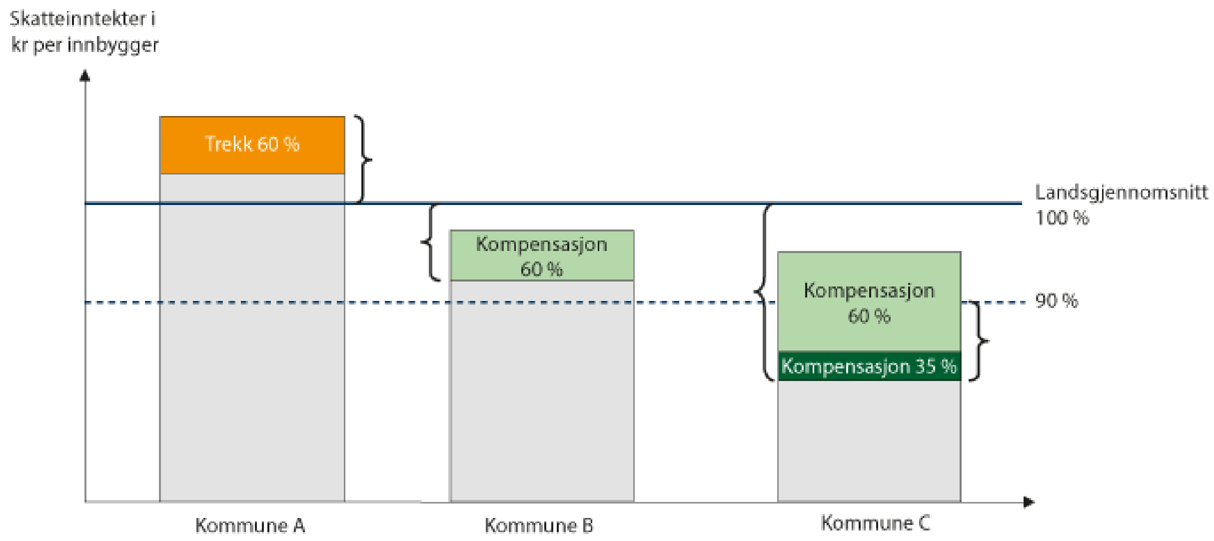

Figure 6.1 Illustration of income equalisation

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The total deduction from local authorities with tax revenues above the national average corresponds to the total compensation to local authorities with tax revenues below the national average within the symmetric element of income equalisation. A universal per capita deduction from all local authorities funds the additional compensation given to local authorities with tax revenues below 90% of the national average.

The income equalisation is carried out continuously, and is calculated ten times a year in connection with the periodic disbursements of the general grant to local authorities. Continuous income equalisation means that deductions or additions in the income equalisation for each local authority are calculated on a rolling basis throughout the year as tax revenues are received. Deductions or additions in income equalisation are offset against the disbursement of the general grant.

Chapter 7.9 discusses the effects of the current income equalisation in more detail.

6.2 The general grant

The general grant consists of seven separate grants and amounts to approximately NOK 149 billion in 2022. The per capita grant is the largest of these grants, and accounts for approximately 96% of the single large block of funding. The remaining 4% mainly consists of grants based on regional policy, which are discussed in more detail in Section 6.2.4. Table 6.1 shows the single large block of funding to local authorities in 2022, broken down into the various grants.

Table 6.1 The general grant to local authorities, broken down into the various grants (items). National budget 2022.

General grant to local authorities	National budget proposal 2022 (NOK 1 000)
Per capita grant	144 268 487
Grants for peripheral municipalities in the South of Norway	808 128
Grants for municipalities in Northern Norway	2 253 346
Regional centre grant	203 375
Grant for municipalities with high population growth	145 756
Urban grant	608 665
Discretionary grant	990 000
Total general grant	149 277 757

6.2.1 Per capita grant

All local authorities initially receive the same amount in the per capita grant, but it also encompasses various mechanisms for income redistribution:

- Expenditure equalisation;
- Correction mechanism for pupils in state and private schools;
- Income guarantee scheme;
- Cases with special distribution, including amalgamation grants for municipalities that merge.

6.2.2 Expenditure equalisation

Municipalities differ considerably in terms of demography of the population, geography and size. Consequently, the services required by residents and the costs incurred by local authorities in providing these services also vary. The objective of expenditure equalisation is to even out these differences and enable all local authorities to offer an equitable service provision. Expenditure equalisation currently encompasses the following sectors: primary and lower secondary education, ECEC, social care services, primary care services, social welfare, child protection, agriculture, administration and the environment. Through expenditure equalisation, local authorities receive full compensation for involuntary cost differences based on a cost matrix.

Variations in local authorities' service provision expenditure can be attributed to factors both beyond and within their control. Since the introduction of the GPGS in 1986, it has been a fundamental principle that local authorities should only receive compensation for involuntary demand and cost differences related to municipal services. Involuntary cost differences pertain to factors within the remit of local authorities that, in principle, they should not be able to influence. In contrast, voluntary cost differences are costs resulting from local authorities' own decisions and are related to variations in efficiency and standard/quality.

Another fundamental principle in the current GPGS is that all local authorities should be *fully* compensated for expenses related to service provision expenditure that they themselves cannot influence. The expenditure equalisation rate for involuntary cost differences is therefore 100%. To prevent expenditure equalisation from evening out self-selected demand and cost factors, it is based on the individual local authorities' estimated expenditure need, not their actual expenditure. The basis for the expenditure equalisation is the estimated national expenditure need (measured per capita), and the estimated expenditure need of each local authority is compared to this average. Expenditure equalisation is a zero-sum game, where the sum of additional funds given to local authorities through expenditure equalisation is equal to the sum of deductions for local authorities that relinquish funds.

6.2.3 The cost matrix

The expenditure needs of the individual local authorities are calculated using the cost matrix. The cost matrix represents a set of criteria and corresponding weights used to calculate an index that reflects local authorities' operating costs.

Two factors influence local authorities' expenditure needs:

- The need for municipal services (the demand);
- The costs of providing a service.

The goal of the cost matrix is to capture the underlying factors that indirectly affect the local authority's costs and the extent of the underlying public demand, such as settlement patterns, municipality size, the age demographic of the population and socio-economic factors.

The cost matrix consists of criteria that explain why local authorities' expenditure needs vary, and each criterion is weighted to reflect the proportion of the variations in the expenditure needs. The criteria and their weighting are primarily based on statistical analyses of the variations in local authorities' actual expenditure. In order to uphold the main principles of expenditure equalisation, emphasis has been placed on ensuring that the criteria are objective, meaning that local authorities cannot influence criteria values through their own decisions. Additionally, the criteria must be based on publicly available statistics that are updated regularly. The cost matrix for 2022 is presented in Table 6.2.

Table 6.2 The cost matrix for local authorities in 2022

Criterion	Weight
Percentage of residents 0–1 years	0.0057
Percentage of residents 2–5 years	0.1355
Percentage of residents 6–15 years	0.2632
Percentage of residents 16–22 years	0.0236
Percentage of residents 23–66 years	0.1051
Percentage of residents 67–79 years	0.0570
Percentage of residents 80–89 years	0.0775
Percentage of residents 90 years and over	0.0389
Graduated basic criterion[1]	0.0159
Zone criterion[2]	0.0100
Neighbour criterion[3]	0.0100
Agricultural criterion[4]	0.0021
Immigrants 6–15 years, excl. Scandinavian	0.0070
Intellectual disability 16 years and over	0.0491
Single 67 years and over	0.0459
Mortality	0.0459
Unfit to work 18–49 years	0.0063
Refugees without an integration grant	0.0082
Concentration index[5]	0.0093
Living alone 30–66 years	0.0189
Children 0–15 years with a single parent	0.0186
Low-income criterion	0.0117
Children aged 1 year without cash-for-care benefit	0.0165

Residents with higher education	0.0181
Total	1.0000

[1] Measures diseconomies of scale.
[2] Measures the settlement pattern and travel distance within the zone in km. A zone is a geographically contiguous area consisting of basic geographical units.
[3] Measures the settlement pattern and travel distance to the neighbouring basic geographical unit.
[4] Consists of three sub-criteria: number of agricultural enterprises (67.9% weight), number of agricultural properties (27.6% weight) and the total area of the municipality (4.47% weight).
[5] Consists of the criteria 'Divorced and separated', 'Unemployed' and 'People with low incomes'.

6.2.4 Sectors subject to expenditure equalisation

Expenditure equalisation currently encompasses national welfare services and services that are heavily influenced by national guidelines. The sectors currently included are primary and lower secondary education, ECEC, social care services, primary care services, social welfare, child protection, agriculture, administration and the environment. Each of these sectors has its own cost matrix that captures involuntary demand and cost factors within the sector. These cost matrices are then weighted together to form an overarching cost matrix for local authorities' expenditure needs.

The sector's (cost matrix's) share of the total cost matrix, and thus the total redistribution in expenditure equalisation, is determined by the size of the sector, measured by net operating costs. Figure 6.2 shows the relative share of each sector within the overarching cost matrix for 2022.

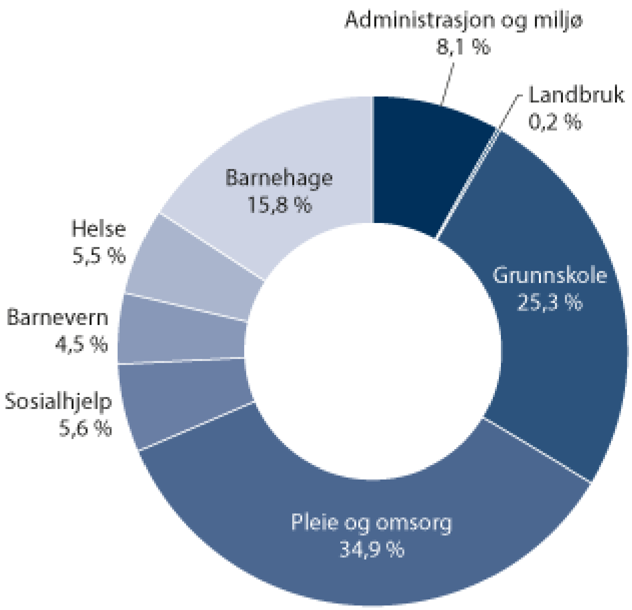

Figure 6.2 Sector shares of the overarching expenditure equalisation for 2022

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6.2.5 Expenditure equalisation in practice

Using the cost matrix and data for each criterion for all local authorities, an index is calculated for the estimated expenditure needs of each municipality. The index is calculated with a national average of 1. Local authorities with an index value greater than 1 have higher estimated expenditure needs than the national average, while those with an index value below 1 have lower estimated expenditure needs than the national average.

The expenditure equalisation is illustrated in Figure 6.3 below. Municipality A has an index value of 0.9 and an estimated expenditure need (per capita) that is 10% below the national average, while Municipality B has an index value of 1.1 and an estimated expenditure need that is 10% above the national average. As a result, Municipality A's per capita grant is reduced by an amount that is equivalent to the difference between its own estimated expenditure needs and the national average, while Municipality B receives a supplement to its per capita grant that is equivalent to this difference. The sum of the supplements for all local authorities is equal to the sum of the deductions for all local authorities included in the expenditure equalisation mechanism.

In 2022, approximately NOK 7.9 billion will be redistributed through expenditure equalisation. A total of 291 local authorities received a supplement, while 65 were subject to a deduction. Tromsø had the lowest estimated expenditure need, with an index value of 0.9, while Utsira had the highest estimated expenditure need with an index value of 2.7.

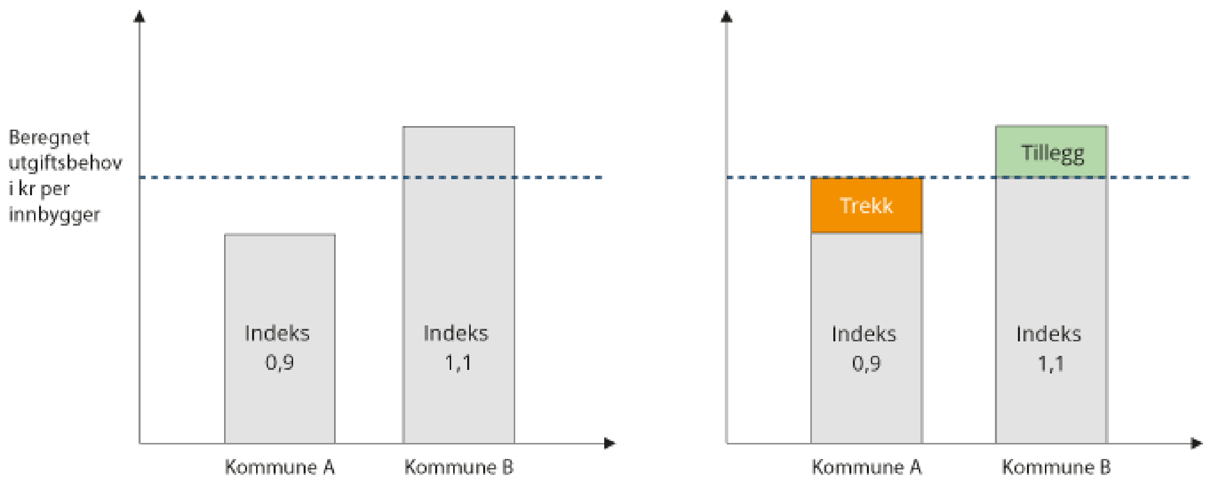

Figure 6.3 Illustration of the redistribution in expenditure equalisation

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In 2022, the national average, represented by an index value of 1, corresponds to an estimated expenditure need of NOK 59 073 per capita. Figure 6.4 shows the estimated expenditure need for each local authority, grouped by population size and sorted according to the level of expenditure need within each group. The figure shows that there is some variation within each size category, but the smallest municipalities have higher expenditure needs than the larger ones. This is partly because small municipalities can have significantly higher values for the cost matrix criteria that measure diseconomies of scale (graduated basic criterion) and settlement patterns/travel distances (zone and neighbour criteria).

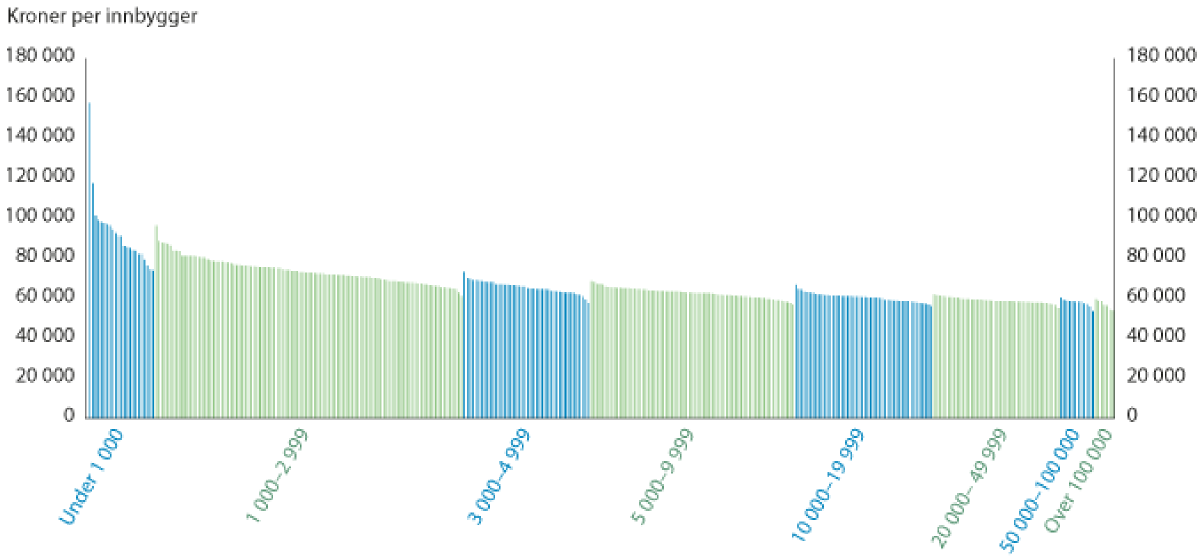

Figure 6.4 Estimated expenditure needs per capita for all municipalities, grouped by population size 2022

The Green Book 2022. Proposition 1 (2021–2022) to the Storting, entitled *Beregningsteknisk dokumentasjon* (available in Norwegian only)

6.2.6 Cases with special distribution

Some of the funding in the per capita grant is excluded from the expenditure equalisation mechanism and is subject to special distribution. This applies to, for example, the financing of tasks that are unique to a few local authorities or for which it is difficult to find an equitable distribution of funds using the standard criteria in the GPGS.

Special distribution, which is not applicable to a few of the local authorities, should ideally only be used for a short period, as stated in the guidelines for state governance of the local government sector.[1] In 2022, approximately NOK 4.3 billion will be subject to special distribution, which corresponds to slightly less than 1% of the unrestricted revenues.

One of the cases that is subject to special distribution is the amalgamation grant for municipalities that merge. This is a separate grant that the newly merged municipality receives from the year the merger takes effect. Through this grant, the municipality is compensated for the fact that the merger will reduce the size of the general grant as a result of lower estimated diseconomies of scale and any decrease in the grant for peripheral municipalities. Full compensation is given for the loss of basic grants and the net decrease in grants for peripheral municipalities as a result of the merger. The amalgamation grant is calculated based on the GPGS in the year the merger takes effect and is adjusted annually for inflation. The new municipality receives the full amalgamation grant for 15 years after the merger. It is then phased out over five years.

6.2.7 Correction mechanism for pupils in state and private schools

In 2022, the total number of pupils at state and private primary and lower secondary schools is approximately 26 870. Local authorities are only responsible for financing special education and

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[1] Ministry of Local Government and Regional Development (2020). *Statlig styring av kommuner og fylkeskommuner* [State governance of local and county authorities]

transport to school for these school pupils. State and private schools are mainly financed by the national budget.

Local authorities' limited financial responsibility for these pupils means that the per capita grant and the expenditure needs of local authorities must be reduced. This is achieved through an annual adjustment of the per capita grant based on changes in the number of pupils in state and private schools nationwide.

The adjustment of the per capita grant means that all local authorities receive the same deduction per capita, regardless of the number of pupils in the municipality who attend state and private schools. This is corrected by redistributing the deduction between the municipalities based on the proportion of the population in the municipality that attends state and private schools.

This redistribution (correction mechanism) is designed in a way that municipalities with pupils in state and private schools receive a deduction in their general grant per pupil, according to fixed rates. The amount collected from these local authorities is then distributed to all local authorities based on their share of the expenditure need. In this process, the correction mechanism serves purely as a mechanism for redistribution among the local authorities.

6.2.8 Income guarantee scheme

The income guarantee scheme was introduced in 2009 and is an established transitional arrangement in the general grant. The purpose of the scheme is to fully protect local authorities from a sudden decrease in the general grant from one year to the next. The scheme guarantees that no local authority has an estimated increase in the general grant from one year to the next that is less than NOK 400 per capita below the estimated national increase per capita, before the financing of the scheme itself. The scheme is financed through an equal deduction per capita for all local authorities.

6.3 Regional policy grants

The current GPGS includes five regional policy grants, each of which is based on various district and regional policy considerations. These are the grant for peripheral municipalities in the South of Norway, the grant for municipalities in Northern Norway, the grant for municipalities with high population growth, the urban grant and the regional centre grant. These regional policy grants were introduced because the GPGS serves as a tool to achieve various regional and district policy objectives. The rationale for the grants for peripheral municipalities includes goals such as maintaining settlement patterns, preserving viable local communities and promoting industrial and commercial development and positive societal development in rural areas. The other grants are partly based on special challenges faced by the largest municipalities and those with extremely high population growth.

Collectively, the regional policy grants make up a relatively small portion of the total general grant. However, for some local authorities, these grants can represent a relatively large share of their total general grant.

6.3.1 Grants for peripheral municipalities in the South of Norway

The grant for peripheral municipalities in the South of Norway is intended to support small municipalities and municipalities in southern Norway with weak societal development and regional challenges. The current grant for peripheral municipalities in the South of Norway was introduced in

2017 and was a merger of the former grant for peripheral municipalities in the South of Norway and the small municipality grant.

The criteria for receiving the grant for peripheral municipalities in the South of Norway are that the municipality:

- has a population of less than 3 200 or a peripherality index value of 46 or lower, and
- has an average tax revenue per capita over the last three years that is less than 120% of the national average.

The peripherality index measures the extent of the challenges a peripheral municipality faces, and consists of various indicators related to centrality, travel distance, population density and development, labour market status and revenue level.

Municipalities with a population of less than 3 200 receive a grant per municipality. The rates vary depending on the municipality's peripherality index value, with municipalities with a value of 35 or lower receiving the highest rates.

For municipalities with a population of 3 200 or more, the grant is provided partly based on a rate per municipality and partly on a rate per capita. Municipalities with a peripherality index value of 35 or lower receive grants at the highest rates, while those with a value between 35 and 46 receive grants at lower rates. The rates for the grant for peripheral municipalities in the South of Norway in 2022 are shown in Table 6.3.

In 2022, a total of 136 local authorities are receiving the grant for peripheral municipalities in the South of Norway, amounting to NOK 808 million.

Table 6.3 Rates for the grant for peripheral municipalities in the South of Norway 2022

	Municipalities with a population of 3 200 or more		Municipalities with a population of less than 3 200
Index value	Rate per municipality (NOK 1 000)	Rate per capita (NOK)	Rate per municipality (NOK 1 000)
0–35	1 307	1 183	6 034
36–38	1 047	947	5 432
39–41	785	710	4 827
42–44	522	473	4 225
45–46	262	237	3 620
Over 46	0	0	3 017

6.3.2 Grants for municipalities in Northern Norway

The grant for municipalities in Northern Norway is given to all municipalities in Troms and Finnmark and Nordland, and some in the northernmost part of Trøndelag. The current grant for municipalities in Northern Norway was introduced in 2017 and was a continuation of two previous grants: the Northern Norway and Namdal grant, and the small municipality grant.

The largest portion of the grant (NOK 1.75 billion) is distributed at a rate per capita to all municipalities in these areas. The rate varies between municipalities in different counties and geographical regions, as shown in the first part of Table 6.4.

Municipalities with a population of less than 3 200 may also receive a small municipality supplement as part of the grant. This supplement is distributed based on the same criteria and rates as the small municipality supplement in the grant for peripheral municipalities in the South of Norway. Municipalities in the former county of Finnmark and in the Action Zone in the former county of Troms receive small municipality supplements at a higher rate than other municipalities, as shown in the second part of Table 6.4.

The grant for municipalities in Northern Norway amounts to a total of NOK 2.25 billion in 2022, and 91 municipalities receive the grant. Of these, 57 receive both the general grant per capita and the small municipality supplement.

Table 6.4 Rates for the grant for municipalities in Northern Norway 2022

Municipalities in:		Rate per capita (NOK)
Nordland and Namdalen		1 861
Troms (outside the Action Zone)		3 570
Action Zone in Troms		4 206
Finnmark		8 716
Small municipality supplement to municipalities with a population of less than 3 200		
Peripherality index value	Small municipality supplement per municipality, outside the Action Zone (NOK 1 000)	Small municipality supplement per municipality, inside the Action Zone (NOK 1 000)
0–35	6 034	13 068
36–38	5 432	11 760
39–41	4 827	10 455
42–44	4 225	9 147
45–46	3 620	7 841

Over 46	3 017	6 534

6.3.3 Regional centre grant

The regional centre grant was incorporated into the GPGS in 2017. The grant is given to municipalities that have merged and subsequently have a population of approximately 8 000 or more. Local authorities in receipt of the urban grant cannot simultaneously receive the regional centre grant.

The grant is partly awarded at a rate per capita and partly at a rate per municipality. In 2022, 37 local authorities have received the grant, and the total amount granted is NOK 203 million.

6.3.4 Grant for municipalities with high population growth

The grant for municipalities with high population growth was incorporated into the GPGS in 2009 and is given to municipalities with particularly high population growth. The grant aims to offset the challenges that municipalities with high population growth may face in the short and medium-term in adjusting their service provision to meet the needs of a rapidly expanding population. They may also find it difficult to finance necessary investments without it affecting other services.

The grant for municipalities with high population growth is given to municipalities that have had an average annual population growth of 1.4% or more over the last three years. Additionally, the municipalities must have had tax revenues of less than 140% of the national average over the last three years (measured per capita). The grant is a fixed amount per new inhabitant above the growth threshold, and in 2022, this rate is set at NOK 62 252 per new inhabitant. The grant for municipalities with high population growth amounts to NOK 146 million in 2022, and 12 local authorities are receiving this grant.

6.3.5 Urban grant

The urban grant was introduced in 2011 due to the unique challenges that cities face in relation to urbanisation and their key role in societal development in their region. In the past, Oslo received its own capital city grant and nine local authorities received an urban supplement through expenditure equalisation.[2] Since 2011, the urban grant has been given to the largest urban municipalities: Oslo, Bergen, Trondheim and Stavanger. In recent years, it has also been extended to include Kristiansand (since 2018) and Drammen (since 2020). The grant is distributed at an equal rate per capita and amounts to a total of NOK 609 million in 2022.

6.3.6 Discretionary grant

The discretionary grant in the GPGS is used to compensate local authorities for special local conditions that are not otherwise covered by the GPGS. The total discretionary grant to local authorities amounts to NOK 990 million in 2022.

County governors distribute the bulk of the discretionary grant to the local authorities in their county, based on guidelines issued by the Ministry of Local Government and Regional Development. County governors can also withhold parts of the discretionary funds for later distribution throughout the budget year.

[2] Bergen, Drammen, Fredrikstad, Kristiansand, Oslo, Skien, Stavanger, Trondheim and Tromsø.

In addition to the discretionary funds distributed by county governors, the Ministry of Local Government and Regional Development withholds portions of the discretionary grant for unforeseen events during the year. In recent years, these funds have largely been used to compensate local authorities that have incurred extraordinary expenses following floods and other natural disasters.

6.4 History – the evolution of the GPGS

In this section, we provide an overview of how the GPGS for the local authorities has evolved from its inception to the present day.

6.4.1 GPGS introduced in 1986

When the GPGS was introduced in 1986, local authorities were an important and integral part of the Norwegian welfare state.[3] Before implementation of the GPGS, local authorities were mainly funded through various earmarked grants.[4] This meant that their finances were closely controlled by central government, which was a major administrative burden for both sides. The GPGS was introduced at a time when a series of reforms and measures were being implemented to strengthen local self-government. These aimed to give local authorities greater freedom to organise their service provision and tailor it to local needs.[5] The new Local Government Act (Norway) in 1992 facilitated greater organisational autonomy for local authorities and an increased degree of local self-government.[6]

When the GPGS was introduced, emphasis was placed on giving local authorities decision-making powers that would give them greater freedom to manage their revenues.[7] Consequently, the introduction of the GPGS brought about a change in central government's control of the local government sector. The GPGS replaced approximately 50 large and small municipality grants from the national budget. This old system was complex and difficult to follow, which sometimes had a negative impact on local authorities' priorities.

In addition to giving local authorities more autonomy, one of the main objectives of the GPGS was a fairer distribution of revenues between local authorities with a view to equalising their conditions for providing an equitable service provision. Another goal was for local authorities to have a better overview of their own revenue situation and more opportunities to plan and manage their own activities. There was also a desire to introduce a system that would lead to efficiency gains for both central government and the local government sector.[8]

6.4.2 GPGS 1986

The GPGS that was introduced in 1986 was based on the work of the Main Committee for Reforms in Local Administration, which reviewed the need for reforms in local administration in various areas. They submitted recommendations in two official reports: Official Norwegian Report NOU

[3] Fimreite and Grindheim (2001). *Offentlig forvaltning*. Universitetsforlaget.

[4] Official Norwegian Report NOU 1996: 1 on a simpler and fairer GPGS for local and county authorities

[5] Fimreite and Grindheim (2001). *Offentlig forvaltning*. Universitetsforlaget.

[6] Proposition (Bill) 46 (2017–2018) to the Storting, entitled *Lov om kommuner og fylkeskommuner (kommuneloven)* (available in Norwegian only)

[7] Report No. 26 (1983–84) to the Storting on a new GPGS for local and county authorities. Ministry of Local Government.

[8] Official Norwegian Report NOU 1996: 1 on a simpler and fairer GPGS for local and county authorities

1979: 44 on a new GPGS for county authorities and Official Norwegian Report NOU 1982: 15 on a new GPGS for local authorities. The Ministry proposed some changes to the Main Committee's proposals, and the proposal for a new GPGS was presented in Proposition 48 (1984–85) to the Storting, entitled *Om endringer i lover vedrørende inntektssystemet for kommuner og fylkeskommuner* (available in Norwegian only).

The mechanism implemented in 1986 consisted of sector-specific general grants for primary and lower secondary education, health and social services and culture. It was based on the principle that local authorities' variations in expenditure needs would be fully equalised.

The local authorities' expenditure needs were calculated using cost matrices, which consisted of various weighted criteria. These matrices were developed based on expert analyses of which factors caused variations in the demand for municipal services and which factors could explain the variations in local authorities' unit costs in the production of services.

In addition to the sector-specific general grants, the general grant consisted of a discretionary grant, a small municipality grant and a transitional arrangement. The small municipality grant was based on experiences showing that smaller municipalities had higher production costs per unit than larger municipalities for services not covered by the expenditure equalisation mechanism, such as administration. The transitional arrangement was intended to ensure that no local authority experienced a sudden change in the grant from one year to the next.

An income equalisation mechanism was introduced in the general grant to local authorities, as a continuation of the tax equalisation scheme that existed prior to the GPGS. Through income equalisation, all local authorities were guaranteed a tax revenue equivalent to 89.4% of the national average. Local authorities in Northern Norway received a higher grant through income equalisation than those elsewhere in the country as a result of the additional costs they incurred due to climatic and structural conditions that were not captured by expenditure equalisation.

6.4.3 Changes to the GPGS 1986–2021

A number of changes have been made to the GPGS since 1986, but the underlying principles are largely the same. The GPGS contains two major equalisation mechanisms to equalise expenditure needs and income, and some grants/schemes based on regional policy. In the following, some of the most important changes that have been made to the GPGS from its inception in 1986 up to the present are highlighted.

1994:

A number of changes were made to the GPGS in 1994, after Report No. 23 (1992–93) to the Storting on the relationship between the central government and the local authorities was adopted:

- The sector-specific general grants were merged into one grant for expenditure equalisation, and the various cost matrices were merged into one cost matrix.
- After this, no special treatment was given to municipalities in Northern Norway with regard to income equalisation, and a Northern Norway county grant was established instead.
- The small municipality grant, which had been a part of the general grant to local authorities, was incorporated into the grant for expenditure equalisation. In conjunction with this, the basic criterion in the cost matrix was given more weight.
- Under the expenditure equalisation mechanism, separate supplements were given to the urban areas and municipalities in Troms and Finnmark.

Box 6.1 The Rattsø Committee

The Rattsø Committee was appointed in 1995 to provide an overall evaluation of the GPGS for local and county authorities, as well as the financing of the local government sector. The Rattsø Committee submitted its report in two parts. The expenditure and income equalisation were reviewed in Official Norwegian Report NOU 1996: 1 on a simpler and fairer GPGS for local and county authorities. In the second part of their report, Official Norwegian Report NOU 1997: 8 on the financing of the local government sector, the committee evaluated the design of the funding mechanism in relation to political and social objectives.

Expenditure equalisation

The committee concluded that expenditure equalisation should encompass national welfare services and administration. This meant that the culture sector was no longer included in the expenditure equalisation.

The committee presented a proposal for new cost matrices, which were weighted together to a common cost matrix for local authorities. Social criteria were given more weight than before in the new cost matrix. The basic criterion was also given less weight than before, as the committee's analyses indicated that small municipalities had previously been overcompensated for diseconomies of scale linked to municipal administration through expenditure equalisation.

The separate supplements for urban areas and municipalities in Troms and Finnmark were removed from the cost matrix in the committee's proposal.

The committee proposed to convert the government grant previously provided as a grant for expenditure equalisation to a purely per capita grant, allocated to the local authorities with an equal amount per capita. It was suggested that the expenditure equalisation should serve as a mechanism for redistribution between the local authorities, on the grounds that it would simplify the expenditure equalisation and that the aims for expenditure equalisation could be determined independently of the size of the general grant.

Income equalisation

The Rattsø Committee proposed a more extensive equalisation of tax revenues than before, on the grounds that this was necessary to ensure a reasonable equalisation of the economic conditions in order to offer an equitable service provision. The committee suggested a formulation in which the local authorities would be compensated for a certain percentage of the difference between their own per capita tax level and a given reference level. Previously, the local authorities had been compensated for 100% of the difference between their own per capita tax level and a given reference level.

Specifically, the committee proposed that the local authorities receive compensation for 90% of the difference between their own tax revenues and a reference level of 110%. Local authorities with over 140% of the national average were to be deducted for 50% of the excess amount.

Financing of the local government sector

In the second part of their report (Official Norwegian Report NOU 1997: 8 on the financing of the local government sector), the Rattsø Committee evaluated the design of the funding mechanism in relation to political and social objectives.

The committee defined four main goals for the financing of the local government sector:

- local underpinning;

- improved distribution and income stability;
- possibility for macroeconomic management;
- clear division of responsibilities between the local government sector and the central government.

The committee pointed out that there will always be conflicts between the different goals, and that it will be necessary to weigh up opposing considerations. Based on the main goals, the committee proposed a number of changes:

- Phasing out of wealth tax as a municipal tax: wealth tax was a relatively small source of revenue for local authorities and phasing it out would simplify taxation.
- A continuation of natural resource tax as a municipal and county tax.
- A continuation of property tax as a voluntary tax for local authorities.
- An increase in the tax share in the local government sector revenues, from approximately 45% to approximately 50%, to provide a greater degree of local underpinning.
- Phasing out of corporation tax as a municipal tax on the grounds that the tax base was very unequally distributed between the local authorities, the basis for the tax was also very unstable and the fact that corporation tax, in many cases, went to the municipality where the head office of the company was located and not to the municipality where operations took place.

[End of box]

1997:

A new and updated cost matrix was introduced in line with the Rattsø Committee's proposal. The expenditure equalisation was also simplified by introducing a per capita grant, which was distributed with an equal amount per capita and the expenditure equalisation was separated out as an individual redistribution mechanism. The separate supplements for urban areas and municipalities in Troms and Finnmark were removed from the cost matrix

A regional grant was introduced for municipalities with a population of less than 3 000. This was justified on the basis of the distributional effect of the new cost matrix and the need to ensure that small rural municipalities would still be able to maintain a high level of services.

Roughly half of an earmarked grant for intellectually disabled people was incorporated into the general grant to local authorities. This led to a change in the cost matrix for local authorities in 1998. Two new criteria were added to the cost matrix: the number of intellectually disabled people under 16 years of age and the number of intellectually disabled people over 16 years of age.

The income equalisation was restructured, which led to a greater degree of equalisation than before. The following changes were to be phased in over a five-year period: local authorities with tax revenues under 110% of the national average were to receive a grant equivalent to 90% of the difference between their tax revenues and the reference level; the deduction mechanism for local authorities with high tax revenues was to be continued; and 50% of the excess amount was to be deducted for local authorities with tax revenues over 140% of the national average.

1999:

Corporation tax was phased out as a municipal tax.

2005:

A share of corporation tax was returned to the local authorities as a municipal tax in order to strengthen their incentive to promote industrial and commercial development. The revenue from corporation tax was included in the income equalisation.

The income equalisation was restructured, and a symmetric calculation model was introduced. Local authorities with tax revenues over the national average were deducted at the same rate (55%), while those with tax revenues under the national average received compensation for this. Furthermore, additional compensation was introduced as a buffer for local authorities with low tax revenues.

Box 6.2 The Borge Committee

The Borge Committee was appointed in 2003 to provide an evaluation of the GPGS for local and county authorities. In 2005, the committee submitted its report, Official Norwegian Report NOU 2005: 18 on distribution, simplification and improvement.

The committee based its proposal for a new GPGS on the need to address the following four considerations:

– equalisation of the economic conditions to enable an equitable service provision (a fair distribution of income);
– local self-government;
– a stable and predictable revenue framework;
– regional policy.

Expenditure equalisation

The committee reviewed all of the cost matrices and submitted a proposal for a new cost matrix. It assessed whether full compensation for diseconomies of scale should still be provided in the cost matrix, and pointed out that this meant that the GPGS would not be neutral in regard to municipal mergers. The committee further proposed the introduction of a new income guarantee scheme to replace the former transitional arrangement.

Income equalisation

The committee proposed a new projection-based income equalisation mechanism to ensure that local authorities have a more stable and predictable revenue framework. The income equalisation grant was to be based on a projection of the national tax level.

Regional policy grants

The committee believed that a weakness of the regional policy grants in the GPGS was that they were only loosely connected to the criteria used in district policy generally. The committee proposed therefore that the existing regional policy grants should be phased out and replaced with a new district policy grant. The new grant was to be designed based on the district policy area when considering which local authorities should receive the grant, as the district policy area has identified local authorities with disadvantages in terms of distance and poor outcomes regarding demographic trends, employment and income level. The committee further proposed that the discretionary grant should be reduced and that its objective should be more narrowly defined.

[End of box]

2009:

In 2009, a number of changes were made to the GPGS. These were proposed by the Norwegian Government under the leadership of Prime Minister Jens Stoltenberg, during his second term of office. The proposals were presented after the Borge Committee had submitted its Official Norwegian Report in 2005 and subsequent to the delivery of a report on the political aspects of the GPGS by the cross-party Sørheim Committee in 2007.[9]

- The local authorities' revenues from corporation tax were phased out. The loss of income was compensated with local authorities receiving a larger share of the tax from personal taxpayers.
- The degree of equalisation in the income equalisation was gradually increased from 55% in 2009 to 60% in 2011.
- The tax share was reduced from roughly 47.2% in 2008 to 45% in 2009.
- A new income guarantee grant was introduced as a replacement for the earlier transitional arrangement.
- A new district policy grant, the grant for peripheral municipalities in the south of Norway, was established for municipalities in southern Norway with weak societal development.
- The Northern Norway county grant was expanded to include 14 municipalities in Namdalen in the county of Nord-Trøndelag.
- The previous regional grant to municipalities with a population of less than 3 200 was continued as a small municipality grant.
- A capital city grant was introduced for the City of Oslo, on the grounds that Oslo carries unique responsibilities and challenges as the nation's capital.
- The grant for municipalities with high population growth was introduced.

2011: Revision of the GPGS

On the basis of the work of the Borge Committee, the Ministry of Local Government and Regional Development reviewed the GPGS for local authorities in 2011. All of the cost matrices were reviewed and revised.

In 2011, the earmarked grant for operation and establishment of ECEC institutions was incorporated into the general grant to local authorities, and an individual cost matrix for ECEC institutions was introduced into the expenditure equalisation for local authorities.

The tax share for local authorities was reduced from 45% to 40% in 2011. This was justified on the basis that local authorities should be allowed to offer equitable service provision and have a predictable financial framework.[10] The reduction in tax revenues was offset with an increase in the per capita grant.

An urban grant was introduced for the four largest cities in Norway: Oslo, Bergen, Trondheim and Stavanger. This was justified on the basis that the largest cities have special challenges linked to

[9] The committee's report (2007), entitled *Forslag til forbedring av overføringssystemet for kommunene* (available in Norwegian only). Ministry of Local Government and Regional Development.

[10] Proposition 124 (2009–2010) to the Storting, entitled *Kommuneproposisjonen 2011* (available in Norwegian only)

urbanisation and high population density. The grant was financed by phasing out the former capital city grant.

2017: Revision of the GPGS

In 2015–2016, the Ministry of Local Government and Regional Development reviewed the GPGS for local authorities again. The Ministry gave prior notification that this review would be viewed in the context of the municipal structure reform. The Ministry presented this work in the municipal proposition for 2017.[11] An agreement was entered into by the two ruling coalition parties: the Conservative Party (*Høyre*) and the Progress Party (*Fremskrittspartiet*), together with the Liberal Party (*Venstre*), on a new integrated GPGS for local authorities, which came into effect on 1 January 2017.

In the Ministry's review, the cost matrix was updated with new analyses. Changes were made to the compensation for diseconomies of scale, such as the introduction of a division between voluntary and involuntary diseconomies of scale, and the grading of the compensation for diseconomies of scale according to the degree to which these were voluntary. These changes were justified on the basis that the GPGS was intended to be more neutral in regard to municipal mergers.

The existing regional policy grants were for the main part continued, but the Northern Norway county grant, the grant for peripheral municipalities in the south of Norway and the small municipality grant were merged into two new grants: the grant for municipalities in Northern Norway and the grant for peripheral municipalities in the south of Norway. The small municipality grant was continued as a small municipality supplement within each of the two grants, and differentiated according to the local authority's value in the peripherality index. The payment rates for the grant for peripheral municipalities in the south of Norway were also revised such that more of the grant was distributed per capita and less per municipality.

Furthermore, a new grant was introduced, the regional centre grant, which was aimed at municipalities that have merged and subsequently have a total population of over 8 000. Local authorities that receive the urban grant cannot also receive the regional centre grant.

[11] Proposition 123 (2015–2016) to the Storting, entitled *Kommuneproposisjonen 2017* (available in Norwegian only)