

# National guidelines on how the municipalities should spend growth in municipal income – do they work?

## English summary

Norwegian municipalities and counties are mainly financed by block grants from the central government. A central principle for financing local governments is that most of the municipal income should be allocated freely in accordance with local needs and preferences. For each year's national budget, The Ministry of Local Government and Modernisation describes the estimated real growth in free disposable income to the municipal sector. In recent years, however, the Ministry has added informal guidelines on how the real growth should be spent. For example the budget proposition for 2017 from the Ministry of Local Government and Modernisation includes the following statement::

From the growth of free disposable income to the municipalities, early efforts in primary education accounts for NOK 150 million, the action plan for drug prevention and rehabilitation accounts for 300 million kroner, the action plan for habilitation and rehabilitation accounts for NOK 100 million and the initiative for strengthening school health services accounts for NOK 50 million. From the growth of free disposable income to the counties, the need to improve and rehabilitate county roads accounts for NOK 200 million. (Author's translation)

Since these are free disposable incomes, the municipalities are not formally obliged to follow these guidelines from the central government. The main research question in this report is what effects (if any) this type of guidelines may have. To answer this question, we have communicated with a sample of municipalities, both through visits, phone interviews and an e-mail survey. In addition, we have studied relevant budget documents and analyzed accounting data and other data on municipal and county municipal services.

### *A short description of the relevant central government initiatives*

This project focuses on four municipal services that are, or have been, targeted by the central government through the descriptions of how higher disposable income should be spent.

In 2010, it was signaled that the growth of free disposable income gave room for strengthening the number of positions in the child welfare services by 400 FTEs. According to the central government, the initiative did not reach a satisfactory success rate, and the next year, a new earmarked grant was introduced instead.

In 2014, NOK 180 million out of the total growth in free disposable income was targeted towards strengthening school health services and health clinics for children and youths. In subsequent years the national initiative has been further strengthened. For 2017, the annual amount targeted to health clinics and school health services reached a total sum of approximately NOK 735 million.

Mental health care and drug rehabilitation are often referred to as a single unified service. In national budget context, however, the two services have been targeted separately. In 2015, 100 million of the increase in free disposable income are justified by the need for improvements in mental health care.

Originally, an equivalent amount was also targeted towards drug prevention and rehabilitation, but this initiative ended up as an earmarked grant in the final budget. The national focus on mental health was discontinued after one year, while the national budgets for 2016 and 2017 contained free disposable income targeted towards drug prevention and rehabilitation.

Maintenance of county roads have been strengthened through growth in free disposable income since 2010, when the counties assumed responsibility for large parts of the national road network. The sector is characterized by a maintenance backlog that is documented with priority lists at the county level, prepared by Norwegian Public Roads Administration. The allocation of funds to municipalities is also based on the documented need for maintenance.

### **Do municipalities follow these guidelines?**

Two challenges make this a difficult question to answer.

First, it is unclear what the state wants to achieve with the guidelines. We could focus on the guidelines' ability to change local priorities, or we could focus on spending compared with the previous year. For example, we find that spending on health clinics and school health services has increased, but the growth was the same in the years before the guidelines. According to our interviews, municipalities tend to sympathize with the services targeted by the central government. The same applies to focus on county roads - all counties acknowledges that there are major unsolved problems in this area. Thus, it may be that the observed priorities would have taken place without the guidelines.

Second, the precision and measurability of the targeted municipal services is generally low. The most recent guidelines are not yet covered by available accounting data. Some guidelines are aimed at interdisciplinary programs, where resources to the specific service cannot be distinguished from more general services.

Since the statistical analyses that we conduct carry a rather high degree of uncertainty, we have to base much of our conclusions on interview- and survey material. This material is relatively extensive, but covers too few municipalities to be used as a representative mapping. The interview data highlights the challenge of defining what it really means to "follow the guidelines". Some of the informants focus on higher spending, while others argue that the reversal of planned budget cuts shows that the guidelines are followed. Some argue that they already provide adequate service levels and thus have followed the guidelines before they arrived. When asked directly about whether their municipality follows the guidelines, between 30 % and 60% answer yes, depending on the sector concerned. If we include those who say that they partially follow the guidelines, we reach a share of 60% to 80%. We did not present a definition of "following the guidelines" before asking these questions.

The most specific and objective measurement of municipal loyalty to the guidelines applies to the initiative for health clinics and school health in 2016. This year, the Norwegian Directorate of Health announced a new earmarked grant for health clinics and school health. The grant would only be paid to municipalities that had already strengthened the service budget by at least 90 % of the targeted amount of free disposable income. 98 municipalities received this grant. If we assume that municipalities that did not apply for the grant also did not qualify, then this means that only 23% of the municipalities followed the guidelines 90 % or more. The grants was mainly awarded to the larger municipalities, so 44% of the population aged 0-19 lived in municipalities that received the earmarked grant.

For 2014 and 2015 we have register data on health clinics and school health. For the country overall, we find that the growth in net expenditure in 2014 was slightly higher than the amount targeted by the central government through the national budget. In 2015, however, municipal spending growth constituted only 39% of the increased value of the guidelines. As mentioned above, the overall

expenditure growth in 2014 and 2015 is equal to the growth in 2012 and 2013, i.e. the last two years before the initiative. There is thus no clear signs of an effect on municipal budget prioritization.

For child welfare, we find that the growth in the number of employees in 2010 was in line with growth in the previous year. There is no evidence that the guidelines provided a growth beyond normal levels. A survey performed in 2010 showed a growth of 173 FTEs, less than half of the target of 400 new full-time positions. In the following year, with earmarked funds, the statistics show annual growth of 400-500 FTEs.

We are unable to measure any effect of the initiatives on mental health and drug rehabilitation. These initiatives are too recent to be visible in available accounting data. In addition, expenditures on these services are difficult to separate from the general health care sector. A report to the Norwegian Directorate of Health shows that there has been a significant growth in reported FTEs in this area. It may therefore appear that the funds are spent in compliance with central government interests. On the other hand, there are almost as many municipalities that have reduced the number of positions, as there are municipalities that have increased the number of positions. The group of municipalities with increased spending is therefore increasing far more than the amount allocated through the national budget, and it is therefore doubtful whether the guidelines as such have clear effects. If spending growth is induced by needs, this is of course positive, but the effect of the guidelines is quite unclear.

Regarding county road maintenance, we have focused on the additional funds that have been allocated from the state budget as of 2014. In 2014, the counties received NOK 780 million extra for road maintenance. The amount increased to NOK 1.003 billion in 2015. The accounts for the counties indicate that most of these additional appropriations were indeed used for increased road maintenance. Admittedly, spending growth was in 2014 less than in 2015, but if we look at the two years 2014 and 2015 in total, the county councils collectively increased their spending for road maintenance more than additional funds from the state. When it comes to the individual counties, there are three counties that have significantly lower growth than what they received from the state, while the spending of the remaining 16 counties matches or grows more than the funds from the national government. The accounts for 2014 and 2015 therefore indicate that the counties quite clearly have followed the national initiative. The counties' budget documents for 2017 give a somewhat more divergent picture, where it seems that several counties have not seen themselves able to increase their maintenance budgets in line with the national guidelines. The answer in terms of actual response after 2015, however, will not be known until we get accounting data for the years 2016 and 2017.

### *How do the guidelines affect local priorities?*

A municipality or county, seen as a single acting entity, has no obvious reason to change its budget priorities because of non-binding guidelines from the central government. Several municipal representatives express the same view as stated in this quote from one of our informants:

We relate to the formal definitions, this is free income to be spent freely as all other general income, and we therefore make our priorities independent of these guidelines. (Author's translation)

Still, the budget process in municipalities and counties is a negotiation between several actors. In these negotiations, most sector managers are able to point to unfulfilled needs. The real impact of the governmental guidelines is to act as an additional argument for those members of the process who already wish to strengthen the targeted service. Consequently, it is important that the information about the national initiatives reach these actors, such that they are able to put this argument to use. We find that the municipal chief executive's role is important. The municipal chief executive controls to some extent how the signals from the central government are communicated and distributed into the municipal organization. If the chief executive sympathizes with the guidelines, it is easier to win the

argument in favor of the national guidelines. If he/she is against the guidelines, it requires more effort from other actors to argue that the funds should be treated differently than general income.

The lack of loyalty to non-binding guidelines is a natural consequence of local autonomy. Municipalities have chosen their prioritization, and must of course have a good reason to change this.

A second reason that the guidelines have less effect than earmarked grants is that the guidelines are less specific. The need to strengthen any municipal service will always vary between municipalities. Some municipalities are lagging far behind, while others already provide a satisfactory level of services. Earmarked grants can be directed to the municipalities that actually increase spending. Unrestricted funds however, are distributed without regard to local spending, and some funds will therefore find its way to municipalities that primarily have other needs and choose to spend the extra funds elsewhere.

A third reason for lack of loyalty is that some municipalities or counties experience reduced total income. With declining total revenues, the budget process primarily becomes a search for budget cuts. This makes it difficult to comply with all expectations from the national government. Our statistical analyses also confirm the importance of income. The guidelines can still have a prioritization effect for low-income municipalities in the sense that budget cuts become smaller than they otherwise had been.

We also identify a reason not to follow the guidelines that is specific to the smaller municipalities. When funds are allocated according to municipal population, the smallest municipalities receive quite insignificant amounts. The guidelines therefore tend to be dismissed as purely symbolic politics from the national government among the smallest municipalities.

If both municipalities with limited financial strength and municipalities with satisfactory service levels choose not to follow the guidelines, we cannot expect the overall strengthening of the sector summed over each municipality / county to match the macro funding from the central government. Further, if small municipalities dismisses the national initiative, quite a large number of municipalities will not comply with the guidelines.

### *The focus on funding makes the guidelines less relevant*

The stated expectations from the central government mainly focus on the financing through free disposable income. Pointing out that the central government's political initiative is supported by national funding, is certainly important for municipal support. However, the municipal sector as such is not a single entity that has the ability to decide whether the guidelines should be followed or not. When the national funding is allocated to individual municipalities, the distribution is not related to the needs of the individual municipalities. This is of course positive in the sense that a distribution of resources based on previous priorities could have detrimental consequences for municipal incentives, but it also means that the guidelines from the central government in parts will end up in municipalities with other needs. The focus on funding and the lack of specific targets for service quality, means that:

- Municipalities that lag behind on service quality are happy to restrict their own efforts to match their share of the growth in national funding, even though they are still lagging behind.
- Small municipalities get very small amounts when the national figure is broken down to the municipality level. The national initiative therefore often seems to be of purely symbolic value for the smaller municipalities.
- Municipalities choose not to increase spending if their own service quality is deemed as adequate compared to either national average, county average or their neighbors.
- The central government and the national interest groups, may get unrealistic expectations about some of the municipalities' interests or ability to strengthening the specific service in question.

The central government can alternatively focus more directly on service quality. By stating expectations about service quality, this would provide a yardstick that could be more relevant for each municipality.

### **Should the central government expect a high degree of loyalty from the municipalities, and should they want such loyalty?**

In our view, the government should not expect that these rather loose guiding signals should provide roughly the same effect as earmarked funds. The fact that they choose not to earmark, should actually imply that full loyalty is not desirable. When the central government uses earmarked grants or legal regulations, the purpose is to change local priorities in a different direction than the municipalities themselves would have chosen.

There may be several possible reasons why central government should intervene. Too low priority to preventive services is a known potential weakness of democratic decisions. Maneuvering towards more prevention and less treatment may therefore be a possible reason for central intervention. On the other hand, these are complex services that can be organized in many ways and that may profit from local adjustments. The guidelines and the funding through free disposable income can be interpreted as attempts to combine central intervention with flexible local adjustments. This can be a sensible reason to use this kind of instrument, but any expectations of concrete and measurable loyalty from the municipalities should be lowered. Earmarking provides stronger control but comes with a higher risk of bad governance.

### **Are guidelines «worth a try»?**

The national government is naturally entitled to have an opinion about how municipalities should prioritize, and the costs of adding some informal central government guidelines are low. Expectations must naturally be lower than with traditional earmarking. However, with lower expectations, it is even more likely that the municipalities will see this as purely symbolic politics and act accordingly. The same applies to the trend in recent years, with more and more municipal services being specifically mentioned in the central budget documents for each new budget year. If this continues, one will in the end risk that the municipalities feel that “all services” should be prioritized higher, and the guidelines are therefore likely to gradually lose status as especially important messages from the central government.

A special warning should also be given. It may be tempting to test guidelines as a low cost political tool before turning to stricter measures. However, it is important not to establish a practice where guidelines are systematically followed by stricter measures in the form of earmarked grants, if the guidelines do not provide sufficient effect. As described above, this was indeed done in the child welfare sector in 2011 when the guidelines in 2010 did not produce sufficient results. Consequently, municipalities that did not follow the guidelines, were rewarded with grants. If municipalities perceive this as an opportunity for funding, they will certainly not have incentives to follow noncommittal guidelines, but rather do the opposite while waiting for special funding soon to be introduced.

National guidelines must be considered a soft political instrument that will normally have weak prioritization effects. If the central government has a clear opinion on necessary changes in local priorities, stronger instruments should be used right away. On the other hand, if municipal flexibility appears to be desirable or even necessary, then flexible adaption of the guidelines should be viewed as a desirable aspect of this policy tool. Thus, national guidelines may represent an interesting and fruitful middle alternative between introducing earmarked grants and doing nothing for the central government.