A time of revolution: British local government finance in the 2010s

26 October 2016

Broadway House, London

The Local Government Finance and Devolution Consortium is generously supported by the following organisations, as well as a large group of local government bodies:
A time of revolution?
British local government finance in the 2010s

David Phillips
A new IFS research programme

• IFS is launching a major programme of research on local government finance and devolution to local areas
  – To inform and learn from the revolution taking place

• Examine the impact of changes so far
  – On budgets, budgetary risk, and wider policy and socio-economic outcomes

• In-depth analysis of main issues for upcoming reforms
  – Timed to contribute to policy developments

• Consider the opportunities and challenges what would arise from alternative (or broader) fiscal devolution
IFS Local Govt Finance and Devolution Consortium

• Programme is supported by a consortium of funders and stakeholders:
  – Economic and Social Research Council (ESRC)
  – Chartered Institute for Public Finance and Accountancy (CIPFA)
  – Capita
  – PwC
  – Municipal Journal
  – The Society of County Treasurers
  – And a range of other councils across England

• Consortium contributes expertise and dissemination opportunities

• We aim to engage with other key stakeholders too
  – Including DCLG and LGA
Coming up

• Key insights from our first report
  – Changes in councils’ revenues and spending
  – Reforms to grant allocation in England
  – The current English business rates retention scheme (BRRS)
  – Moves to a 100% BRRS in England
  – What about reforms in Scotland and Wales?

• What kinds of questions might our programme look at?
English councils’ revenues

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  - Council tax revenues down 8%
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Accounting for reserve draw-down: spending power down 23%
Cuts to council spending by service area in England between 2009-10 and 2016-17

Figures in brackets are amount spent in 2009-10
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- Total service spending (£49.5bn)
- Planning & development (£2.5bn)
- Housing (£3.0bn)
- Cultural & related (£2.7bn)
- Transport (£7.2bn)
- Libraries (£1.1bn)
- Central services (£3.6bn)
- Environmental services (£5.9bn)
- Social services (£23.2bn)
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Cuts have been smaller in other parts of Great Britain
  - 15% in Scotland
  - 11.5% in Wales

But pattern across services similar
  - Social services down 1%, planning and development down 30-50%

Reflects smaller cuts in grants by devolved governments
  - In part because less protection for health in these countries (so cuts elsewhere less steep)

Figures reflect council tax freeze in Scotland (coming to end)
  - Council tax bills up substantially in real-terms in Wales
Cuts to service spending, 2009-10 to 2016-17, by councils’ grant-dependence in England

- Cuts to spending have been much larger in (poorer) areas more reliant on central government grant funding.
Grant allocation in England (I)

• Long-standing idea that grant allocations should take account of grant-dependence of councils

• But this system broke down during this period

• DCLG made a number of tweaks but still underlying problems
  – ‘Banded Caps’ actually redistributed as much to least grant-dependent councils as most grant-dependent councils
  – And undid much of the attempted 2013-14 equalisation ‘reset’

• System abandoned completely in 2014-15 and 2015-16
  – All councils of a given type saw same grant % grant cut
  – Much bigger impact on overall spending power if more grant-reliant
Grant allocation in England (II)

• From 2016-17 cuts to grants do take into account differences in grant-dependence
  – Much more equal cuts to overall spending power across councils

• But last six years characterised by opaque and unstable grant policies that was often at odds with stated intentions
  – Bigger cuts in areas more reliant on grants was not inevitable
The business rates retention scheme (BRRS)

• Half of business rates revenues devolved to local government from 2013-14 onwards

• Local areas do not retain 50% of all business rates in their area
  – Initial assessment of how much revenues areas ‘need’
  – ‘Tariffs’ on areas with high revenues / low needs pay for ‘top-ups’ to areas with low revenues / high needs
  – These ‘tariffs’ and ‘top-ups’ then indexed in line with inflation

• Local areas retain up to 50% of the growth in business rates as a result of new developments, refurbishments etc
  – And bear 50% of revenue reductions

• Levies on revenue growth in high revenue areas fund ‘safety nets’ to stop areas where revenues fall seeing very big budget cuts
Gains and losses (2013-14 to 2016-17) relative to sharing in national growth in business rates

% of overall budget

Shire Districts
London Boroughs
Metropolitan Boroughs
Unitary Authorities
Fire Authorities
County Councils
100% business rates retention

- Government has announced local areas will keep 100% of the growth in their business rates by 2020
  - Propose to abolish levies on growth in high revenue areas but keep some form of safety net system

- Stronger incentives for revenue growth but also more risk
  - Year-to-year volatility in revenues
  - Long-term divergence in revenues across councils

- Big unknown: are the incentives worth the risk?
  - Can councils do much to boost growth? Do incentives matter?
Dealing with divergence

• Financial incentives require potential for divergence

• But if based on current 50% scheme, divergence will arise even if business rates grow same % in all of England
  – This is because ‘tariffs’ and ‘top-ups’ are indexed to inflation, but business rates can grow faster or slower than inflation
  – So amount of redistribution can fall or rise over time
Revenues grow 0.1% real-terms a year everywhere for 10 years
Revenues grow 1% real-terms a year everywhere for 10 years.
Revenues *fall* 0.1% real-terms a year everywhere for 10 years.
Dealing with divergence

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- Indexing ‘tariffs’ and ‘top-ups’ to average growth addresses this
  - Redistribution keeps pace with average revenue growth
Resetting the system

• Without a full or partial reset of the system, divergence in funding could continue indefinitely

• How often should the system be ‘reset’? Factors to consider:
  – How fast and large divergence could be
  – Whether such divergence is result of local policy or outside factors
  – Judgement on how much divergence is acceptable

• Fixed resets can provide an incentive to delay development
  – Can a rolling reset be implemented?
Devolution of additional services to councils

• Business rates revenues to be devolved will be substantially more than general grants that will be abolished:
  – Around £10 billion to find
  – Roll in additional specific grants (e.g. Public Health) and/or additional responsibilities

• A range of criteria against which to judge candidates for devolution
  – Fit with existing services and expertise
  – Ability to tailor to local needs / preferences
  – Fit with economic development
  – Fit with resources available to local government

• Easier to ensure fit with resources in year 1 than subsequent years
  – And even if fits nationally, may not at local level given potential for spending need and revenue divergence
Change in attendance allowance spending 2005-06 to 2010-11, by council in England

Change in spending on attendance allowance vs. change in business rates revenues.
Scotland and Wales

• Scotland and Wales are moving in somewhat different directions
  – Changes to council tax band relativities
  – Possibly bigger changes to council tax and business rates
  – Possible assignment of part of income tax revenues to councils in Scotland and possibility of new local taxes in Wales?

• On spending side
  – More collaboration across councils in Wales (proposed mergers cancelled)
  – Moves to take education out of the general local government funding system in Scotland?
Summary

• Big cuts in revenues and spending, especially in England
  – Cuts in England biggest for poorer, more grant-reliant councils
  – Not inevitable

• A major move towards provision of fiscal incentives for growth and development in English council funding system
  – Lots of ‘technical’ but important decisions to take
  – Are these incentives worth the risks?

• Different directions in Wales and Scotland
  – Funding system increasingly differs from England
Next Steps in Research Programme (I)

• This report is just first stage of our research programme

• In future, will look in more detail at 100% rates retention scheme
  – What factors likely to drive riskiness and divergence in revenues?
  – How much could funding diverge under different policy options?
  – What are the pros/cons of devolving different service areas?
  – What should be done about rates appeals and revaluations?

• To do this will build a council finance model and dataset

• What might the impacts of changes to local taxes in Scotland and Wales be? What if such changes were introduced in England?

• What might impacts of reforms on businesses and households as well as councils be?
Next Steps in Research Programme (II)

• Most challenging part will be to estimate how councils and local economies have responded and may respond to reforms
  – How have they responded to recent and past reforms that affect incentives for different councils differently?
  – How likely is significant tax competition between councils?
  – What can we learn from other countries?
Final Thoughts

• Will not be able to say exactly what the impact of the revolution to local government finance will be
  – Even ex post impact evaluation will be difficult

• But still important to learn what we can from past reforms and other countries’ experiences

• And careful analysis of policy options vital as ‘technical’ details can have major impacts

• Knowing what is ‘unknown’ is also important for good policy-making
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