

English council funding: what's happened and what's next?

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Executive summary

We are in the midst of major changes to local government funding – both its level and its system. This note brings together some of the key findings of our research on this topic, updating them where possible, and highlights where to find further information.

- On average, local government spending on services has fallen by 21% in real terms since 2009–10. However, those cuts have not been equally distributed across the country, and have been larger in more deprived than more affluent areas. This pattern of cuts has meant that spending per person in the most deprived fifth of councils has fallen from 1.52 times to 1.25 times the level in the least deprived fifth between 2009-10 and 2017-18.
- Cuts have also varied significantly across services, with councils prioritising services like adult social care (down 5%) and children’s social care services (up 10%). In contrast spending on children’s and youth centres is down more than 60%, planning & development and housing down more than 50%, and highways & transport and cultural and leisure services down more 40%.
- Cuts to overall budgets seem to be ending. But revenues from council tax and business rates – the two sources councils are set to rely on for the vast bulk of their funding in future – are highly unlikely to keep pace with rising demands and costs for public services. For example, even if council tax were to be increased by 4.7% a year (which is the average increase this year) every year, adult social care could account for more than half of revenues from these taxes by the mid 2030s, even without increasing service provision. This would leave little in the way of additional revenues for other services, including children’s social care, public health and housing.
- This means either that we will have to accept lower levels of service provision or that councils will have to be provided with additional funding. This funding could be raised via national taxation and given to councils in the form of grants or by devolving additional tax revenues and powers to councils.
- If one wanted to devolve a significant additional revenue source to councils, then a local income tax looks to be the most sensible option and would give councils additional discretion to choose tax and spend levels. However, it would entail additional administration and compliance costs, and require a system to redistribute revenues from richer to poorer parts of the country. This is because some areas – such as Blackpool, Blackburn and Hull – could raise less than half the average revenue per person from a flat-rate local income tax, while other areas – such as richer parts of West London and Surrey – could raise more than twice the average.
- The government is already committed to increasing the proportion of business rates retained by councils to 75%, but this is being paid for by cutting grants to councils. At the same time, it is proposing some sensible reforms to the business rates retention scheme (BRRS), which include centralising the risk associated with challenges and appeals against businesses’ property valuations (which is a risk outside councils’ control). Big decisions remain about how frequently and fully to ‘reset’ the system to redistribute revenues according to spending needs – which involves a trade-off between

providing incentives for revenue growth and helping to ensure councils can afford comparable services even if their business rates revenues perform very differently.

- In what it terms the Fair Funding Review, the government is also reviewing how it assesses spending needs and accounts for how much councils can raise themselves via council tax. Its proposals for council tax are broadly sensible, and plans to use spending needs formulas for social care services based off analysis of individual and small-area data are welcome.
- However, the statistical analysis the government has conducted is not, on its own, a good rationale for basing the spending needs formulas for a raft of other services (including environmental, planning & development, culture & leisure and housing services) on population only, as it has suggested. Indeed, determining councils' spending needs is not simply a statistical exercise, but necessarily relies on contentious subjective judgements.
- Overall, big choices loom for local government – both on the level of funding, and how it is raised and distributed. Are we willing to accept higher taxes or cutbacks elsewhere to pay for the rising costs and demands for council services? How do we balance local discretion and incentives versus consistency in services across the country? Such questions do not have just one right answer, but we cannot continue to muddle on as we are. The reform of the local government finance system is not just a technical issue – it will have profound implications for the type of country England is.

Introduction

The 2010s will be remembered as a time of profound change to the funding of English local government. This won't just be because funding levels have fallen significantly – although they have, with spending on local services per person down by a quarter as a result. It is also because, by 2020, the funding *system* will have changed quite radically. In particular, councils will be much more reliant on local tax revenues, with general-purpose grant funding from central government abolished. Related to this, the system will be more focused on giving councils financial incentives to grow their local tax bases, and less focused on ensuring funding is redistributed according to up-to-date assessments of spending needs.

Details of just how the council funding system will operate post-2020 are still to be finalised though. And in making those decisions it is important to understand the changes so far and the challenges and options for the future.

Over the last few years, we have been studying these very issues. This note brings together some of our key findings, updating them where possible, and highlights where to find further information.

Later this year, we also plan to launch a new annual report on the state of local government finance, which will build on our work so far and ensure that our scrutiny of funding changes continues into the next decade.

Read more:

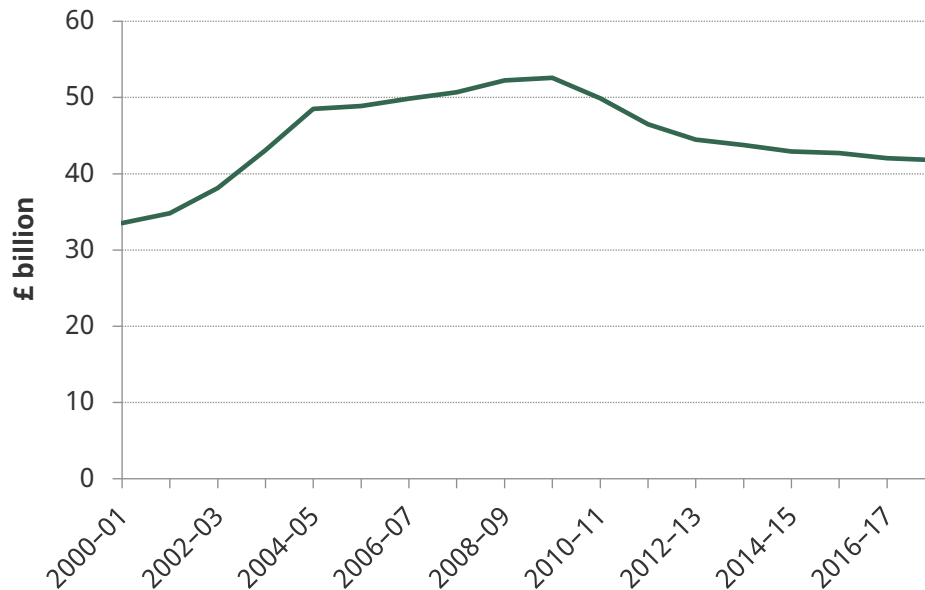
Keep up to date with the IFS's research on local government finance at:

www.ifs.org.uk/research/local-finance

Local government spending has fallen significantly, especially in deprived areas...

Figure 1 shows the path of local government spending since 2000. Spending rose consistently through the 2000s, increasing by 57% in real terms between 2000–01 and 2009–10, but began to fall from 2009–10. Since then, it has fallen continually. **Overall, local government spending was cut by 21% in real terms between 2009–10 and 2017–18.**

Figure 1. Service spending by English local authorities, 2000–01 to 2017–18



Note: Our measure of service spending excludes spending on police, fire, and education services, as well as spending on some very small categories that are inconsistently recorded over time.

Source: Authors' calculations using Ministry of Housing, Communities and Local Government (MHCLG) local authority revenue expenditure and financing statistics outturns, and CIPFA Finance and General Estimates.

However, these falls have not been spread evenly across councils – **they have been larger for councils serving more deprived communities than for those serving less deprived communities.** For example, cuts have averaged 31% for the most deprived fifth of council areas, compared to 17% for the least deprived fifth of council areas. Spending *per person* in the most deprived areas has fallen from 1.52 times that in the least deprived areas on average in 2009–10 to 1.25 times in 2017–18.

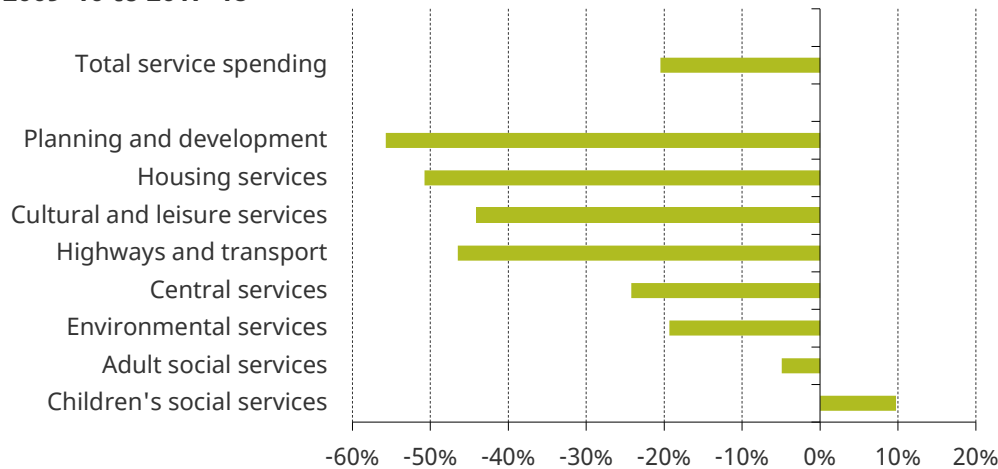
This pattern reflects the fact that cuts to funding from central government between 2010 and 2015 did not fully (and, at times, did not at all) take account of differences in the extent to which different councils relied on that funding. This happened despite the government claiming it had 'taken unprecedented steps to protect councils most reliant on central government funding' – which it was able to do because of the complexity of the funding system in place at that time. This illustrates the importance of having a system that is clear and transparent.

The way cuts were made was reformed in 2016–17 to generate more equal cuts to overall spending power. However, it still does not take full account of the fact that deprived areas can raise less from increasing council tax rates than more affluent areas.

... with councils focusing budgets on statutory and acute services

One way councils have adapted to reduced funding is by making significant cuts to more discretionary services in order to provide relative protection for statutory and more acute services. Figure 2, for instance, shows that councils' net expenditure on planning and development and housing services is down more than 50%, and that on highways and transport and on cultural and leisure services is down more than 40%. However, spending on adult social care services has been cut by just 5% and spending on acute children's social care services (such as social work, safeguarding and fostering) is actually up around 10%.

Figure 2. Real-terms changes in local government service spending by service area, 2009–10 to 2017–18



Note: Service spending is a measure of local authorities' revenue expenditure, which excludes spending items such as local tax collection, capital spending charged to the revenue account, and debt and interest payments.

Source: Authors' calculations using MHCLG local authority revenue expenditure and financing statistics outturns.

Focusing on specific service areas provides further evidence of this strategy. For example, while spending on acute children's social care services has risen, spending on more general children's services, such as Sure Start, has fallen by more than 60%. Looking at housing services, while budgets for homelessness have increased, budgets for housing advice, for the Supporting People programme and for improving and renewing private-sector housing have fallen by around two-thirds. And the numbers of people receiving adult social care services have fallen much more than spending, as support has been focused on those with the highest care needs.

Read more:

'Extra local government funding found to ease cuts has benefited councils serving richer areas more than councils serving poor areas', <https://www.ifs.org.uk/publications/13771>

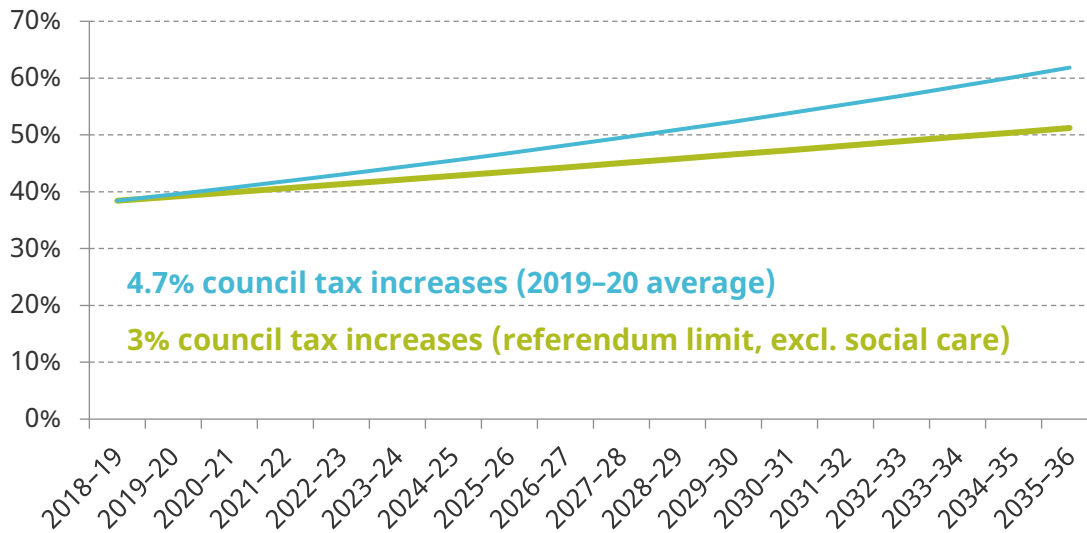
'Changes in councils' adult social care and overall service spending in England, 2009–10 to 2017–18', <https://www.ifs.org.uk/publications/13066>

Future costs and demands likely to outpace planned funding

It is not clear, however, whether such a strategy is possible in future if costs and demands outpace funding, given how much more discretionary services have been cut already. And such a scenario is likely – unless new funding streams are announced.

This is because the government plans to abolish general and public health grants for councils from April 2020, instead increasing the share of business rates revenues retained by local government to 75% (up from 50% as it is now). This means that councils would rely on council tax and (75% of) business rates for the bulk of their funding, and revenues from these taxes seem highly unlikely to grow fast enough to meet rising costs and demands.

Figure 3. Projections of the percentage of council tax and business rates revenues needed to meet rising demands and costs of providing adult social care



Source: Authors' projections using estimated council tax and retained business rates revenues from MHCLG local authority revenue expenditure and financing statistics budgets for 2018-19, and projections for social care spending pressures reported in P. Johnson *et al*, 'Securing the future: funding health and social care to the 2020s', IFS Report R143, available at: <https://www.ifs.org.uk/publications/12994>.

To illustrate this, Figure 3 shows projections of the percentage of councils' revenues from council tax and business rates that would have to be spent on adult social care services to meet rising demand and costs, under two scenarios for council tax increases:

- 3.0%, which is the maximum increase councils can currently impose without a referendum if powers for extra increases for social care lapse (2019-20 is the last year for which such powers are currently planned);
- 4.7%, which is the average increase in England in 2019-20, but the second highest increase for a decade, and a rate that would mean the average Band D rate would increase by £1000 (from £1,750) in just ten years.

Figure 3 shows that meeting projected demands for adult social care spending would require an increase in the share of local tax revenues allocated to these services from 38% to over 50% over the next 15 years, even with 4.7% increases in council tax every year. This would mean only limited increases to budgets for other areas including housing, public health, and children's social care. With 3% increases, the share of local tax revenues needed to meet rising costs and demands for adult social care would increase to over 60%. This would mean sustained cuts to other service areas – on top of what has amounted to nearly a decade of cuts already.

Therefore, one of three things will very likely need to happen at some stage: councils will have to be relieved of some of their responsibilities for providing services (whether this be adult social care or other services); central government grant funding to councils will have to be retained and increased over time; or councils will have to be given access to additional sources of revenue themselves.

Read more:

'IFS Response to the HCLG Committee's Local Government Finance and 2019 Spending Review inquiry', <https://www.ifs.org.uk/publications/14107>

A local income tax is worth considering – but would have costs

If we wish to pursue the latter approach, it is important to realise that not all taxes are suitable for devolution to local government. After considering a range of taxes against a set of criteria for devolution, we conclude that:

- **A local income tax would be the most sensible option for devolution of significant new revenue-raising powers.** Concerns about tax competition between councils, and inequality in the revenues that different councils could raise, could be mitigated by restricting powers to a flat-rate local income tax. Each 1% on all tax bands would raise around £6 billion per year across England.
- While tourist accommodation taxes would be administratively feasible and would raise useful amounts in a few well-visited areas, a £1 per night charge (the level often discussed) would raise little more than £0.4 billion across England.
- Because of the complexity of apportioning corporate profits, value-added mean corporation tax and VAT, these are unlikely to be good candidates for devolution. Stamp Duty Land Tax revenues can be apportioned between areas but are very unequal and highly volatile, and this is a particularly damaging tax that should be abolished – not entrenched via devolution.
- Councils could be given more discretion over currently mandatory discounts and exemptions from council tax, and the referendum requirement for increasing council tax seems hard to justify (we do not have such a requirement for any other tax). However, giving councils more significant powers – such as the ability to revalue properties in their own areas – could pose significant problems for the

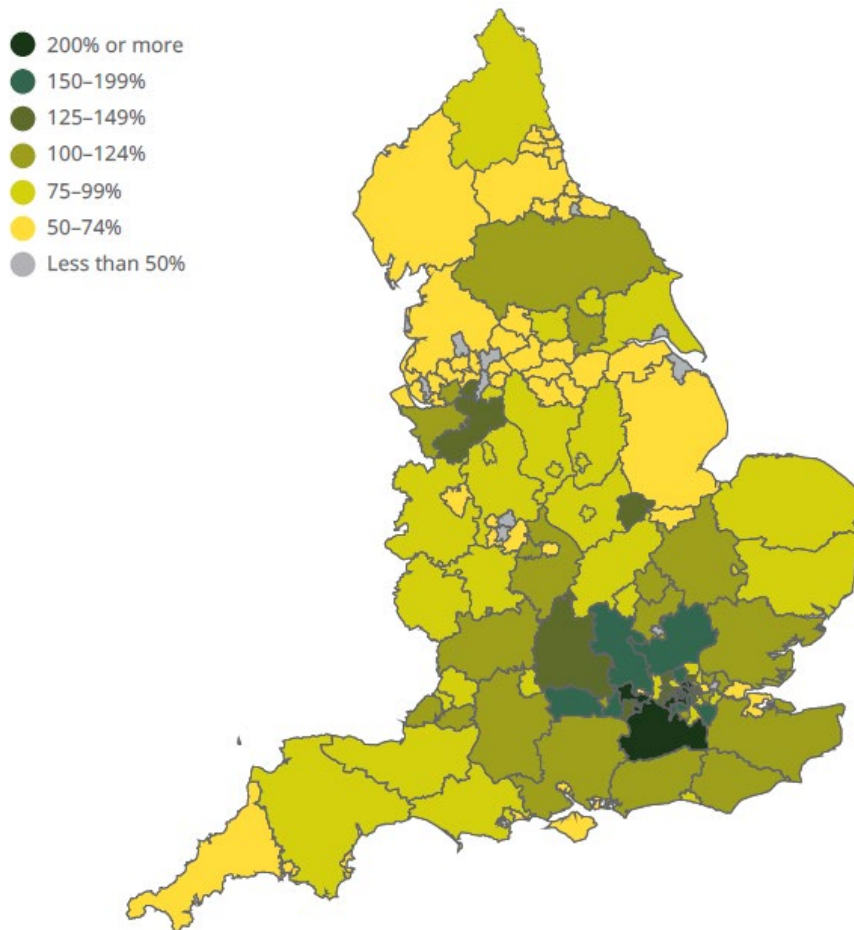
redistribution of funding between councils. It would be better to revalue and reform council tax at a national level, which is overdue.

Devolving local income tax powers would not be without its challenges though. For instance, because there is currently no statutory duty for people to tell HM Revenue and Customs (HMRC) where they live, HMRC does not have up-to-date address details for all taxpayers. This (and people with multiple homes) has caused difficulties with devolution of income tax to Scotland and Wales and may need reform if a local income tax were to be introduced in England

It is also the case that even if powers were restricted to a flat rate, revenues would still vary quite substantially between areas, as shown in the map in Figure 4. Our estimates suggest that revenues per person in richer parts of West London and Surrey, for instance, would be more than twice the national average, while in places such as Blackpool, Blackburn, Hull and Sandwell, they would likely be less than half the average.

A system to redistribute revenues between richer and poorer council areas would therefore be needed – akin to what already exists for council tax and business rates.

Figure 4. Revenues per person from flat rate local income tax, % of national average



Read more:

'Taking control: which taxes could be devolved to English local government',
<https://www.ifs.org.uk/publications/13991>

Big decisions loom on flagship 'business rates retention scheme'

The focus of government at the moment is on devolving additional revenues from one of those taxes already partially devolved to councils: business rates.

As mentioned above, the plan is to increase the share of business rates retained by local government as part of the BRRS from 50% to 75% from April 2020 – paid for by abolishing a range of grants.

The aim of this is to provide councils with stronger financial incentives to grow their tax bases, for example, by creating an environment conducive to the development of business and other non-domestic property. This is because rather than retaining 50% of any growth in business rates revenues as a result of property development (or bearing up to 50% of any reduction in revenues if property is demolished), local councils will retain 75% of the growth (or reduction).

The flip side of these stronger incentives though is scope for bigger divergences in funding between different councils, as differences in their business rates revenues growth will matter more for their funding. In this context, three areas of potential reform to the BRRS are worth highlighting:

- Currently, in addition to gaining or losing as properties are built or demolished, councils bear the financial risk of occupiers or landlords successfully challenging or appealing against the valuation assigned to their property. The impact of this on revenues is difficult to forecast and can vary significantly between councils. And it is a risk that is outside councils' control as valuation is performed centrally by the Valuation Office Agency. **Proposals to reform the BRRS – so that the risk of challenges and appeals is borne centrally rather than by individual councils – are therefore sensible.**
- At the moment, in areas of England with two-tier local government, lower-tier districts retain 40% of the growth in business rates revenues, while upper-tier counties retain 10%. This is by conscious design: districts are responsible for planning control, and therefore have the most direct lever for supporting property development; and counties have responsibility for services such as adult social care, where statutory duties may limit the ability to respond effectively to falls in revenue.

However, this has led to relatively large divergences in the funding that districts have received from the BRRS, and counties have lost out on most of the growth in retained revenues that has taken place. **Our analysis suggests that when moving to 75% retention, increasing the share of revenue growth/decline borne by counties would help to limit the scale of funding divergences among districts without leading to much larger divergences among counties.** This is because of the larger

size of counties (which cover multiple districts) and their wider responsibilities, which mean that the change in revenues following the development or demolition of a property is smaller relative to counties' overall budgets.

Of course, this would also shift some of the incentive to grow local tax bases from districts – with their planning functions – to counties, which may or may not be considered desirable.

- The main way the government proposes to deal with the divergences between funding and spending needs that would otherwise grow indefinitely under the BRRS is to periodically reset the system. This will involve redistributing business rates revenues either fully or partially, to account for changes in the spending needs and council tax bases of different councils. **Whatever decisions are taken with the frequency and fullness of resets, the plan to implement them on a phased basis is welcome: it will avoid the problematic distortions to councils' incentives that take place when resets are implemented in one go at fixed dates.**

Many key questions still remain to be addressed though, including the frequency and fullness of resets, as well as arrangements for so-called safety net and levy payments. And this can only really be done if empirical analysis of their effects is made available, which is not currently the case.

The appropriate choices for these and other policy parameters need to reflect trade-offs between giving councils financial incentives to grow revenues, on the one hand, and both insuring them against revenue risks and ensuring funding does not diverge too far from spending needs, on the other. But how big are these revenue risks and how far and fast could funding diverge from spending needs under different systems? Without such information, it is not possible to say what those policy parameters should be.

The government should therefore prioritise the publication of empirical analysis of the potential effects of different policy choices before final decisions are made later this year. Ideally, it would have published such analysis alongside recent consultations.

Read more:

'Response to the Ministry of Housing, Communities and Local Government's consultation on the reform of the business rates retention scheme',
<https://www.ifs.org.uk/publications/13915>

More detailed discussion of particular issues can be found at:

'Spending needs, tax revenue capacity and the business rates retention scheme',
<https://www.ifs.org.uk/publications/10542>

'100% business rate retention pilots: what can be learnt and at what cost?'
<https://www.ifs.org.uk/publications/12913>

'The business rates revaluation, appeals and local revenue retention',
<https://www.ifs.org.uk/publications/8962>

Updating the system for redistributing funding is tricky and could mean big winners and losers

Alongside the review of the BRRS, the government is also reviewing its approach to assessing councils' spending needs and measuring councils' abilities to raise revenues themselves (e.g. via council tax). The outcome of this Fair Funding Review will be used to set new funding baselines when councils move to 75% business rates retention, and will provide the updated assessments of funding needs for the BRRS's resets.

Neither task of the Fair Funding Review is straightforward. The assessment of councils' spending needs is challenging because we do not directly observe them and must instead infer them from our prior beliefs about what is likely to drive needs, and from things we do observe. These include things such as actual spending patterns, levels of service usage and costs, and the demographic, socio-economic and geographic characteristics of different local areas.

Where possible, data on small geographical areas – or even individuals – should be used in the statistical analysis needed to estimate formulas for spending needs. This is the approach being used to develop formulas for estimating spending needs for adult and children's social care, two of the largest areas of council spending.

Where this is not possible, caution must be used in inferring spending needs from cross-council spending patterns. In particular, historic spending patterns and the spending needs formulas based on them may end up reflecting historic funding allocations, which may not necessarily align with spending needs.

Our analysis of spending on environmental, protective, planning and cultural services (EPCS), the need for which will be accounted for in a so-called 'foundation formula', shows this clearly.

For instance, using spending data from 2009–10 to construct a formula taking account of population, deprivation and rurality, and then applying that to the most recent data on these indicators would lead to estimated spending needs per person for the most deprived tenth of councils that are 38% above the national average. However, using 2016–17 data for the initial construction of the formula would mean their needs would now be assessed to be 15% above the national average. Conversely, while the least deprived councils would be assessed to need 21% *less* than average under the 2009–10 formula, they would be assessed to need only 5% less under the 2016–17 formula.

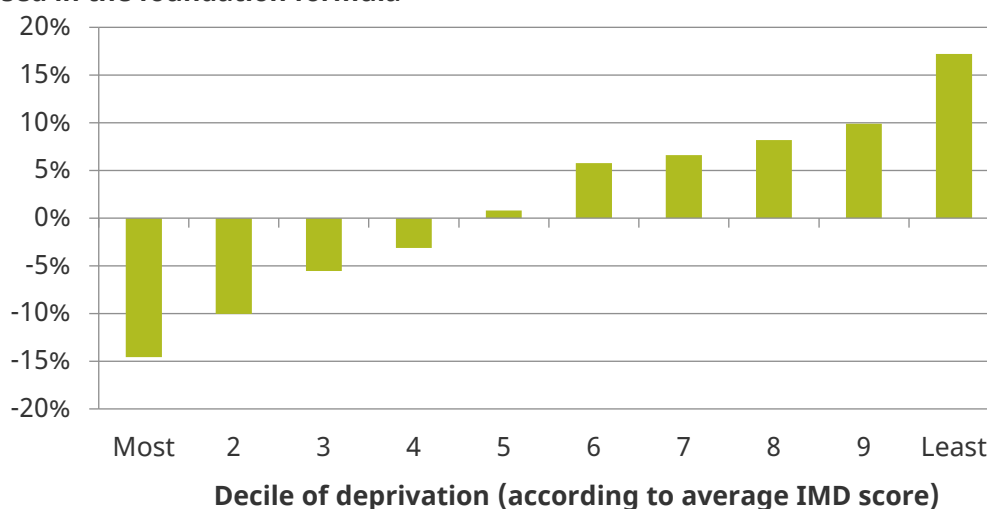
Why is there this big difference? As discussed earlier, as funding for councils has been cut since 2009–10, the way it has been cut has meant bigger cuts for more deprived councils that rely more on central government grants. Combined with restrictions on council tax increases, this has necessarily meant spending has fallen in such areas relative to richer areas (from 1.52 to 1.25 times the amount per person), even if spending needs have not.

But this begs the question: did the relative funding allocations for different councils in 2009–10 better align with needs, or do more recent allocations? Unfortunately with council-level data only, there is no objective way to tell. Judgement and subjective decisions will therefore necessarily play a key role in the assessment of spending needs.

In its recent consultation, the government has proposed to make a big judgement call: that the foundation formula would account for population only. Its justification is that deprivation now explains little of the variation in spending on EPCS across councils. However, this statistical analysis is not, on its own, enough to support such an approach: deprivation may explain a small part of variation in spending but may still be an important factor determining spending needs; and data from before the funding cuts took effect would suggest that deprivation explained much more of the variation in spending. If the government therefore decides to remove factors such as deprivation from the foundation formula, it should be clearer about why it thinks these factors do not matter for spending needs.

The decision the government takes will matter. Figure 5 shows that compared with the current formula for EPCS, a population-only foundation formula would lead to significantly lower assessments of spending needs for deprived councils and higher assessments of spending needs for more affluent councils, for these service areas, redistributing funding accordingly.

Figure 5. Average change in assessed need per person for EPCS if only population is used in the foundation formula



This does not mean that the Fair Funding Review as a whole will redistribute funding from deprived to affluent areas: that will depend on the impact of the new needs formulas for other services, and the way revenue-raising capacity is measured. Two changes to the way council tax is accounted for are worth noting:

- As already discussed, the funding system in place between the late 2000s and 2015–16 did not properly take into account how much councils relied on grant-funding and how much they could raise themselves via council tax. Reintroducing a system that does this would likely shift funding from areas with large council tax bases (which tend to be either in London or in relatively affluent areas of the South) to those with small council tax bases (generally more deprived urban areas in the North and Midlands).

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- From 2016–17 onwards, councils' actual council tax revenues in 2015–16 have been taken into account when determining grant allocations. It would not be sensible to stick with such outdated data into the 2020s and beyond, and simply updating figures for council tax revenues would be problematic: councils would have an incentive to cut tax rates and offer more generous discounts and reductions, safe in the knowledge that their funding allocations would offset the costs.

Proposals to base the new assessment of revenue-raising capacity on what councils would raise if they all set the same rates (and provided reliefs etc. on the same basis) are therefore sensible. If the *notional* tax rate is set close to the average, it would redistribute funding from those councils that set low tax rates (which, since 2016–17, have had these partially offset via grant allocations) to those that set high tax rates.

Measuring councils' tax bases (rather than actual tax revenues) in this way will be tricky – not least because of the complex ways their reduction schemes for poor residents vary – but it is worth the effort.

In summer 2019 we plan to analyse how the various parts of the Fair Funding Review could fit together and affect funding levels for different councils.

Read more:

'Response to the Ministry of Housing, Communities and Local Government's consultation', <https://www.ifs.org.uk/publications/13922>

More detailed discussion of particular issues can be found at:

'The Fair Funding Review: is a fair assessment of councils' spending needs feasible?', <https://www.ifs.org.uk/publications/13275>

'The Fair Funding Review: accounting for resources', <https://www.ifs.org.uk/publications/13247>

We need to decide what we want from local government

This note has highlighted big choices about the level and sources of funding, and big questions about how to balance a desire for the funding system to provide incentives for growth, with a desire to ensure service standards do not vary too significantly across the country.

These are not questions with only one right answer. Opinions can and do differ – both at Westminster and within local government. But the issues at stake are so significant that we cannot keep muddling along.

Take funding levels. Are we willing to raise the additional revenues needed to meet rising costs and demands – let alone improve service provision – over the coming decades? Or

are we willing to lower our expectations of what councils can provide, in order to keep taxes down?

A proper national debate is needed on this, which has so far been lacking. Without it, we will default to a situation where the services councils provide are gradually eroded without any explicit decision being taken – until ad hoc funding is found as a response to political pressure. Such an approach would not be conducive to long-term planning by either central government or councils.

How should additional funding be raised and distributed between councils? Raising it via national taxes and then allocating according to need would likely result in service provision being more comparable across councils. And it would be administratively simpler than devolving further tax revenues and powers. But raising revenues locally and letting councils bear more of the change in local revenues would allow different councils to make different decisions on tax and spending levels, and give them stronger incentives to grow local tax bases.

So are we willing to accept greater differences in services between different areas in exchange for greater local control? Or should redistribution, ring-fenced funding and common standards be a central feature of the funding system?

Again, a proper debate is needed. Without it, the risk is that we continue with reforms to the funding system that reduce the role of redistribution in order to provide stronger financial incentives for growth, while trying to regulate for common standards in the context of a funding system that is not set up to deliver them.

There are few service areas where these questions matter more than social care.

New national standards for assessing eligibility for care, additional requirements for the services councils have to provide and a growing pot of ring-fenced funding suggest that the government is aiming for more consistent services across the country. (Indeed, the last Health and Social Care Secretary said as much.) However, the plan is for the bulk of funding to come from retained business rates, growth in which could vary significantly around the country. The forthcoming Social Care Green Paper is an opportunity for the government to show that it recognises that this is a conundrum that needs addressing.

Read more:

‘Equalisation, incentives and discretion in English local public service provision’,
<https://www.ifs.org.uk/publications/13202>

‘The local vantage: how views of local government finance vary across councils’,
<https://www.ifs.org.uk/publications/9731>

‘Adult social care funding: a local or national responsibility?’,
<https://www.ifs.org.uk/publications/12857>