

## *Needs and Resources*

# Response to the Ministry of Housing, Communities and Local Government's Consultation

**IFS Mimeo**

Neil Amin-Smith

Tom Harris

David Phillips

## *Needs and Resources*

# **Response to the Ministry of Housing, Communities and Local Government's Consultation**

**Neil Amin-Smith**

**Tom Harris**

**David Phillips**

*Institute for Fiscal Studies*

### **Note**

David Phillips is an Associate Director at the Institute for Fiscal Studies (IFS), with responsibility for leading analysis of local and devolved government finance, and taxation in developing countries. Neil Amin-Smith is a Research Economist at the IFS. Tom Harris is a Research Officer at the IFS. However, the views and opinions expressed here are those of the authors only; the IFS has no corporate views on these or other issues.

---

## Summary

This note is a response to the consultation from the Ministry of Housing, Communities and Local Government concerning the needs and resources of local authorities.

The key points made by this note are:

- **The overarching approach for assessing spending needs seems sensible.** It makes sense to consider the spending areas that are likely to have different drivers of spending needs separately. Separating out factors affecting need for service provision and those driving the costs per unit of provision (via the area cost adjustment) is also sensible. And making use of neighbourhood and individual level data for assessing the need for social care services spending is likely to result in substantially more robust spending needs formulas than if council-level data had been used to derive them. However it is important to note that any formula derived from analysis of spending and service usage will be affected by the level of funding available at the time the data was collected – and if overall funding levels were higher or lower, spending and service use patterns and needs may differ.
- **The rationale for basing the Foundation Formula (for services such as waste collection, libraries, parks, housing, planning and central administration) on population only is weak: the statistical results cited by the MHCLG are not strong enough to support such a decision.** In particular, the fact that population explains the vast majority of variation in spending and factors like deprivation explain very little is unsurprising: population varies so much between councils (e.g. less than 40,000 in Rutland to more than 1.5 million in Kent) that it is inevitable that it will drive nearly all differences in overall spending levels. This would be true even if factors like deprivation are highly significant drivers of variation in spending need *per person*. The government should seek expert advice as to whether factors beyond population – such as deprivation – are in fact likely to be drivers of needs for such services, and use this alongside more appropriate statistical analysis in its decision making.
- **A population-only Foundation Formula would lead to lower assessments of needs – and hence lower funding – for deprived (often inner city) councils than both the current formula and an updated formula that included deprivation.** It would lead to higher assessments of needs – and higher funding – for less deprived (often suburban and rural) councils. However, the impact of the Fair Funding Review as a whole on different councils is still uncertain as we do not know the impact of other changes (such as reforms to social services formulas, transition, etc.) which will also matter greatly.
- **The consultation is right that when taking account of ability to raise council tax revenues it is important to do this on the basis of a common notional tax rate and set of tax rules – rather than each council's actual rate and rules.** This is to ensure fairness between areas setting higher or lower tax rates, and to avoid perverse incentives to cut tax rates in the knowledge that reductions in revenues will be compensated for by extra grants (or higher top-ups or lower tariffs).

- 
- **The data to do this for most policies is readily available from councils' Council Tax Base statistics - although deciding the exact notional tax rate and rules to use may be tricky. However, council tax support for working age families is a much more difficult case as up-to-date data to do this accurately is not readily available.** This means either a costly data collection exercise; relying on data from 2012-13 when a common council tax support scheme was applied across the whole country; or use of a statistical proxy instead.
  - **The consultation suggests taking into account projected population growth when assessing councils' spending needs in future years, but not taking it into account when assessing how their capacity to raise revenues via council tax may change over time. This is inconsistent *unless* the aim is to reward and incentivise population growth and housing development,** on top of the incentives provided by the New Homes Bonus. If this is the case, the government should be explicit about this.
  - **An issue not raised in the consultation is whether to use fixed weights or changing weights for different service blocks when projecting forward overall spending needs.** This matters because one might expect the need for different service areas to be growing more or less quickly over time due to demographic or socio-economic changes. Adult social care needs may be expected to rise rapidly because of an ageing population for instance, whereas this may not be the case for all other service areas.

## 1. Introduction

This note is a response to the consultation from the Ministry of Housing, Communities and Local Government concerning options for the assessment of English councils' spending needs and resources (i.e. their revenue-raising capacities). It covers the following areas:

- The assessment of councils' spending needs (questions 1 & 4 of the consultation);
- The assessment of councils' ability to raise revenues from council tax, including issues related to council tax rates, discounts and premiums, support schemes for low income households, and collection rates (questions 5 – 10).
- And the proposed treatment of growth in council tax revenue-raising capacity between resets (question 11).

## 2. The assessment of councils spending needs (questions 1 – 3)

### 2.1. Policy background

**A key part of the Fair Funding Review is to update the assessments of councils' relative spending needs: the most recent estimates are currently for 2013-14 using formulas originally based on data from over 15 years ago in some instances.**

This is a difficult task because we do not directly observe relative spending needs. Instead we must infer them from our prior beliefs about what is likely to drive needs, as well as things that we do observe such as relative expenditures, levels of activity (such as the number of people receiving different services) and prices, and the demographic, socio-economic and geographic characteristics of different local areas.

In order that this process is as transparent as possible, it is useful to have a set of principles and a clear structure for the needs assessment process. Information on the calculations used should be published.

**It is also important to be clear that assessments are of relative spending needs, rather than absolute spending needs:** the latter depends even more on subjective judgements about the breadth and quality of services councils are expected to provide. Evidence can guide decisions on the quantum of funding required to meet these expected service levels, but use of a formula to decide that overall quantum of funding (rather than just how it is distributed) is probably unwarranted.

### 2.2. Response to consultation questions

*The consultation describes the proposed structure of the relative needs assessment and asks for views on this (Q1).*

**The MHCLG proposes that there should be: separate formulas to assess the need for different service areas; that these formulas should incorporate adjustments to account for variation in the cost of providing services in different parts of the**

---

**country; and that the results of these formulas should be weighted to provide an overall assessment of the relative spending need of each council.**

**This structure makes sense:** it is conceptually clear, and while not as significant a simplification as originally proposed (there was some discussion about having significantly fewer formulas than is now proposed), this reflects the fact that different service areas have different needs drivers.

**Proposals to use formulas derived using analysis at a sub-council and even individual-level for adult and children’s social care are welcome.** This is because such analysis is more robust to other factors affecting activity or spending levels (such as the level of funding available to different councils, or their political preferences over spending levels) than analysis at a council-level.

**Formulas based on council-level spending (proposed for highway maintenance, and flood and coastal protection) can end up reflecting to a large extent past allocations of funding.** As funding allocations change over time, formulas based on spending patterns on different years will change to reflect those changes in allocations, which may swamp any true changes in relative spending needs. Our recent paper on spending needs assessment showed that this had been the case for spending on so-called environmental, protective and cultural (EPCS) services between 2009-10 and 2016-17. Funding cuts that were much larger for urban and more deprived councils saw formulas based on 2016-17 spending patterns result in much lower relative needs assessments for such councils than formulas based on 2009-10 spending patterns.<sup>1</sup> In this context we have to ask in what year we think funding allocations best reflected needs, making the whole needs assessment process somewhat circular. Expert judgement must therefore be used alongside any statistical analysis of spending patterns.

**It is also important to recognise that any formulas based on past activity or spending levels (even at a sub-council level) will be driven to at least some extent by the overall quantum of funding available.** This means such formulas may not do so well at assessing the relative needs of different councils if, in future, relative funding levels and service provision are substantially higher or lower than when the formula was estimated.

#### **Assessing the MHCLG’s arguments on the Foundation Formula**

**Probably the most significant proposal in the consultation is to base the so-called foundation formula (which covers services like refuse collection and disposal, public transport, libraries, leisure, planning, housing and central administration) on population and an area-cost adjustment only.**<sup>2</sup> This is in contrast to the current approach which also takes account of factors such as deprivation and daytime population (including commuters and visitors) and fixed costs of operation irrespective of population.

**This is justified by the MHCLG on the basis that statistically-speaking, variation in population explains the vast majority of variation in spending on relevant services across councils, whereas factors such as deprivation explain very little. This is a poor**

---

<sup>1</sup> Amin-Smith, Harris and Phillips (2018), ‘The Fair Funding Review: is a fair assessment of councils’ spending needs feasible?’, IFS Report 148, available at: <https://www.ifs.org.uk/publications/13275>.

<sup>2</sup> Within this response, we refer to these services collectively as Environmental, Protective and Cultural Services (or EPCS).

---

**justification and is reading far too much into such statistical analysis.** The reason that population explains so much of the variation in spending across councils is that population varies so much between councils. For upper-tier services, population varies from 40,000 in Rutland to over 1.5 million in Kent; for lower-tier services, population varies from 35,000 in West Somerset to over 1.1 million in Birmingham. Even if spending needs per person vary a fair bit and deprivation were a highly significant driver of that variation (in spending needs *per person*), population would still explain a large majority of the variation in *total spending needs*.

**The key point is that focusing just on variation in *total spending needs* when populations of areas vary so much means one is likely to miss factors driving spending needs per person.**

A better statistical analysis would therefore also consider variation in spending per person and the extent to which factors such as deprivation explain that. **However, as we have argued previously, statistical analysis of council-level spending patterns cannot be used on their own when deciding what factors to include in a spending needs formula – expert judgement must be used too.**<sup>3</sup> This is because spending patterns in any given year will not just reflect variation in spending need – but also variation in funding available in that year (which could reflect past needs assessments). This is particularly relevant at the moment because the austerity period has seen much bigger cuts to funding for councils with high levels of deprivation than councils covering more affluent areas. This means spending while spending is still correlated with deprivation, it is much less correlated than it was in 2009-10, before austerity began.<sup>4</sup> This begs the question: when did funding patterns and resulting spending patterns best reflect needs? And what does this imply for how deprivation (and other factors) should be taken into account of in any Foundation Formula?

This isn't something statistical analysis of council-level data can tell you – which is why expert and political judgement are key. **Is there a reason we might expect deprivation or other factors to be a needs driver or not?** For deprivation, for instance, relevant issues might include whether demand for certain services is likely to be higher (or lower) according to residents' income, employment, health or education; whether opportunities for cross-subsidisation between deprived and affluent residents are important; and whether scope for involving volunteers or community trusts are expected to vary according to deprivation.

**Assessing the impact of a population-only Foundation Formula across councils**  
**If taken forward, a Foundation Formula with only population as a cost driver is likely to lead to lower needs assessments for urban and deprived areas than both existing formulas and an updated formula which incorporated deprivation.** All else equal this would shift funding from such areas to more suburban/rural and affluent areas. However, it is worth noting that the *overall* impact of the Fair Funding Review on different areas will depend on a range of other factors including spending needs formulas for other areas, assessments of revenue-raising capacity, and transitional arrangements.

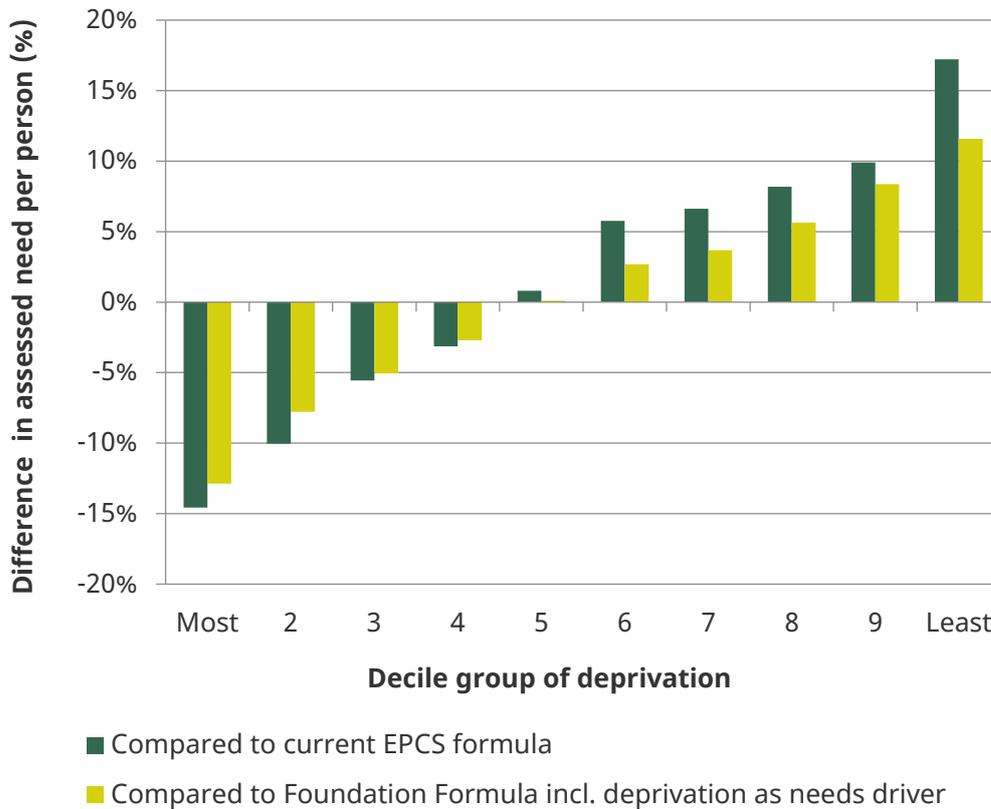
---

<sup>3</sup> Amin-Smith, Harris and Phillips (2018), *ibid*.

<sup>4</sup> For example, in our analysis, while deprivation explains less than 1% of the variation in overall spending (4% for spending per person) on the sorts of services in the Foundation Formula in 2016-17, it explained about 7% of the variation in overall spending (37% for spending per person) in 2009-10, a much higher share.

However, it is still worth looking at what the proposed changes to the Foundation Formula may mean on their own. To do this, Figure 1 ranks councils according to their level of deprivation (from most to least deprived). It shows how much lower or higher assessed spending needs per person would be under a population-only formula than under the formula for (broadly) equivalent spending areas we currently have; and an updated formula that includes deprivation as well as population (note, this updated formula is indicative only: the precise deprivation measure that the MHCLG was proposing to use was never confirmed so we base our formula on the Index of Multiple Deprivation).

**Figure 1. Difference in assessed spending need per person under a population-only Foundation formula compared to the current EPCS formula and an updated formula that includes deprivation as a needs driver, by decile of deprivation**



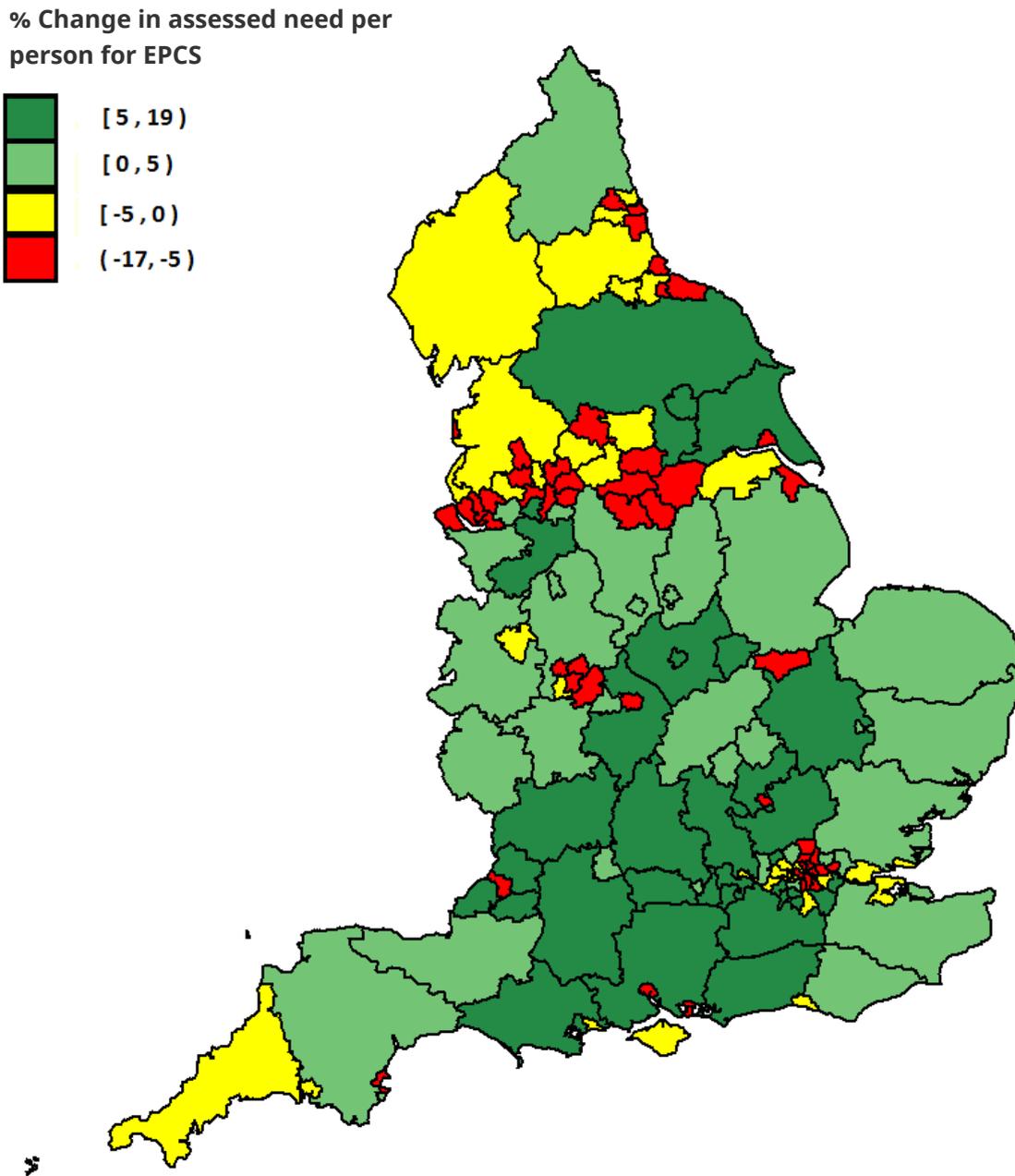
**The Figure shows clearly that compared to both the current formula and an updated formula that included deprivation, a population only formula would mean:**

- More deprived councils seeing lower assessed needs, and losing funding;
- Less deprived councils seeing higher assessed needs, and gaining funding.

This is true for both lower-tier and upper-tier councils.

Figure 2 shows this in the form of a map of England, focusing on just the comparison between an updated Foundation Formula that did include deprivation, and the MHCLG’s proposal to include population only.

Figure 2. Difference in assessed needs per person under a population-only Foundation Formula compared to a Foundation Formula also including deprivation



It shows our modelling suggests use of a population-only formula would mean lower assessments of spending needs (and hence lower funding, all else equal) for urban and deprived areas like:

- Most Inner London boroughs;
- Other urban councils like Birmingham, Liverpool, Manchester, Bristol, Newcastle, Sheffield and Kingston-upon-Hull;
- And to a lesser extent, some poorer county councils such as Cornwall, Lancashire and County Durham.

---

**In contrast, it would lead to higher assessments of spending needs (and hence higher funding, all else equal) for less deprived areas, including most of the Home Counties and Shire Counties, and many suburban parts of outer London.**

### **Weighting and spending needs projections**

We discuss proposals to take account of population projections when projecting forward spending needs assessments later (when discussing the treatment of population or household growth projections for council tax revenue-raising capacity assessments).

### **An issue not raised in the consultation is whether to use fixed weights or changing weights for different service blocks when projecting forward overall spending needs.**

This matters because one might expect the need for different service areas to be growing more or less quickly over time due to demographic or socio-economic changes. Adult social care needs may be expected to rise rapidly because of an ageing population for instance, whereas this may not be the case for all other service areas.

**More generally, if/when weights are changed,** this should be done transparently as it will be a major driver of overall spending needs assessments and hence funding allocations.

### **Area cost adjustments**

**The so-called area cost adjustment is designed to take into account differences in the price of providing a unit of services in different council areas.** Traditionally, this has been based on variation in wages and in property costs (proxied by business rates rateable values).

**Proposals to also incorporate adjustments for travel time and costs are broadly sensible, but care must be taken to avoid double counting such effects in the underlying needs assessment formulas too.**

One potential drawback of including such costs in this way (rather than in the underlying spending needs assessments) is that the impacts will be mechanical rather than statistically estimated. This could matter if, for instance, councils where travel costs are high are able to effectively reduce costs by changing the way they produce services (e.g. making more use of mobile services – like mobile libraries – or e-services), that a mechanical area cost adjustment approach cannot pick up.

---

### 3. Taking account of variation in council tax revenue-raising capacity (questions 5 – 10)

#### 3.1. Policy background

As the consultation points out, in 2020–21 ‘council tax will account for a greater proportion of the income available to local authorities than ever before’. In 2016–17, council tax revenues in England amounted to £23.3bn, or 53% of councils’ (and fire authorities’) estimated core spending power. However, this proportion varied significantly – from a low of 24% in Westminster to a high of 77% in Buckinghamshire. In part, this variation reflects differences in how much councils were historically assessed to need to spend, but it also reflects differences in council tax revenues across areas, driven both by variation in the size of council tax bases and the rates, discounts, and support schemes for poorer residents that different councils set. If no account were taken of these differences, there could be large disparities in councils’ abilities to provide services to their residents.

#### 3.2. Response to consultation

*The consultation poses a number of questions relating to how council tax income should be taken account of by the reformed funding system. In particular, it asks whether the Government should take account of notional or actual revenues, and how various discretionary and non-discretionary exemptions, discounts, and premiums should be factored in to its calculations. It also asks about how (and whether) variation in collection rates should be accounted for. (Questions 5 to 10)*

**As a general principle, it makes sense to take account of differences in council tax income to the extent that they are outside of councils’ control (at least in the short term), but not to take account of differences that are the direct result of councils’ policy choices. Thus, we support the government’s proposals that council tax revenues be taken into account on a notional rather than an actual basis.**

Essentially this implies taking account of councils’ effective tax bases, and not accounting for discretionary adjustments. This means:

- Using a notional rather than an actual rate of tax for the purposes of equalisation;
- Taking into account the effect of non-discretionary discounts, exemptions and premiums and pensioner-age local council tax support on councils’ taxbases. This can be done by using information in Council Taxbase Statistics, but care must be taken to ensure this information is calculated before the impact of any discretionary policies are taken into account;
- Using a notional measure of the effect on councils’ taxbases of discretionary discounts, exemptions and premiums and a notional measure of the effect of working age local council tax support.

A system that observes this general principle in taking account of council tax is preferable for a number of reasons:

- 
- **Equalisation on the basis of actual revenues would give councils an incentive to set lower tax rates or grant more discretionary discounts (or more generous local council tax support) than they otherwise would**, since they could expect their grant and top-up funding to rise (or tariff payments to fall) to compensate for the lower tax revenues – potentially undermining council tax as a source of revenue. Equalisation on the basis of notional revenues would not have such an effect;
  - By a similar token, **equalisation on the basis of actual revenues reduces the discretion and financial accountability of councils**. Part of the revenues that would arise from any increase in local tax rates or reduction in discretionary discounts) would essentially be siphoned off through equalisation, and councils would not bear the full cost of setting lower tax rates. There would thus be less scope for councils to vary the balance struck between taxation and spending according to local preferences;
  - **Basing equalisation on actual council tax revenues would mean taxpayers in different areas paying very different tax rates<sup>5</sup> for similar levels of service provision**, which could be seen as unfair. This would be true even if equalisation were not updated regularly (which could be one way of removing the incentive to reduce tax rates discussed above).

### Choosing the notional tax rates

As discussed in the consultation, the level that is chosen for the notional council tax rate will be an important determinant of councils' funding, since it essentially determines the level of equalisation provided by the system. This is because it determines the amount of 'total notional England spending power' which is used to set allocations. Setting the notional rate equal to the average rate would imply 'full' equalisation of differences in council taxbases – the amount available for redistribution would be equal to total national council tax revenues (abstracting from discounts etc).

The implication of the level of the notional rate for an individual council is that whilst a higher notional rate increases the overall amount of funding to be allocated according to need, it also increases the value of that council's taxbase for the purposes of equalisation. **As a result, a higher notional level would benefit councils that have a share of national needs greater than their share of the national council tax taxbase, and vice-versa.**

The level at which the notional council tax rate were set could also have some implication for the incentives provided to different councils by the system – **councils with a tax rate above than the notional rate would have an incentive to grow their taxbase whilst councils with a tax rate below the notional rate would have a, somewhat perverse, incentive to reduce the size of their taxbase.**

This is because, for a council with a tax rate higher than the notional rate, the extra revenue from increasing its tax base by one property would exceed the reduction in grant/transfer funding based on the notional rate. The council would thus see an increase

---

<sup>5</sup> In 2016–17, council tax rates for Band D properties ranged from just over £700 to just over £1500.

---

in its overall revenues, meaning it would have an incentive to grow its tax base. The opposite would be true for a council with a tax rate lower than the notional rate.

**The consultation also asks how the notional rate should be split between different authorities (e.g. districts, counties, fire authorities) where multiple authorities are involved.** One (but not the only) approach would be to base this on the average splits across England. However, for the reasons outlined in Example 4, whatever is chosen, it would be preferable to apply common tier splits across the country.

**Choosing the notional levels for discretionary discounts, support schemes, etc.**

Deciding upon the level of any notional tax rate is only one part of the logistical challenge of taking account of council tax income. Decisions also have to be taken on how to set notional levels for discretionary discounts, exemptions and premiums and for working-age local council tax support schemes.

**With discretionary discounts, exemptions, and premiums, the best approach is likely to be to apply the same notional assumed scheme to all councils.** As discussed above, taking account of each councils' actual policy would encourage them to make schemes more generous (for political gain) than they otherwise would, as they would expect to be compensated for lost revenue through increased grant/transfer income. **Information on the impacts of these notional schemes could be obtained from councils' Council Tax Base Statistics submissions.**

**The choice of assumed scheme, however, could have important effects on funding for certain councils.** For example, if the number of second or empty homes varies significantly across councils, the extent to which these are allowed to change the effective tax base for equalisation purposes will have an impact on the distribution of funding between councils. **One potential approach would be to base the notional scheme on the typical or average scheme, potentially updating this as that typical or average scheme changes.**

**Turning to local council tax support schemes for working age adults, differences in employment and incomes means there is significant variation across councils in the percentage of their taxbase affected by such schemes .** If this variation was not taken into account, those in areas with higher than average need for council tax support would have to bear the above-average cost of providing that support – either through higher levels of council tax, less generous support schemes, less to spend on other services, or a combination of all three.

**Unfortunately while Council Tax Base statistics show the impact of councils' actual support schemes, they do not contain the information needed to calculate the impact of a common notional scheme – which depends on the precise details on local residents' incomes and living arrangements.** Instead, three main approaches seem possible:

- The government could undertake a large scale data collection exercise making use of information from councils' housing and council tax support scheme administration systems and model the notional support scheme at the impact of the individual household level. However, this would likely be very costly and time

---

consuming and would omit households who would be eligible for the notional scheme but are not eligible for their council's actual scheme.

- Alternatively, the councils' taxbases could be adjusted based on figures from 2012-13 when a consistent national support scheme was in place (which would mean one would not need to worry about any impacts of local variation in the scheme). However, this would mean councils would have to bear the impact of any changes in the profile of taxpayers in their areas since 2012-13, and would essentially mean taking the generosity of the national scheme as a measure of the need for council tax support in an area. This may not be considered appropriate given that schemes have typically become less generous since 2012-13, in particular through the introduction of minimum payments.<sup>6</sup>
- **Finally, the government could rely on statistical analysis of the factors driving the cost of council tax support schemes – controlling for the characteristics of the schemes (such as minimum payments). The IFS currently has a database of such schemes up to 2018-19 and the MHCLG may be able to obtain access to this database.**

#### Accounting for non-collection of council tax

The consultation asks for views on an appropriate approach to accounting for non-collection of council tax.

**As with the discretionary policy parameters discussed above, it is important that the adjustment is not based on each council's actual non-collection rate – as this would disincentivise councils from trying to collect council tax (they would be compensated for this, and presumably their residents would quite like not being chased to pay their bills).**

One option would be to use a common notional non-collection rate for all councils. But this could be problematic if we believe there are factors that mean non-collection rates are unavoidably higher for some councils than others.

An alternative approach would be to undertake statistical analysis of the factors driving differences in non-collection rates (such as deprivation, mobility and age of population, housing tenure status, etc.). This could be used to derive bespoke notional rates for different councils that take account of their circumstances, but which they cannot manipulate themselves (so that they still have an incentive to collect as much of their council tax revenues as they can).

#### 4. Projecting forward council tax revenue-raising capacity (and spending needs)

**As discussed above, the consultation suggests taking into account projected population growth when assessing councils' spending needs in future years. However it proposes that population (or household number) growth should not be**

---

<sup>6</sup> Adam, Joyce and Pope (2019), 'The impacts of localised council tax support schemes', IFS Report 153, available at: <https://www.ifs.org.uk/publications/13827>.

---

**taken into account when assessing how councils' capacity to raise revenues via council tax may change over time. This is inconsistent *unless* the aim is to reward and incentivise population growth and housing development,** on top of the incentives provided by the New Homes Bonus. If this is the case, the government should be explicit about this.

**Moreover, as council tax rates increase over time, councils with large tax bases will benefit more from this. The government should therefore also consider taking into account notional *increases* in council tax rates when projecting forward revenue-raising capacity of different councils.** Otherwise, periods between resets could see relative funding levels fall for councils with low council tax bases, and rise for those with high council tax bases. (This would be the case unless other councils other sources of revenue such as business rates grow faster than council tax, which may be unlikely given business rates are capped at inflation).