1. About LGiU

1.1. The LGiU (Local Government Information Unit) is a membership body for over 200 English councils. Our charitable mission is to promote local democracy, which we do through a programme of policy research, campaigns and events. Since early 2018 we have been running the Local Finance Taskforce, in partnership with our local authority members, to debate and shape a sustainable system of council funding for the future. Our campaign has been calling for a formal consultation on the options for council finances beyond Business Rate Retention; so we are delighted that the HCLG Committee has launched such an inquiry and welcome the opportunity to contribute our findings to date.

1.2. Our submission draws upon:
- Results from our seven annual State of Local Government Finance Surveys, which asks English Chief Executives, Leaders, Chief Finance Officers and Cabinet Members for Finance for their views on their current and projected financial situation;
- Our on-going consultation with the sector on the options for council funding contained within our Local Finance Scorecard, comprising several roundtable discussions, an online survey and party conference events (all part of the work of the Local Finance Taskforce); and
- Findings from our 2017 Devolution Network research programme, including a dedicated meeting on finances with sector experts.

See Appendix for full details of relevant LGiU work.
2. Summary

2.1. We have now passed the point where any further efficiency savings can be made within local government and the ongoing cuts alongside financial uncertainty are demonstrably harming service quality, undermining councils’ financial sustainability and damaging public trust.

2.2. Local government has experienced some of the deepest and most sustained cuts to its funding compared with other parts of the public sector while also contending with a major overhaul of its funding system and rising demand for adult and children’s social care.

2.3. It is not just the quantum of funding which is of concern, it is also the uncertainty around how councils will be funded post-2020.

2.4. The large reduction in staff since 2010 is causing detrimental effects through lost expertise.

2.5. Councils have been forced to prioritise acute and crisis services, leading to concern about problems building up for the future in the absence of early intervention and preventative services.

2.6. Despite strong attachment to council tax within local government, the system as it stands is woefully distorted between areas and unfair for taxpayers. There is support for the addition of extra bands at the top end and for removing the referendum requirement.

2.7. The Government’s core objectives for the 100% Business Rates Retention Scheme (BRRS) (drive local economic growth and promote financial self-sufficiency) are undermined in a few ways: questionable evidence of the link between business rates income and local growth; existence of perverse incentives; the mismatch between need and business rate income damaging service quality; and failing to capture much modern business activity.

2.8. To tie local authorities’ fortunes to business rates may result in some areas doing much worse than others, without them being able to control the factors which drive their success. A digital tax or a local share of income or corporation tax may correct some of these imbalances, as would measures to reduce its volatility.

2.9. The prospect of successfully implementing 75% BRRS before the Revenue Support Grant (RSG) is phased out in April 2020 now seems remote. We suggest the Government temporarily reinstates RSG or equivalent to give themselves more time to implement the BRRS properly and to give councils the certainty they need to plan for the next 1-2 years.

2.10. Finding a solution to adult social care funding is central to guaranteeing the sector’s financial sustainability. Part of this must entail finding a better way for health services and councils to work more closely and collaboratively.

2.11. There is frustration about the recent shift towards handing out small policy-specific grants to councils – an inefficient use of public resources – instead of simply having a coherent and adequately financed system of funding.

2.12. There is appetite within local government for a wider range of funding sources, including tourism tax and a local share of income tax and/or Digital Services Tax.

2.13. We believe the approach to the Spending Review should focus on the several aspects including: commitment to fairness and transparency and to increase the overall quantum of funding; providing financial certainty; mitigating the worst effects of council tax and business rates; clarity on devolution, social care and Business Rate Retention policy; a joined-up approach to local services in collaboration with other departments; and a short-term plan to secure service quality in the life-and-death areas.
3. What lessons can be learned from past changes to local government funding in England, the current financial situation of councils, and how this has affected their ability to deliver services.

3.1. Many across local government would accept that the beginning of the austerity process in 2010 precipitated necessary efficiency improvements and a reduction in wastage. However, we have now undoubtedly passed the point where any further efficiency savings can be made and the ongoing cuts are now demonstrably harming service quality, undermining councils’ financial sustainability and damaging public trust. One in twenty (6%) councils say there is a danger they will be unable to fulfil statutory duties this year due to financial constraints and 1 in 10 councils expect to face legal challenges this year due to service cuts.

3.2. Confidence among senior council decision-makers is low; 8 in 10 say they lack confidence in the sustainability of local government funding. Local government has experienced some of the deepest and most sustained cuts to its funding compared with other parts of the public sector. But in contrast with other public sector bodies, local government has also been contending with a major overhaul of its funding system which has seen the Revenue Support Grant phased out without the promised Business Rate Retention system in place to replace the lost funding. At the same time demand for adult and children’s social care has risen; social care now accounts for 54% of all council spending and is their top financial pressure.

3.3. One very clear message we have been hearing through discussions with our members is that it’s not just about the quantum of funding (although this is evidently a major component). It is also the uncertainty around how councils will be funded post-2020 that is causing much of the financial trouble, as they are unable to plan their operational and service spending or calculate cashflow, affordability or returns for investments in e.g. service improvements or infrastructure. Many councils have had to postpone or cancel such projects, causing backlogs in housing repairs, road maintenance, and economic regeneration work. Not knowing exactly how much they can expect to keep from their local business rate share means they cannot make informed decisions about how much they should be investing in their local economy or how much they should be keeping in reserve for day-to-day service delivery in the coming years.

3.4. Since 2010, local government in the UK has seen a reduction in staff headcount of 860,000 and many senior figures have told us of the detrimental effects of losing expertise. This is particularly noticeable in planning work, where officers are struggling to deal with small site or complex planning enquiries and to challenge poor developer practices, and in social services teams, where high staff turnover and large caseloads are undermining the quality and continuity of care to vulnerable children.

3.5. Cuts to early intervention and prevention services is another concerning feature of the post-2010 local government landscape; as money has become more scarce councils

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3 https://www.local.gov.uk/sites/default/files/documents/5.40_01_Finance%20publication_WEB_0.pdf
8 https://www.lgiu.org.uk/report/small-is-beautiful-delivering-more-homes-on-small-sites/
have been forced to prioritise acute and crisis services above all else. Many senior figures have told us how worried they are about the problems that are building up for the future in the absence of early intervention and preventative services, the negative effects of which will spill over into wider society through poorer educational attainment, more acute health problems, increasing crime and rising social inequality. Moreover, intervening at crisis points – when a child needs to be removed from their family, a person is sleeping rough, a family has arrived at a women’s refuge, a pupil has been excluded from school, an elderly person has fallen and broken a hip – is much more complicated and expensive, so cuts to local government now are building in spiralling costs for the wider public sector in the future.
4. The efficiency, fitness for purpose and sustainability of the current system for funding local government (central government funding, council tax, business rates retention and other income); how it could be improved, including options for widening the available sources of funding; and what lessons can be learned from other jurisdictions.

4.1. Council tax

4.1.1. Despite its shortcomings as a regressive form of taxation, there is a strong attachment to council tax within local government as it provides a non-volatile and easily-collectable source of income and enhances local accountability.

4.1.2. Nevertheless the council tax system as it stands is woefully distorted between areas and unfair for taxpayers. For one, it is based on property values from 28 years ago, meaning that fluctuations in an area’s housing market and local economy are not reflected in people’s bandings. In addition, the effective cap on council tax rises has punished areas with low tax rates by freezing them at their 2012-13 rates, while councils that would otherwise like to reduce their council tax in some years feel concerned that they will be stuck at that lower rate indefinitely.

4.1.3. Although it would be the ideal solution, there is recognition within the sector that a full revaluation is politically challenging and this may not be a realistic request at this moment in time. In lieu of this, there is broad support for the addition of extra bands at the top end in order to reduce the inequality caused by expensive properties sitting in the same band as much cheaper ones. A few councils have trialled this on a voluntary basis with some success (see Westminster and Islington Councils).

4.1.4. There is also support for removing the referendum requirement for council tax rises over a centrally-dictated threshold (62% of councils\(^9\)), in order to allow councils more freedom to set a rate that suits their residents’ ability to pay and their needs, without the perverse incentives that accompany the current system. However, this should only be done alongside a wider plan for council funding – otherwise some councils may feel extreme pressure to push through large council tax rises in order to fund social care. As discussed further below, social care need bears little relation to the size of the local tax base (council tax or business rates) so we should avoid over-reliance on these mechanisms to ensure adequate provision, especially without addressing the system’s distortions.

4.2. Business rates retention

4.2.1. The principle behind business rate retention, i.e. allowing councils to retain the proceeds of growth from their local economy, enjoys fairly widespread support across local government but there are serious misgivings about transitioning towards reliance on business rates income.

4.2.2. At the outset, the Government’s core objectives for the 100% Business Rates Retention policy were: to drive local economic growth; and to promote financial self-sufficiency for English local government. These objectives are undermined in a few ways.

4.2.3. Firstly, several groups, including the National Audit Office\(^10\) and the Institute for Fiscal Studies (IFS)\(^11\) have questioned whether business rates have a strong or

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\(^11\) [https://www.ifs.org.uk/publications/10542](https://www.ifs.org.uk/publications/10542)
clear link with local growth. Indeed, our research with the IFS and PwC found that the vast majority of councils were unable to determine if their areas had gained or lost under the existing 50% BRRS regime. Similarly, we found that only 41% of councils believed that 100% BRRS will incentivise local economic growth (when asked in 2017).

4.2.4. Secondly, due to the type of properties that are taxed under the business rates system there may be perverse incentives for councils to encourage certain types of economic activity over others in order to maximise business rate income, eg businesses with large floorspace needs over those with an office layout.

4.2.5. Thirdly, financial self-sufficiency may be hard to achieve in some areas under the 75/100% BRRS system because of the mismatch between an area’s level of need and their business rate income. For example, an area (1) with high deprivation, a large elderly population and high unemployment is likely to need more funding per head than, say, an area with near full employment and populated by working age people (2). However area 1 is also likely to have a less thriving local economy and therefore cannot raise much through business rates income; moreover the gap between their spending need and their business rates income is likely to grow over time through a vicious cycle.

4.2.6. Long term sustainability is likely to be undermined by the failings of the underlying business rates system unless it is adapted to suit the realities of the modern economy. There is consensus across local government and the business sector that the current system is broken; in particular it fails to capture much digital or online business activity, with the result that businesses with physical retail or industrial presence are penalised. Without a redesign, it is doomed to become irrelevant and badly distort behaviour and incentives. To tie local authorities’ fortunes to this tax may result in some areas doing much worse than others, without them being able to control the factors which drive their success. A digital tax or a local share of income or corporation tax may correct some of these imbalances.

4.2.7. The volatility of business rate income is also a key concern within local government. Some areas may be reliant on a small number of large companies for their local business rate income; if one was to close down it would have a very large and sudden impact on the council’s budget. Pooling arrangements, perhaps across combined authorities could be one solution.

4.2.8. Another source of volatility is central government itself, which will retain control over most overarching aspects of the business rate system. It is essential that the Government commits to reimbursing councils for any changes to business rates policy (e.g. mandatory rate reliefs, changing from RPI to CPI), rather than ad-hoc arrangements through Section 31 grants. Similarly, the Government must ensure that commercial property valuations are done promptly and accurately by properly resourcing the Valuation Office Agency, and at defined intervals, so that councils do not have to hold back millions of pounds in reserve to cover potential business rate appeals payouts.

4.3. Central government grant funding

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4.3.1. There is less than a year until the 1st April 2020 deadline for the Revenue Support Grant to be fully phased out, after which councils do not know how they will be funded. The prospect of deciding on the details and implementing 75% BRRS in advance of this date now seems remote given the level of political attention and commitment the MHCLG will need to set a clear course.

4.3.2. We suggest the Government provides councils the certainty they need to plan for the next 1-2 years ahead by temporarily reinstating RSG or an equivalent grant, to give the Government more time to implement the BRRS properly and with a view to including other funding sources and powers to complement it. Moreover, 75% BRRS is not the 100% councils were initially promised, so there will need to be some additional funding to make up the shortfall.

4.3.3. Finding a solution to adult social care funding is central to guaranteeing the sector’s financial sustainability. Several options have been debated during our consultation, including: funding social care centrally through grants (as with education); introducing place-based budgeting, bringing health and social care governance and budgeting closer together and lining up their geographical boundaries; and national insurance-style personal funding for social care provision. None of these ideas have unanimous support within the sector but there is recognition that we must find a better way for health services and councils to work more closely and collaboratively.

4.3.4. A point of frustration within the local government sector has been the recent shift towards handing out small policy-specific grants to councils, for which they must prepare lengthy bids and which come with limiting and sometimes even punitive criteria (see Future High Streets Fund, potholes funding and Pocket Parks). Although welcome, this way of allocating money is no substitute for a coherent and adequately financed system of local government funding. It is also an inefficient use of public resources which forces civil servants and council officers to track the grant cash and make sure it complies with the relevant criteria.

4.4. Other funding sources

4.4.1. Almost all (97%) councils told us they plan to increase fees and charges this year. Although an essential part of the local funding mix, we are hearing that councils are having to increase charging to cover financial shortfalls from reductions in Revenue Support Grant. Increasing use of fees and charges in this way risks undermining the democratic and redistributive aspects of local taxation; if people start seeing council services like waste as something they purchase separately, they may feel cheated when they are also charged council tax on top.

4.4.2. There is strong appetite for a local tourist tax. Although it may not be the right tool for every area, it is seen as a win-win solution for areas suffering the negative effects of tourism who do not want to burden residents with extra charges.

4.4.3. The Digital Services Tax is a welcome proposal and we would strongly suggest that it should contain a locally-retained element in order to balance out the shortcomings of the business rate retention system outlined above.

4.4.4. Local income tax also has the potential to provide a counterweight to the existing regressive forms of local taxation. Although difficult to administer as a truly local

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17 https://www.themj.co.uk/EXCLUSIVE-Grimsey-criticises-speed-of-high-streets-bidding-process/213195#
18 https://www.bbc.co.uk/news/business-46007351
tax in this country (i.e. set and collected locally) it could be feasible to devolve a slice of the local income tax pot (i.e. still set and collected centrally, but a portion paid to councils). We suggest that this would be in conjunction with council tax (and business rates) in order to retain a locally-controlled element which enhances local democratic accountability.

4.4.5. Overall, we believe that any future system must contain a range of levers and funding sources in recognition of the individual strengths and shortcomings, and the fact that different areas may suit different solutions.
5. The approach the Government should take to local government funding as part of the 2019 Spending Review, what the key features of that settlement should be, and what the potential merits are of new or alternative approaches to the provision of funding within the review.

5.1. The approach to the Spending Review should focus on the following aspects:

5.1.1. Commitment to fairness and transparency, particularly around the funding formula;

5.1.2. Commitment to increase the overall quantum of funding available to local government, in recognition of the fact that local government has been squeezed extremely hard during austerity and cannot continue cutting without risking breaching their statutory duties of care;

5.1.3. Allowing extra time to figure out and implement the new system of funding without rushing it through – including addressing the major questions around redistribution and outcome divergence – alongside a 3-year interim confirmation of funding levels to allow councils to plan their activities;

5.1.4. A plan for how the Government will mitigate the worst effects of the current regressive and outdated local taxes (i.e. council tax and business rates) to prevent unfair tax burdens and perverse economic incentives;

5.1.5. Providing clarity in the Government’s strategies for further devolution, social care and Business Rate Retention (and wider local government funding);

5.1.6. Promoting a joined-up approach to local services in collaboration with other departments, such as DfE, DHSC, DfT and DEFRA, especially around health and social care integration, local economic strategies and delivering environmental commitments;

5.1.7. A clear-eyed articulation to the rest of Government and the public of the seriousness of this issue, not only the importance of an adequate level of funding but giving councils the clarity and certainty they need to make sensible decisions;

5.1.8. At the very minimum we must emerge from the Spending Review with a clear idea of how service quality will be secured in the life-and-death areas of children’s and adult social care and homelessness.
Appendix

Relevant LGiU work

State of Local Government Finance Survey – This annual survey gives a snapshot of the key pressures facing councils and the impact of ongoing financial uncertainty on their communities, from the perspective of senior decision-makers at each of England’s councils (Council Leaders, Chief Executives, Cabinet Members for Finance/Resources and Directors of Finance/Resources). We receive responses from a broad cross-section of councils, encompassing county, district and unitary authorities, a mixture of political control, and all regions.


- **Feb 2018** – This year we received 132 responses from 113 individual councils, meaning that a third of English councils are represented in the results. The survey questions covered topics including income sources, confidence, service level spending, funding system design and thoughts on future policy. [https://www.lgiu.org.uk/report/lgiu-mj-state-of-local-government-finance-survey/](https://www.lgiu.org.uk/report/lgiu-mj-state-of-local-government-finance-survey/)

- **Feb 2017** – This year received 163 responses from 131 individual councils, meaning that over a third of English councils were represented. The survey questions covered topics including borrowing intentions, confidence, service level spending, social care precept and business rates retention. [https://www.lgiu.org.uk/report/2017-state-of-local-government-finance-survey/](https://www.lgiu.org.uk/report/2017-state-of-local-government-finance-survey/)

Local Finance Scorecard [July 2018] – This scorecard is intended to kick start the conversation about the future of local government funding outlining the key features of some of the ideas for local government finance reform, their advantages and disadvantages, what sort of places they would benefit and where they have been tried. LGiU is running a year-long consultation on these options and will be publishing the findings in summer 2019. [https://www.lgiu.org.uk/report/local-finance-taskforce-finance-scorecard/](https://www.lgiu.org.uk/report/local-finance-taskforce-finance-scorecard/)


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