Written evidence submitted by the Institute for Fiscal Studies
[FSR 090]

Note

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Summary

This note is a response to the Housing, Communities and Local Government Committee's Local Government Finance and the 2019 Spending Review inquiry.

The key points made by this note are:

Past changes to local government funding and the current situation in councils

- **Local government has had to adapt to significant reductions in funding in recent years.** As a result spending on local services fell by 21% in real terms between 2009–10 and 2017–18. Underlying this are much bigger cuts to services like planning and development (56%), housing (51%), highways and transport (47%) and leisure and culture (44%). This allowed the relative protection of adult social care services (down 5%) and acute children's social care services (up 10%). This suggests councils have managed in large part by significantly cutting back spending on more discretionary services (and in some cases relying more on income from fees and charges to fund these), to focus resources on statutory services and those clients with the greatest needs. It is not clear whether such a strategy is possible in future though, given how much more discretionary services have been cut back already.

- **Cuts have been larger in more deprived council areas than more affluent council areas,** despite claims that the government was taking ‘unprecedented steps’ to prevent this. This shows that having a transparent and well-functioning system for allocating funding between councils matters.

- **A range of indicators suggest councils are finding the funding situation increasingly difficult.** Pressures seem to be greatest for upper-tier councils with social care responsibilities, with lower-tier districts having healthier reserves positions and reporting less concern about funding cuts impacting service quality. Among upper-tier councils, the most acute difficulties seem to be among counties, despite the fact that they have seen smaller cuts than average. This suggests some other factor (such as funding levels that were relatively low to start with, increases in relative needs, or political or institutional issues making the delivery of cuts particularly difficult) must play a role in these cases.

Fitness-for-purpose of the local government finance system and options for reform
The first major problem with the current system is that there is no well-functioning system for assessing how much funding different councils need, and allocating funding accordingly. Instead, current allocations represent the end result of at least a decade of inconsistent policymaking. The Fair Funding Review is therefore not only welcome but vital in order to deliver a coherent, rational and clear funding system.

The overarching question facing the Fair Funding Review is how to balance redistribution of funding according to need versus the desire to provide councils with financial incentives to tackle needs and boost growth. Answering this question – and hence, the precise design of the local government system – needs both empirical analysis and political debate and discussion, both of which are currently lacking.

The second major problem with the current system is that a system where councils rely on council tax and business rates for the bulk of their funding is highly unlikely to provide sufficient funding. Rising costs could see adult social care account for more than 60% of local tax revenues within 15 years if council tax increases are capped at 3%, and more than 50% even with increases of 4.7% a year. This would limit resources for other areas.

Additional funding could be provided by central government in the form of grants, or via devolving additional revenue-raising powers to councils. The choice over which to do should depend on judgements about the importance of redistribution and consistency in tax and spending (in which case grant funding would be preferable) relative to incentives and local discretion (which tax devolution supports). It may also be worth bearing in mind that central government may have to significantly increase taxes to pay for things like health and pensions for which it is directly responsible.

A local income tax would be the most sensible option for devolution of significant new revenue-raising powers if that were the favoured option. It would not be without its challenges (including the fact HMRC does not currently know where everyone lives) but would be easier than partially-devolving other big taxes (like VAT or corporation tax) and would raise much more than ideas like tourist accommodation taxes.

Assessing spending needs nationally and locally

The spending needs formulas being developed as part of the Fair Funding Review aim to measure how much funding each council needs relative to other councils, not how much they need in absolute terms. Measuring absolute funding needs is difficult as it requires an explicit judgement on the range and quality of services that councils should be able to provide (which is inherently political), and the expected efficiency with which they are expected to do so (which is difficult to determine).

However, when determining funding arrangements for local government one has to at least attempt to account for service quality expectations, and estimates of the costs of meeting those expectations. The latter requires data
and methods that allow one to identify the drivers of costs – such as local demographics, wages and property costs, projections of how these cost-drivers may evolve over time, and evidence on how costs vary with expected service quality. A number of studies have recently attempted to do this for health and social care, but we are not sure what analysis, if any, the government undertaking for council services in advance of the Spending Review.

1. Introduction

This note is a response to the House of Common's Housing, Communities and Local Government Committee's inquiry into local government funding. It covers the following areas:

- Past changes to local government funding and the current financial situation of councils, and the lessons that can be learned from this analysis.
- The fitness-for-purpose of the current funding system and options for reform and improvement.
- The approach to assessing the funding needs of councils and local government more generally.

We do not discuss specifically how the government should approach the issue of councils' funding in the upcoming Spending Review. However, it is clear that the approach should take into account the outcomes of the ongoing Fair Funding and Business Rates Retention Scheme reviews and the forthcoming Social Care Green Paper, and be consistent with the government's expectations in terms of the standard and consistency of service provision across the councils. This means it is not only the quantum of funding that matters – but also how the system for distributing it trades off allocation according to need versus the provision of financial incentives for growth, and trades off consistency in service standards versus local discretion in tax and spending choices.

2. What can be learned from past changes to local government funding and the current situation in councils?

In this section we describe how the size and profile of local government spending has changed in recent years, focusing on the period since 2009-10, and highlight some of the lessons that can be learned from the past decade. We then discuss some indicators of financial pressure.

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.

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. This is illustrated in Figure 2, which shows cuts per person of 36% for the most-deprived fifth of council areas, compared to 22% 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.

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

Note: Service spending is a measure of local authorities’ revenue expenditure, which excludes certain spending items. We also exclude spending on police, fire, and education services, as well as sending on some very small categories that are inconsistently recorded over time.

Source: Authors’ calculations using Ministry for Housing, Communities and Local Government (MHCLG), local authority revenue expenditure and financing statistics outturns, and the Chartered Institute of Public Finance and Accountancy (CIPFA), Finance and General Estimates.
As discussed in more detail in Section 3, below, this reflects cuts to funding from central government that did not fully (and at times did not at all) take account of differences in the extent to which councils can raise revenues themselves via council tax. And it 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 system. This illustrates the importance of having a system that is clear and transparent, and being clear about judgements about the levels of funding different areas (e.g. more and less deprived) should and are receiving.

To protect statutory and acute services, big cuts have been made elsewhere. Delving deeper to look how spending has changed by service area shows that councils have adapted to reduced funding by making significant cuts to more discretionary services in order to relatively protect statutory and more acute services. Figure 3, for instance shows councils’ net expenditure on planning & development and housing services is down more than 50% and on highways & transport and cultural & leisure services is down more than 40%. On the other hand, 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%.

1 Department for Communities and Local Government (2010).
2 Gross expenditure on planning & development, highways & transport and cultural & leisure services has fallen by rather less than net expenditure as income from fees and charges has become relatively more important.
Figure 3. Real-terms change 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.


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 (up 23% between 2009–10 and 2016–17, for instance), budgets for housing advice, the Supporting People programme and improving and renewing private sector housing (which includes housing standards enforcement) have seen very large cuts (60%, 69% and 87% respectively over the same period). And the reductions in 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.

With costs and demands for social care services likely to continue to rise (due to a range of factors, not just an ageing population), it is not clear the extent to which such a strategy would be sustainable going forwards.

Various indicators suggest funding cuts causing increasing problems...

Analysis of spending levels and changes, while useful, cannot tell us whether councils have enough funding to meet service expectations. Indeed as we discuss in Section 4 of this submission such an assessment of absolute spending needs is inherently very difficult (although worthwhile) and is beyond the scope of our submission.

However, a range of indicators do suggest that councils have found it increasingly difficult to manage rising demands and costs given the large funding cuts they have faced.

For example, a range of measures tracked by the Institute for Government’s Performance Tracker (https://www.instituteforgovernment.org.uk/our-work/performance-tracker) suggest growing difficulties. Staff turnover and vacancies have increased in social care
services; targets for completing various tasks are being missed more often; and a slow but steady decline in satisfaction with a range of services such as waste collection, libraries and road maintenance.

Further evidence on how funding cuts have affected councils thus far is available in the form of an annual survey carried out by the LGiU and the Municipal Journal. They find that 6% of councils said that there is a danger they will not be able to fulfil statutory duties this year, and only 37% said that they would be able to ‘comfortably provide a range of non-statutory services to their residents’.

Analysis also suggests that additional money and policy focus can help tackle problems. For instance, the Institute for Government’s Performance Tracker shows that delayed discharges from hospital due to a lack of social care services were steadily increasing between March 2014 and March 2017. But they have fallen significantly since then as additional funding was provided to councils for adult social care services, and new targets were put in place to reduce these delays.

Similarly, there have been falls in the proportion of councils citing adult social care services as their biggest immediate pressure in the LGiU and Municipal Journal’s survey since 2017; and children’s services now top this list (adult social care remains the most cited long term pressure).

One thing that needs careful interpretation is trends in reserves. Figure 4 below shows how the amount held in reserve by local authorities has changed over the past decade. It shows that the total amount held in reserve by local authorities increased by 62% between March 2010 and March 2015. Since then the amount of reserves has decreased – notwithstanding a slight increase during 2017–18 – with further falls forecast for the year that just ended, 2018–19. If these forecasts are correct, by March 2019 the total amount held in reserve was forecast to have fallen by 12% from March 2015.

However, it is difficult to interpret these movements. For example, increasing reserves could be a sign that authorities have more funding than they need to spend, but could also indicate that they expect to face more acute funding shortages in future and are thus building up reserves. The explanation for falling reserves is similarly ambiguous.

More can be learned by digging deeper to look at how changes in reserves differ between types of authority. The graph also shows that since March 2014 counties and other upper tier authorities have been, on aggregate, drawing down their reserves, whilst districts have contined to build theirs up. This may reflect what is shown in Figure 3 above – upper tier authorities, unlike district councils, have responsibility for providing adult’s and children’s social services, which councils cite as the areas of greatest pressure, and which they have protected relative to other service areas.

Figure 4. Reserves held by local authorities, 2010 to 2019

Note: Dotted lines indicate forecasts. The data point for each year is the amount local authorities in England had in reserve at 31st March of that year. The amounts shown do not include reserves held specifically for schools or public health. The March 2019 figure is calculated by taking the reserves position at March 2018 and subtracting from that the net amount that authorities have forecast they will reduce reserves by in the year 2018–19. The three lines for counties, districts and unitaries and boroughs do not sum to the national total because that includes other authorities, such as independent police and fire authorities, waste authorities, and the GLA.


It is also worth noting that although the graph shows that district and county councils were forecast to have similar amounts held in reserve by March 2019, this implies that the very different levels of reserves relative to their spending. Districts’ reserves are set to amount to 125% of the value of their total service spending in 2018–19, whilst counties’ reserves are set to amount to only 27% of their total service spending - suggesting possibly significant differences in the strength of their financial positions. All other upper tier authorities are set to be holding reserves amounting to 41% of the value of their total service spending in 2018–19.

Other work has used the amounts that councils have held in reserve as a measure of their financial resilience. CIPFA, for example, has calculated the number of years it will take each council to deplete their reserves ‘if they continue to use their reserves at the same rate as the last three years to March 2018’. They find that 12 upper tier councils, by that measure, will exhaust their reserves in under four years. This compares to only two district councils.

... but biggest issues are not among those councils that have faced biggest cuts

It is also worth noting that those councils that seem to be facing the biggest financial difficulties are not, in general, those that have seen the biggest cuts, which have tended to be lower-tier district councils and urban single-tier councils. Instead problems seem to be concentrated among county councils (including most notably

4 CIPFA (2018)
Northamptonshire, but also others such as East Sussex, Norfolk Somerset and Surrey), which have tended to see smaller-than-average cuts (even controlling for the fact that social care services make up a large fraction of these councils’ budgets).

This suggests some other factor (such as funding levels that were relatively low to start with, increases in relative needs, or political or institutional issues making the delivery of cuts particularly difficult) must play a role in these cases – not just the scale of the cuts.

3. How fit-for-purpose is the local government finance system, and how could it be improved and made more sustainable?

In order to address these questions, we first explain the current local government finance system – highlighting the main sources of funding, and the rules for how this funding is allocated between councils. We highlight why this system needs reform, and the looming choices both about the level of funding and its distribution. We end with a discussion about options for providing councils with more funding – drawing on our recent report on the options and issues for devolving additional tax powers to local government.

Councils have five main sources of funding
Currently councils receive funding from five main sources:

1. General-purpose grants from central government which councils can spend on any of the services they provide. The largest is the Revenue Support Grant, which was traditionally allocated in such a way so as to iron out differences in councils’ own revenue-raising capacity. Other examples include Rural Services Delivery Grant and New Homes Bonus, which are allocated using specific formulas, but which councils are free to spent as they see fit.

2. Ring-fenced grants from central government which councils must spend on specific service areas. Examples include the Improved Better Care Fund (for adult social care services) and the Public Health Grant.

3. Council tax, which councils set and collect themselves. However, to increase council tax by more than specific percentage limits set by central government, councils must hold and win a referendum of local residents.

4. Revenues from the business rates retention scheme (BRRS). Prior to the introduction of the scheme in 2013–14, an assessment was made of how much business rates revenue each council needed. Since then, councils have retained that amount plus a share of the local growth (or decline) in local business rates revenues. In those parts of England still operating the original BRRS, that share is 50%, but large parts of the country are piloting retention of 75% or even 100% of the local growth (or decline) in local business rates revenues.

5. Sales, fees and charges for certain services. Councils are able to charge for certain services on a cost-recovery basis. The services where such fees generate the most money include social care for the over-65s (social care is means-tested
and many people have to pay at least some of the costs themselves), parking, cultural and leisure services, and planning services.

Councils have become increasingly reliant on sources (3), (4) and (5) in recent years as general grant funding in particular has been cut back. The plan is to abolish the main general grant (Revenue Support Grant) and certain specific grants (such as Public Health Grant) from April 2020 and increase the business rates retention rate to 75% everywhere. However, further changes will be needed to make the system fit-for-purpose and sustainable for the longer term. Why is this?

The funding system does not operate as a coherent whole

The first reason is that various funding sources do not work together as a coherent and consistent whole. In particular there is no functioning system for assessing how much funding different councils need, and allocating funding accordingly. The Fair Funding Review is thus not only welcome – it is vital.

As discussed above, Revenue Support Grant was traditionally allocated to compensate for differences in councils’ spending needs and capacities to raise revenue themselves (via council tax). But this system progressively broke down and Revenue Support Grant allocations, and hence overall funding levels, are increasingly arbitrary:

- The so-called Four Block Model of funding in place between 2006–07 and 2013–14 was overly complex and flawed, and took progressively less account of differences in how much councils could raise themselves via council tax as grant-funding from central government was cut.5

- In 2014–15 and 2015–16, cuts to grant-funding took no account of differences in how much councils could raise themselves via council tax. This, on top of the impact of the Four Block Model led to the much larger cuts in overall funding and spending for poorer councils shown in Figure 2 in the previous section.

- Since 2016–17, cuts to grant-funding have taken into account how much council tax different councils were raising in 2015–16.

The current system, then, does not allocate funding according to a deliberate set of choices made by government. Instead, the allocations represent the end result of a decade of inconsistent policymaking. It means that without reform, councils’ funding in the 2020s and beyond would depend to a large extent on a (flawed) funding system in place for a few years in the late 2000s and early 2010s, and council tax rates and tax bases in a single year, 2015–16. This is clearly undesirable.

The most important thing for the Fair Funding Review to do then is deliver a coherent system, which takes account of differences in spending needs and revenue-raising capacities in a transparent and rational way.

That does not necessarily mean that funding allocations need to account for 100% of these differences - there is a trade-off between redistribution and incentives. Full and very frequent redistribution of funding on the basis of needs and revenue-raising

5 We discuss the problems with the Four Block Model in more detail in Amin-Smith and Phillips (2018); Gibson and Asthana (2011) provide a more technical discussion of some of these problems.
capacity can mean very little financial incentive for councils to tackle needs and boost their local tax bases (e.g. by increasing the amount of business property, and increasing employment to reduce the cost of council tax support schemes). On the other hand, limited and infrequent redistribution of funding on the basis of needs and revenue-raising capacity could mean large differences in service provision across council areas.

As we discuss in our analysis of the Fair Funding Review, and our submission to the Ministry of Housing, Communities and Local Government's (MHCLG) recent consultation on reform of the BRRS, the task facing the government is to strike an appropriate balance. This will depend on:

- Empirical analysis of the extent to which differences between councils’ spending needs and funding could open up under different policy options. Indeed, such analysis should be a vital element in consultations on plans, but has yet to be published.

- A political judgement on the priority to place on redistribution according to need versus the provision of financial incentives and rewards to councils that see their (relative) spending needs fall and their tax bases grow. We have not seen any real debate or discussion about this important judgement.

There has been significantly more discussion of more specific part of the work of the Fair Funding Review – the development of new formulas to assess the spending needs of councils for different services. We discuss this work in a subsequent section which addresses the inquiry's question on approaches to assessing councils' spending needs.

Existing local tax revenues are likely to be insufficient in future

The second reason further reform is needed is that a system where councils rely on council tax and (75% of) business rates for the bulk of their funding – the plan post April 2020 – is highly unlikely to provide sufficient funding to maintain current services, let alone allow improvements.

To illustrate this, Figure 5 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% - the maximum increase councils can currently impose without a referendum if powers for extra increases for social care lapse (2019–20 was the last year for which such powers were planned);

- 4.7% - the average increase in England in 2019–20, but the second highest increase for a decade, and a rate which would mean the average Band D rate would increase by £1000 (from £1,750) in just 10 years.

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8 Harris and Phillips (2018) and Amin-Smith, Harris and Phillips (2019a) provides a detailed discussion of the MHCLG's plans to assess councils' spending needs.
The Figure 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. With 3% increases, the share would increase to over 60%, requiring sustained cuts to other service areas (including potentially children’s social services) – often on top of what has amounted to nearly a decade of cuts already.

One of three things will therefore very likely have to happen at some stage: either 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.

It is possible that the forthcoming Social Care Green Paper will signal a centralisation of social care services – or at least the responsibility for funding them. In that case we could shortly be discussing how revenues could be extracted from councils to help pay for these newly centralised responsibilities (or what responsibilities could be devolved in their place).

Views on redistribution, incentives and local discretion should influence how additional funding is provided to councils

Without such a move though, the main question that will need addressing is whether councils should be provided with additional grant funding or additional revenue-raising powers.

A number of factors should affect such a decisions:

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**Figure 5. 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 the local authority revenue account budgets (2018–19), and projections for social care spending pressures reported in P. Johnson et al (2018).
The priority placed on redistribution according to need versus financial incentives to tackle needs and boost local growth. The more that we value redistribution, the more suitable grant-funding is likely to be: it makes less sense to devolve additional revenue-raising powers to councils if we then redistribute revenues on a frequent basis.

The extent to which we think preferences over tax and spending are likely to differ between areas, and our willingness to see such differences acted upon. If we think preferences differ significantly and we value local discretion, giving councils powers to raise their own revenues (and raise different amounts) may make more sense.

Our views on whether it is more feasible for central or local government to be able to raise sufficient revenues to fund increases in costs and demands. Central government will likely have to implement substantial tax rises to pay for the NHS and pensions in coming years – or accept cut backs in services and generosity –, which might mean spreading the political pain of increasing tax revenues to councils appealing.

A local income tax is most sensible option for significant tax devolution
Our latest report on local government finance assesses the options for devolving additional tax revenues and powers to English councils. The key findings are 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 between councils in revenues could be mitigated by restricting councils powers to a flat-rate local income tax, although significant redistribution of revenues would still be needed. 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.

The complexity of apportioning corporate profits and value added mean corporation tax and VAT 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 seems hard to justify. However, giving them 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.

Amin-Smith, Harris and Phillips (2019b).

There is also increasing pressure to reform business rates. As described in Mirrlees et al (2011) and in IFS Senior Research Economist Stuart Adam’s response to the Treasury Select Committee inquiry on business rates (Adam (2019)), there is a strong case to replace business rates with a Land Value Tax.
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 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.

The report also highlights that tax devolution per se is not the solution to perceived funding shortfalls – more funding is. Devolving a tax would only provide additional funding to councils if central government received less funding from it – meaning spending cuts, higher borrowing, or increases in other taxes –, or increases in the tax in question. This fundamental truth cannot be forgotten.

Local government often has access to revenue from more sources in other countries

Our report highlights the range of taxes devolved or assigned to local or regional government in a range of countries. It finds that while property taxes (like council tax and business rates) are the most common local taxes, various countries devolve other taxes too, with tourist accommodation taxes being particularly common.

Table 1. Examples of taxes devolved or assigned to local or regional government

<table>
<thead>
<tr>
<th>Devolved</th>
<th>Assigned</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income tax</td>
<td>Flat-rate in Sweden, Finland, Denmark. Progressive in Canada, US, Spain. Germany</td>
</tr>
<tr>
<td>Sales tax/VAT</td>
<td>US (sales taxes); Canada (VAT), Italy, Portugal, Spain, Germany</td>
</tr>
<tr>
<td>Corporation tax</td>
<td>Germany (‘trade tax’), Canada, Italy Denmark, Finland, Portugal</td>
</tr>
<tr>
<td>Tourism tax</td>
<td>Italy, Germany, Netherlands</td>
</tr>
<tr>
<td>Inheritance tax</td>
<td>Poland, Spain Germany</td>
</tr>
<tr>
<td>Vehicle taxes</td>
<td>Belgium, Spain Germany</td>
</tr>
</tbody>
</table>

Notes: In some cases, taxes are devolved or assigned to regional or local governments, or both. The table provides examples of countries where taxes are devolved or assigned and is not exhaustive.

However in the course of work it became clear there is little good comparative information on how local government finance systems operate in other jurisdictions. This is particularly true when it comes to details about the powers local government have over tax rates and bases, and the rules on redistributing revenues and grant-funding. It would be worthwhile the government (or parliament) carrying out or commissioning research in this area.

4. How are current and future funding needs assessed? And how can these be better understood nationally and locally?

As mentioned in the last section, the government is developing new formulas to assess councils' spending needs as part of the Fair Funding Review.
It is important to understand that these (and previous) formulas aim only to determine how much funding each council needs relative to other councils. They do not attempt to determine how much each council needs in absolute terms. This means the formulas are not designed to provide an assessment of the overall amount of money needed for local government to provide the services it is expected to provide. Instead, the overall amount available is determined in a rather untransparent way in Spending Reviews and subsequent Local Government Finance Settlements, and councils are then allocated shares of that overall amount according to their relative assessed needs (and other funding allocation rules).

One advantage of this system is that it avoids the government's needs assessments being interpreted as centrally-mandated spending targets that councils should adhere to. Indeed councils complained that the system in place between 1990-91 and 2002-03 that explicitly translated assessments of relative spending needs into cash amounts (given the total funding available) could be misinterpreted as doing just that. From 2003-04 the government therefore expressed spending needs assessments as shares of the national total to emphasise their relative nature.

Explicitly assessing absolute spending needs is also more difficult. It requires an explicit judgement on the range and quality of services that councils should be able to provide (which is inherently political), and the expected efficiency with which they are expected to do so (which is difficult to determine). In contrast, assessments of relative spending needs can be based on the prevailing services and levels of efficiency at the time the assessments are undertaken.

However, when determining funding arrangements for local government one has to at least attempt to account for service quality expectations, and estimates of the costs of meeting those expectations. The latter requires data and methods that allow one to identify the drivers of costs – such as local demographics, wages and property costs, projections of how these cost-drivers may evolve over time, and evidence on how costs vary with expected service quality. A number of studies have recently attempted to do this for health and social care,\textsuperscript{11} but we are not sure what analysis, if any, the MHCLG is undertaking for council services in advance of the Spending Review. Without such analysis, it will be more likely that there will be a mismatch between expectations and funding arrangements.

It is important to note that even relative spending needs assessments are difficult – as we discuss in significant detail in Amin-Smith, Harris and Phillips (2018). This is because it is difficult to disentangle differences in spending needs from differences in local choices and differences in past funding allocations (both of which will have a significant impact on past spending levels of councils).

With this in mind, plans to make use of comparisons of spending between different areas (or on different individuals) within councils to assess needs for social care services are very welcome. These methods are more robust than those relying on comparisons between councils only, and are one way in which the Fair Funding Review is making use of high quality statistical analysis.

\textsuperscript{11} See for example, Bottery et al (2018) and Johnson et al (2018).
One area where the Fair Funding Review has relied on much poorer use of statistical analysis is the MHCLG’s recent suggestion that spending needs assessments for services like housing, the environment, leisure and culture, and planning and development should be based on population only. The rationale for this was that population explained most of the variation in spending on these services – but this is unsurprising given population varies so much between councils. Factors like deprivation now explain little of the variation in spending per person on these services, but this reflects the bigger cuts to budgets in more deprived areas previously illustrated in Figure 3. In earlier years, prior to these cuts, spending levels were much more correlated with deprivation levels. This example therefore illustrates the difficulty in trying to infer spending needs from council-level spending patterns, that are so influenced by past funding decisions.

April 2019

References

Adam, S. (2019), ‘Submission to Treasury Select Committee inquiry: the impact of business rates on business’ (shortly to be published on the Committee’s website)


\[12\] Ministry of Housing, Communities and Local Government (2018).


