Lessons 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

Local authorities in England (including police and fire services) have faced periods of relative growth and contraction during the past 50 years. Councils have from time to time faced Treasury demands that they cut expenditure (eg, in the mid/later 1970s and the early 1980s) but also when there has been significant expansion (eg, in the early-1970s and during the 2000s). Since 2010, there has been a continuous period of reduction in current spending, amounting to an average fall in expenditure of 25-30 per cent between 2010-11 and 2019-20. There is no precedent for this scale of fall in local authority expenditure since 1945.

Over the longer-term period since 1945, successive governments have increased real terms expenditure (and often spending as a share of GDP) on State pensions, social security, the NHS, education and, latterly, overseas aid. Since the later-1970s, such increases have occurred against the backdrop of efforts under successive governments to reduce taxes and also to cut the share of GDP devoted to public expenditure. Consequently, less-favoured services, including local government, defence, transport, police and housing have inevitably faced regular Treasury efforts to reduce their scale within Total Managed Expenditure (TME). This pattern is well-established and apparently inescapable. Indeed, at some point in the future, unless there is a change to the tax and spending policy outlined above, there would be no resources available for unprotected services.

The government’s 2010 and 2015 spending reviews sought to continue the protection of large parts of TME while restraining overall public expenditure. Inevitably, local government and other unprotected provision have faced sharp reductions. According to the National Audit Office, local government in England’s spending power fell by 28.6 per cent between 2010-11 and 2017-18. Although there have been additional resources made available to councils to fund adult social care since 2015-16, this money is ring-fenced, so all other services have continued to face reductions.

Remarkably, residents remain highly satisfied with council services, although there has been a small reduction in satisfaction over the past five years. Dissatisfaction with roads and

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1 See: Inevitable trade-offs lie ahead: long-run public spending pressures, Briefing Note, Rowena Crawford and Carl Emmerson, IFS, 2017
2 See: ‘Britain faces a simple choice: raise taxes or cut services, Chris Giles, Financial Times, 2 August 2018
3 Financial sustainability of local authorities 2018, National Audit Office, HC 834, Session 2017-2019, 8 March 2018
pavement maintenance, which have faced above-average reductions in expenditure since 2010, is relatively greater.

Comparisons between local government and the NHS are instructive. Councils, which have faced spending reductions of almost 30 per cent in real terms since 2010 have seen only a modest decline in satisfaction with their services, whereas the in NHS, where spending has risen by more than 10 per cent in real terms over the same period, there has seen a sharp fall in satisfaction. However, the fact councils have been seen to manage reductions in the resources so well has not resulted in any recognition of their capability. Indeed, almost all projections of the future path of unprotected services’ revenue spending show a continuing reduction up to the end of the next spending review period in 2023-24.

Local authorities have proved remarkably adaptable and flexible in managing average real terms spending power cuts of around 30 per cent. In some cities, the cuts have been above this average. The government has already decided to inject additional resources (as compared to the figures originally determined in the last spending review) for adult social care, in recognition of the difficulty of delivering an effective service, given the demographic change increasing the demand for older people’s care. What is not clear is how children’s social care, environmental provision, highways and transport will fare if overall spending continues to be cut in the period covered by the 2019 spending review. Whether councils can continue to be sustainable if average resource reductions were to reach 40 or 50 per cent must be open to doubt.

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

Local government in England is significantly under-powered as compared to the systems in other major democracies. A straightforward way of understanding the relative weakness of England’s local government finance system is to compare tax-raising powers in the UK with those in similar countries.

The table below shows the taxation revenue available to sub-national governments (including ‘state’ or ‘province’ levels where these exist) as a share of GDP. The UK is a significant outlier, with council tax the sole sub-national revenue in England. (Retained non-domestic rates is, in effect, an assigned revenue rather than a locally-determined tax.) Thus, according to OECD

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4 Polling on resident satisfaction with councils, Round 21, October 2018, Local Government Association
5 British public’s satisfaction with the NHS at lowest level for over a decade, King’s Fund and Nuffield Trust, 2019
6 See, for example, Spring forward or fall back: The questions facing the UK economy ahead of the spring statement 2019, Figure 24, Resolution Foundation, 2019
statistics, taxation available to UK local government is equivalent to just 1.6 per cent of GDP. Since the figures in this table were compiled, Scotland and Wales have been given some control over additional taxes at the devolved government level. But the picture will be broadly unchanged: councils in England (and, indeed other parts of the UK) have very limited access to taxation powers. In England, council tax is subject to central capping, which means it, too, has attributes of a national tax.

### Taxation revenue available to sub-national governments as a % of GDP

<table>
<thead>
<tr>
<th></th>
<th>Local government</th>
<th>State/regional government</th>
<th>Local and state/regional</th>
<th>Federal or central government</th>
<th>Social security</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canada</td>
<td>2.8</td>
<td>12.1</td>
<td>14.9</td>
<td>12.7</td>
<td>2.9</td>
<td>30.5</td>
</tr>
<tr>
<td>France</td>
<td>5.8</td>
<td>0.0</td>
<td>5.8</td>
<td>15.1</td>
<td>24.0</td>
<td>45.0</td>
</tr>
<tr>
<td>Germany</td>
<td>3.0</td>
<td>8.0</td>
<td>11.0</td>
<td>11.5</td>
<td>13.9</td>
<td>36.5</td>
</tr>
<tr>
<td>Italy</td>
<td>7.1</td>
<td>0.0</td>
<td>7.1</td>
<td>23.6</td>
<td>13.1</td>
<td>43.9</td>
</tr>
<tr>
<td>Spain</td>
<td>3.2</td>
<td>4.5</td>
<td>7.7</td>
<td>13.8</td>
<td>11.1</td>
<td>32.7</td>
</tr>
<tr>
<td>Sweden</td>
<td>15.8</td>
<td>0.0</td>
<td>15.8</td>
<td>21.4</td>
<td>5.5</td>
<td>43.7</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>1.6</td>
<td>0.0</td>
<td>1.6</td>
<td>24.9</td>
<td>6.2</td>
<td>32.9</td>
</tr>
<tr>
<td>United States</td>
<td>3.7</td>
<td>5.1</td>
<td>8.8</td>
<td>10.5</td>
<td>6.1</td>
<td>25.4</td>
</tr>
<tr>
<td>OECD total</td>
<td>3.9</td>
<td>4.9</td>
<td>8.8</td>
<td>20.4</td>
<td>8.4</td>
<td>34.2</td>
</tr>
</tbody>
</table>

*Source: OECD Revenue Statistics*

A number of official inquiries have considered the possibilities for raising additional local revenues. The Layfield Committee (1976) recommended the possibility of a local income tax, while the Lyons Inquiry (2007) proposed improvements to and greater freedom to use existing property taxes. Inquiries in Scotland, Wales and London have made recommendations which have included greater devolution of national taxation powers to sub-national (including local) government. The Treasury has reviewed the incidence and operation of non-domestic rates in England, leading to reliefs for smaller ratepayers.

Recently, a number of councils have themselves proposed the possibility of introducing some form of tourism tax. Local authorities in Edinburgh and Bath & North East Somerset have taken steps to encourage their respective governments to allow the use of such taxes. Westminster City Council introduced a voluntary additional levy on higher-value homes for 2018-19 and has advocated powers to raise council tax levels on such properties.

But there has been no government review of local government finance in England since the Lyons Inquiry, which itself led to no significant change. Council tax continues to be based on house price valuations in 1991 and is clearly in need of revaluation. Capping has been retained, though the government has latterly allowed authorities to put up council tax by

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larger annual percentages than hitherto so as to provide additional resources for adult social care. Non-domestic rates, which are to some extent a local revenue, have been criticised by a number of business groups for their impact on, for example, traditional retailers.

The system continues to function. However, there is no consistent relationship between what councils spend and the taxation they raise. Changing levels of central support mean that in a particular council in a particular year an increase in council tax may be associated with falling spending on services. Or, in the past, vice versa. There are powerful reasons to believe that a full review of the local government finance system in England is overdue.

**How funding needs of local government are assessed. The current and forecast needs of local government and how these needs can be better understood at both a national and local level**

England (and other UK nations) evolved highly-sophisticated needs assessment arrangements since the 1960s. Full equalisation of relative spending needs and actual tax resources was a key objective of the system of local government finance operated, much aided by the increasing availability of computing power. Formulae which attempted to measure drivers of councils’ need to spend were the subject of annual negotiations involving central government and local authority representatives. Grants were then adjusted each year to reflect changing relative circumstances.

Central government controls the amounts each council can spend by applying maximum annual council tax levels, by allocating grants and, effectively, by allocating a share of retained business rates. Overall, the determination of each authority’s ‘spending power’ is really about relative spending. Urban authorities tend historically to have had higher assessed needs than rural ones and thus today have higher spending, albeit the relative difference has narrowed since 2010.

The government does not assess councils’ overall need to spend in order to deliver a particular level of service. Indeed, no such minimum levels of service spending exist. Rather, Whitehall sets an annual total for local government expenditure and then, effectively, allocates this amount between councils. There is no periodic assessment of local authorities’ absolute need to spend, simply of the relative needs of one council in relation to another.

It would in theory be possible to measure how much local government needs to spend to deliver the services it is required to deliver, though previous efforts to determine minimum spending levels have proved difficult. However, it would also be possible to ask an independent organisation such as the Office for Budget Responsibility to report annually on the relative spending needs of local government services as compared to, say, the NHS or education. This could be done by reference to demographic and other data.

There is no way of allocating resources between councils which all of them will judge to be ‘fair’. The Fair Funding review is a cake-cutting exercise, however complex and well-researched the formulae that are used within it. In addition, the way in which equalisation works is almost impossible to explain. Changes to a council’s relative needs and resources
feed through into its spending power by means of adjustments to elements buried within the operation of business rates and residual grant funding. It is virtually impossible for anyone other than a small number of experts to understand how an individual council’s spending power has been arrived at. Accountability is not well served by such arrangements.

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 of new or alternative approaches to the provision of funding within the review

The government is committed to delivering the results of the Fair Funding review from 2020-21, which is the first year covered by the 2019 Spending Review. Any redistribution of spending power from council to council will take place within a total fixed by the Treasury. If there is no increase in overall spending power in 2020-21, the Fair Funding review will, in effect, simply take spending power from some councils and give it to others. It would be possible to allow councils which lost resources to increase their council tax to compensate for lost, though this would compound the impact of recent years’ higher council tax levels.

The 2019 Spending Review is of significant importance to local government. After nine years in which revenue spending has fallen by almost 30 per cent, the Treasury will have to decide if it will continue the pattern of protecting the NHS, State pensions, overseas aid and now defence and, if it does so, whether to continue to reduce council spending. If the government decides to continue to reduce local authorities’ spending power, then it seems unlikely that simply reducing local authority spending by two or three percent each year, on top of reductions made since 2010, would be a plausible way forward. It might be necessary to consider whether councils should continue to deliver the full range of services provided today. But even to consider which local services might cease to be statutorily required would be politically very difficult for ministers. Alternatively, councils could be given access to new revenue sources so as to allow them to continue to fund existing services. There are no easy ways forward.

April 2019