The Spending Review and Local Government Finance

Housing, Communities and Local Government Committee. November 2020

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This submission relates to the following key issues outlined in the terms of reference

- The approach the Government should take to local government funding as part of the 2020 Spending Review and what the key features of that settlement should be.
- The current financial situation of councils, how this has affected their ability to deliver services and the demand for services, including Adult Social Care.
- What the financial challenges facing councils are as a result of the COVID-19 pandemic, including lost income and local tax losses.
- What the impact is of another one-year spending review and a further delay to a multi-year settlement and the Fair Funding Review

1. The approach to local government funding key features of that settlement

On 25 November the chancellor announced the outcome of the Spending Review for 2021/22, including the funding settlement for English councils in the forthcoming financial year. Whilst the reliance on annual budgeting is thoroughly understandable given the dynamic crisis caused by COVID-19 – indeed, one of us has argued previously that such an approach is necessary in an emergency situation (Ferry and Eckersley 2012) – ministers need to introduce a longer-term, more fundamental change to local government finance arrangements after the pandemic is over, led by Parliament and preferably informed by an independent inquiry. This would move central-local relations onto a more stable and long-term statutory footing, make the system more sustainable and transparent, and hence improve accountability. The new system should also incorporate periodic reviews of the key elements as part of its basic design.

A comprehensive and systematic review of local government finance has been warranted since before the turn of the century. Although there were large increases in local authority grant funding between 2000/2001 – 2010/2011, these have been wiped out over the last decade and there has been a fall the funding that local government receives as a percentage of national income, by approximately 8% between 2000/2001 and 2018/19.

The current system is neither fair nor fit for purpose, because *inter alia*, it is based on outdated property valuations, and subject to frequent partial, ad hoc and piecemeal reforms (such as the retention of business rates). The committee in its previous report in 2019 acknowledged that "a revaluation for council tax purposes is long overdue" but in its response the government simply announced that it had "no plans to undertake a review of council tax. Council tax provides a well understood, stable and predictable mechanism for raising funds for local authorities to deliver local services".

There are substantial economic disparities across England (Brien, 2019); long-term structural changes in the economy have meant that councils in more deprived and urban areas are much more reliant on central funding than their more affluent counterparts (Gray and Barford 2018). As Section 3 of our response (below) elucidates, in many cases these same areas have been worst hit by the COVID pandemic, meaning that their councils experienced a major drop in business rates revenue during 2020, as well as reduced revenue from fees and charges (for example for leisure services and car parking). At the same time, many have faced increased demands for housing services, social care, children's services and waste collection – and (in those areas where Universal Credit is yet to be rolled out) housing and Council Tax benefit advice. The pandemic has exacerbated the impact of long-term reductions in central government revenue and capital grants since 2010 – particularly in these poorer parts of the country. These areas are affected more by grant reductions and have less spending power, and as the system moved further towards being dependent on local income generation through fees and charges such as planning fees, this has further increased inequality and inequity. Unacceptable resource variations require an effective mechanism for re-distribution across the system. For many years prior to 2013 it was substantially based on the updated indexes of multiple deprivation.

In the government's response to the MHCLG Select Committee report 'Local Government Finance and the 2019 Spending Review'), it acknowledged the need to "develop a simpler, more up-to-date, evidence-based funding formula for Local Government" (MHCLG 2019. It stated that "we are making good progress on developing a simpler, more up-to-date, evidence-based funding system for local government". At that time the aim was to implement the review in 2021-22, although one of the main issues outstanding after the 2016, 2017, and 2018 consultations was how the proposed system was to take account of deprivation (Sandford 2019). It was also not clear whether the formula would equalise fully for relative resources (which was the historical practice) or whether it would do so only in part. On 30th April the government confirmed a further delay to the Fair Funding Review due to the disruption cause by the pandemic and therefore we still do not know what it will look like.

We agree with the LGA's view, expressed in its submission to the Spending Review, that

> “a three-year Spending Review presents an opportunity to draw a line under short-term budgeting and to allow councils to set reliable medium-term financial strategies. To do so, the Government should commit to a three-year local government finance settlement to follow the Comprehensive Spending Review**.** This should encompass general grant funding, specific grants such as the public health grant and council tax flexibilities” (LGA 2020).

In addition, however, a more structured and transparent process through which subsequent funding settlements are agreed (after 2024-25) would be even more helpful, because it would allow councils to identify how their future funding streams might be affected by developments over the subsequent years. There is a risk that three-year settlements could result in a similar uncertainty towards the end of this period and then a potentially substantial change in the revenue that some councils have at their disposal at the beginning of the next spending review. If the government can create clear and transparent indicators relating to local need and link these criteria to the revenue streams they provide, then this would reduce uncertainty and enable councils to be even more strategic in their long-term financial planning.

The overall approach should recognise that the vast majority of local authority services are needs-based, and therefore, whether it is relative need or absolute need, in the long-term we should be moving to an evidence base that looks at needs across the country and takes into account the totality of public spending within a local or regional area. The key features of the new financial settlement should be:

- A means to generate local taxation and other income and a means to distribute a part of central taxation/income, together with appropriate robust borrowing arrangements.
- A system based on real spending needs that also takes into account the totality of support within an area.
- A dynamic process of resources equalisation. This could for example use multiple deprivation indices and the financial resilience data and assessment being developed by CIPFA and the Redmond Review.
- A review of the national local authority database held by government against contemporary needs and uses rather than utilising the existing legacy system.

2.**The current financial situation of councils, how this has affected their ability to deliver services and the demand for services, including Adult Social Care.**

Unlike in earlier historical periods, cuts in local government funding over the last decade have been accompanied by consistent upward service pressures. During this period the population has been growing and, as we pointed out in previous evidence to the committee in its 2019 inquiry, the parts of the population that rely more on local authority provided services have been growing more quickly than the population as a whole (HCLG Select Committee 2019a). As government macroeconomic policies since 2010 have protected significant parts of spending from reductions, unprotected areas such as local government have fallen disproportionately. This has had a significant impact on non-statutory local services in particular, as councils have had to re-allocate budgets towards those functions that they have to provide by law. Corporate and regulatory functions such as planning or trading standards have also been severely affected, meaning that many councils lack not only the capacity to think strategically about future place-shaping, but also the operational resources to implement and enforce existing policies (Eckersley and Tobin 2019).

To illustrate how council spending priorities have shifted in recent years, at the last select committee inquiry Professor Tony Travers pointed out that the proportion of local government spending that is devoted to social care rose from 44-45% to nearly 60% between 2000/2001 and 2018-19 (HCLG Select Committee 2019a). Despite this increase, however, demographic changes and smaller council budgets overall in real terms mean that this level of spending is still insufficient. As the committee's most recent report on adult social care highlighted, there is need for new revenue resources both at a local and national level: "Local government must be given additional central government funding or powers to raise more revenue to deal with growing demand" (MHCLG Select Committee 2019b). Furthermore, there are also wide geographical economic and social disparities in the demands on the service. Both factors have been highlighted and exacerbated by COVID-19, but the underlying trends were already apparent prior to the pandemic and are unlikely to change in the foreseeable future. If anything, they are likely to reassert themselves as health inequalities continue to increase.

In its response to the Select Committee report *Local Government Finance and the 2019 Spending Review,* (MCLG 2019), the government recognised that "Local Government is under increasing pressure because of the rising demands of social care". It provided extra resources in the short term via dedicated grant across adults and children's services and a temporary precept for 2020-21 and committed to a clear plan "to fix adult social care and give vulnerable people the dignity and security they deserve". As with the overall funding settlement for 2021-22, we understand and recognise the need for the Chancellor to introduce emergency arrangements for social care in the next financial year, due to the uncertainty caused by COVID-19. However, we also note that the Association of Directors of Adult Social Services described the additional resources available for 2021-22 as "fragmented" and falling "alarmingly short" of what is necessary even to stabilise the current situation. It is over nine years since the Dilnot Report (Dilnot Commission 2011). We are still waiting for a clear plan that would put adult social care on a secure financial footing and enable the sector to plan strategically for how it might develop over the medium and longer term.

3. What the financial challenges facing councils are as a result of the COVID-19 pandemic, including lost income and local tax losses.

In its submission to the Comprehensive Spending Review in September 2020, the LGA drew on estimates from the Institute of Financial Studies (Ogden *et al.* 2020) to suggest that another £2 billion might be needed this year to meet all the pressures and non-tax income losses that councils have experienced and will experience as a result of COVID-19. Further, the LGA cautioned that this could rise to £3.1 billion, depending on whether councils' assumptions about the end of the pandemic are correct. Additional funding will also be required to cover local tax losses, as well as one-off costs that will be incurred to help local areas recover from the impact of the pandemic.

These estimates did not take account of the tiered restrictions since September, the second wave of infections that began in October 2020, any possible third wave that may occur in the New Year following the relaxation of restrictions over Christmas, nor the recent announcements about vaccine development. They clearly could not take account of the Chancellor's announcement on the 25th November. As such, they will need to be recalibrated in the in the light of the latest information available and the changes in the risk environment. The LGA also mentioned other significant pressures set out in the IFS report, such as the fragility of the adult social care provider market and the impact of a future revaluation of pension funds, which could lead to a funding gap of £5.3 billion by 2023/24 "even if council tax increases by 2 per cent each year and grants increase in line with inflation". Although Brexit is not the focus of this particular committee inquiry, the end of the transition period on 31 December will result in additional financial challenges for local government, due to uncertainties over business rates, grant funding and other revenue, which are likely to persist even if the UK and EU are able to agree and ratify a trade deal before the end of the year.

The IFS agree that the UK was still in a period of great uncertainty, with no allowance made for longer-lasting service demand impacts of COVID-19 to councils. On behalf of councils, the LGA (2020) called for

> "a multi-year financial settlement which provides local government with certainty over their medium term finances, sufficiency of resources to tackle day-to-day pressures and the lasting

impact of COVID-19 on income and costs, and that recognises the benefits of investment directed by those closest to the opportunities for shared prosperity".

As we outlined in Section 1, we would echo these calls for longer-term stability in local government funding arrangements, which should be underpinned by transparent criteria that ensure councils receive funding based on local needs. Such an eventuality would help to mitigate the financial challenges caused by pandemics, severe weather events or other major shocks in the future.

4.What the impact is of another one-year spending review and a further delay to a multi-year settlement and the Fair Funding Review

The pre-2013 local government finance system included a complex and fine-grained annual assessment of local authority need. The Government discontinued this assessment when it introduced the Business Rate Retention Scheme. By 2016, the then Secretary of State recognised the problems with this approach when announcing the Fair Funding Review, acknowledging that the underlying assessment of needs had not been updated in "more than 10 years". Any further delay inevitably exacerbates this sub-optimal pattern of distribution as, at best, it can only be implemented from 2022/2023 at the earliest and will in any case involve some transitional arrangements (the 2018 consultation invited comments on four principles to govern a transitional system as this too remains unresolved).

Individual councils will develop their own specific responses to the delay, in accordance with their own needs and priorities, and some will be more affected by it than others. Therefore, it is difficult to make a general statement about how we expect it to affect local government across England. However, although the delay is both inevitable and understandable due to the pandemic, it will impact on all service users and recipients; it impacts on all local authorities and the strategic planning of future services. It further erodes the confidence and morale of those delivering services to the public. It also further compromises all stakeholders' obligations to ensure public money is fairly distributed and that value for money is being achieved. Therefore, we hope and expect that both the multi-year settlement and the Fair Funding Review will be published as soon as possible, to help councils to address these challenges and plan for the future.

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