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Institute for Fiscal Studies

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SCT conference

@TheIFS

# The fiscal state of the nation

# Coming up

- The broad (bleak) economic and fiscal context
- The 2025 Spending Review
- Local government funding
  - Reform of the funding system
  - Impacts across places
  - Our views on key elements of reform
- Innovation, productivity and VfM more important than ever

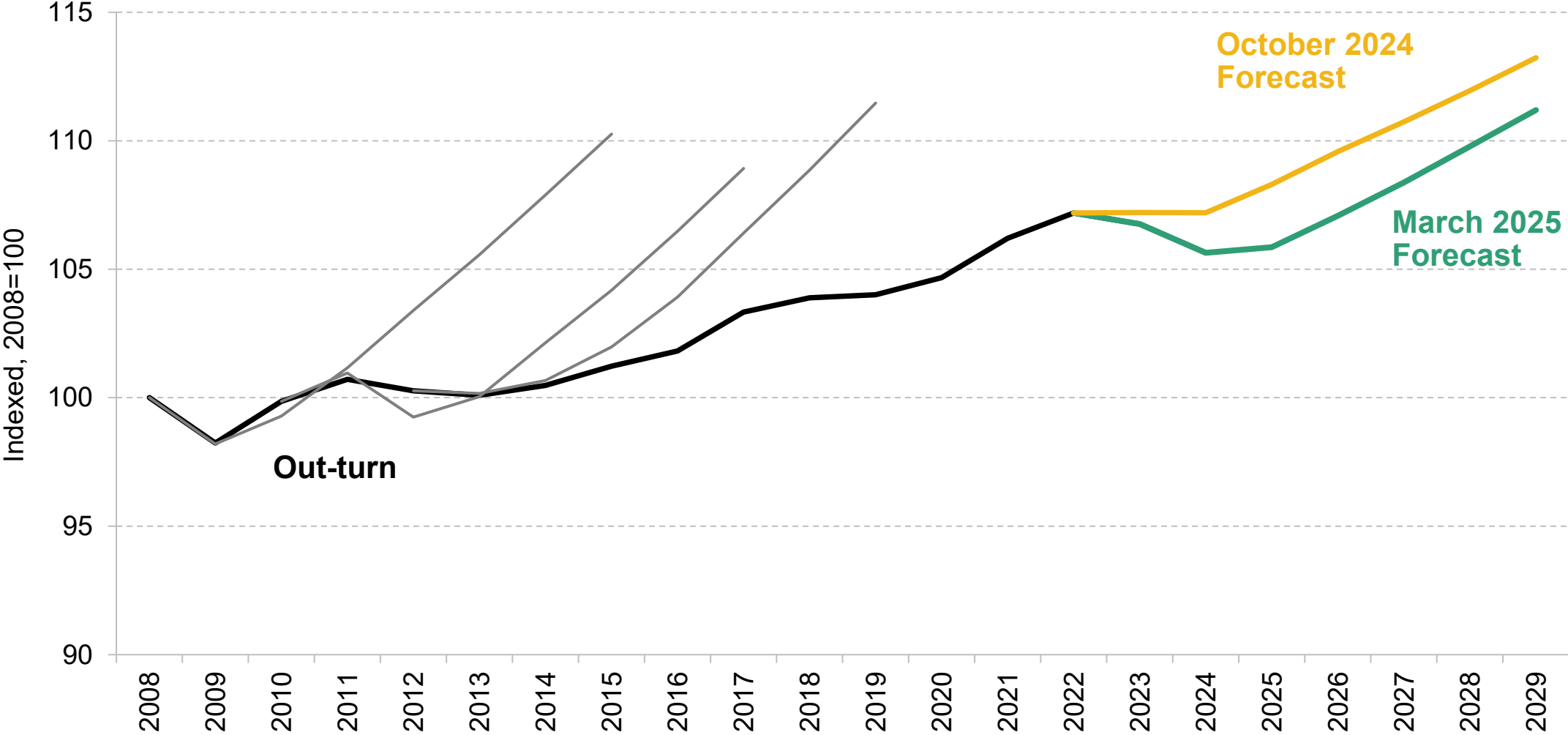


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# Economic and Fiscal outlook

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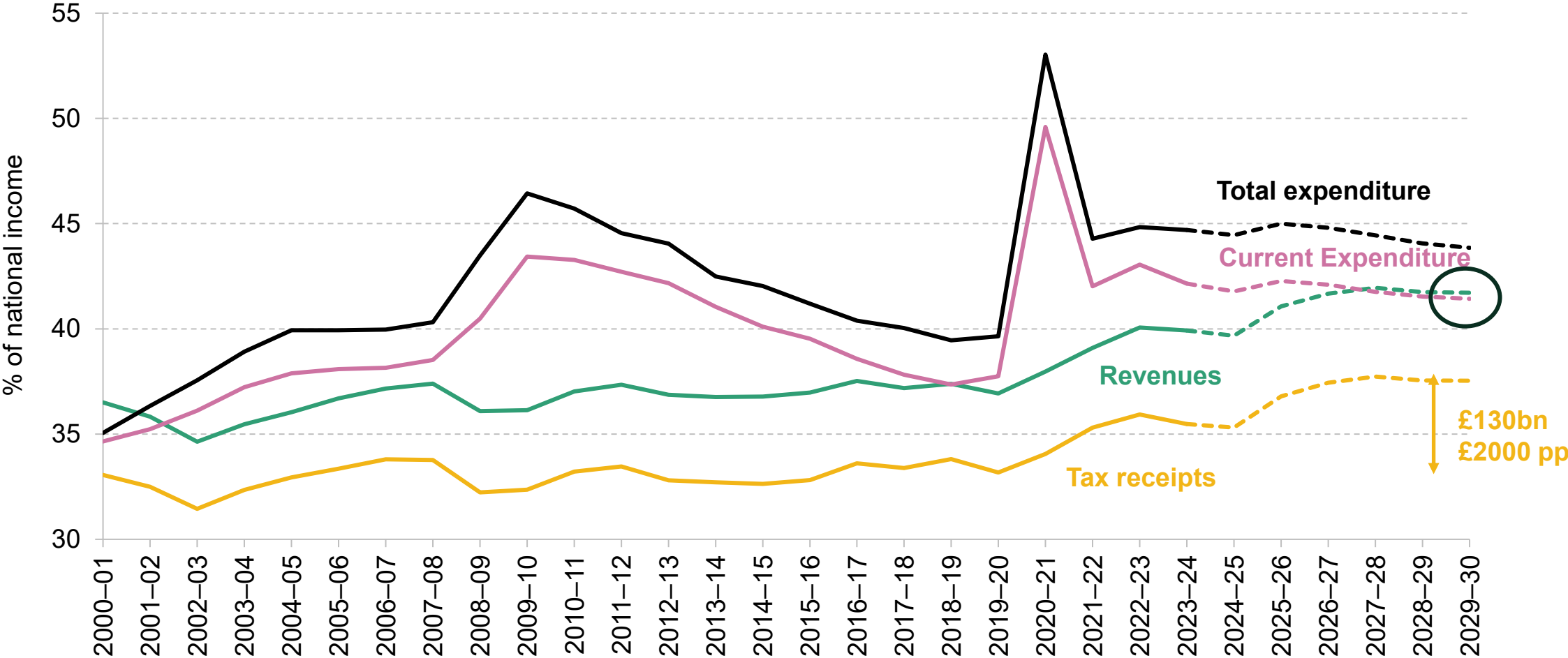
# Poor productivity growth holds UK back



Source: IFS analysis of Spring Statement 2025 and OBR EFO (successive editions), <https://ifs.org.uk/collections/spring-statement-2025>.

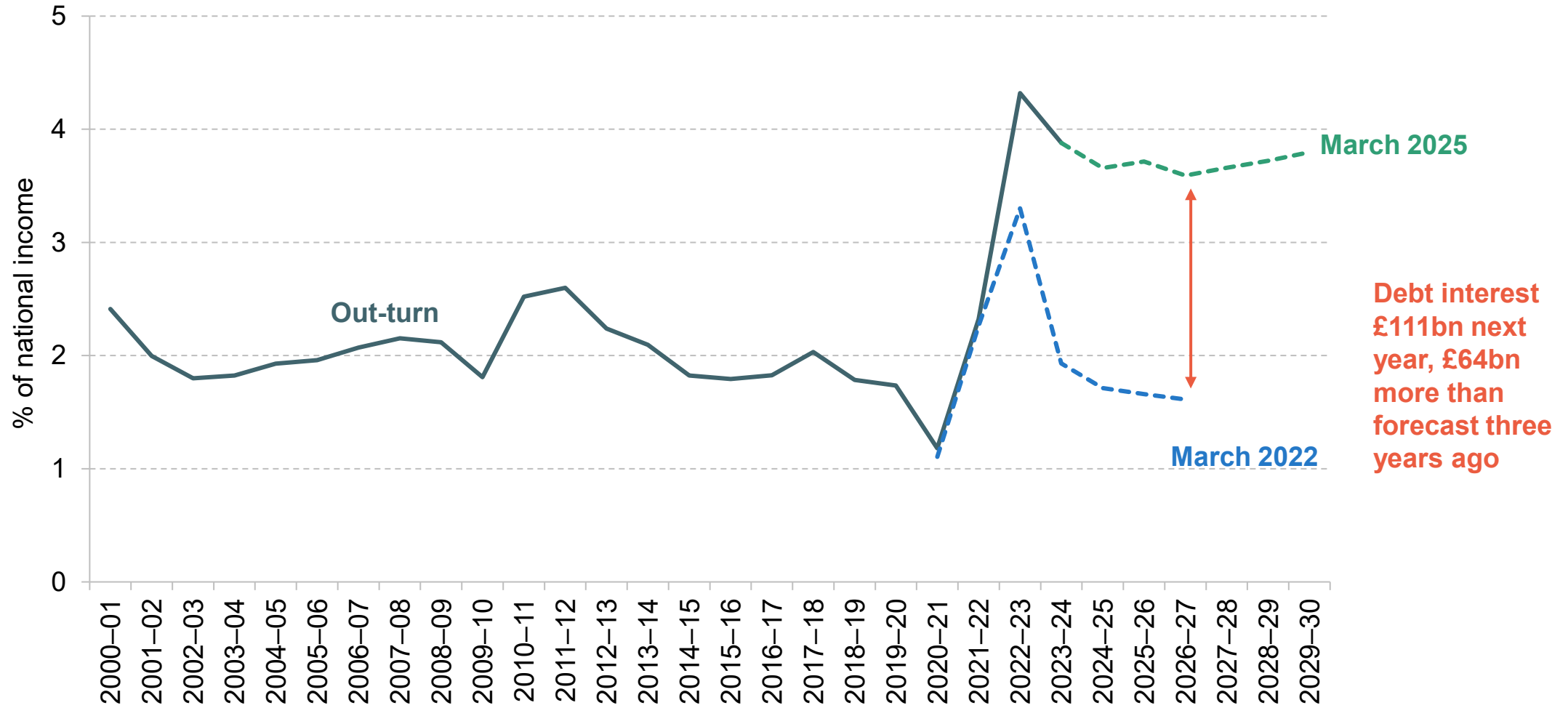
# Spending and revenues at historic highs

Government spending & revenues (out-turn & March 2025 forecast)



Source: Office for Budget Responsibility, Economic and Fiscal Outlook (March 2025)

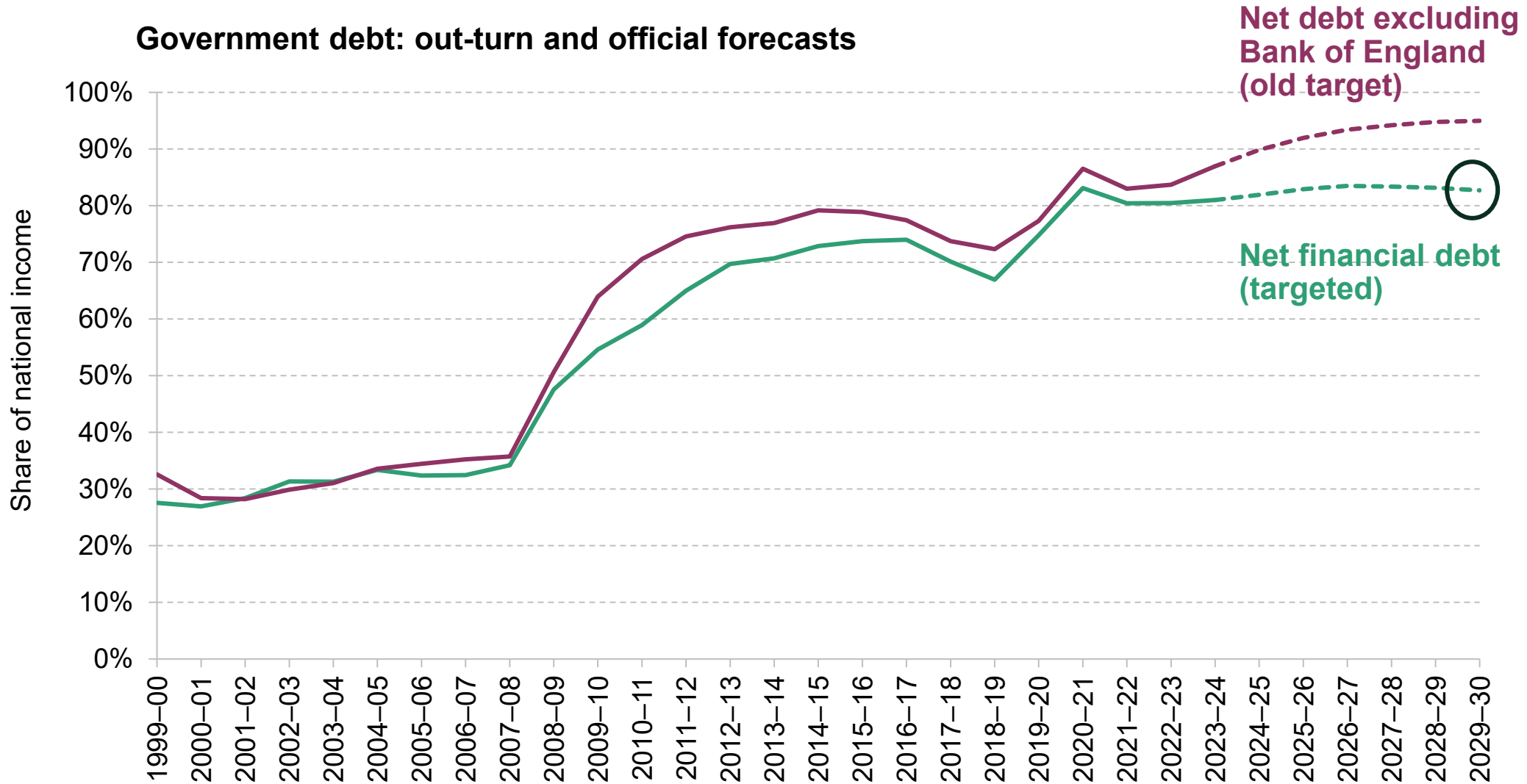
# Debt interest remains elevated



Note: Central government debt interest net of APF income shown; in per cent of national income as forecast/measured at the time of the relevant forecast (disregarding later revisions).

Source: Office for Budget Responsibility, Economic and Fiscal Outlook (successive editions).

# Debt high and only stabilising by 2030



# Risks to the forecasts...

- Even in March, OBR say only slightly better than 50/50 chance of meeting fiscal targets
- Since then
  - Donald Trump's trade policies have become clearer
  - Policy u-turns on disability benefits and winter fuel payment, costing over £6 bn a year
  - Rising govt borrowing costs, especially for long-dated gilts (e.g. 5.5% for 30 years vs 5.1-5.2% back in February), potentially costing similar amount
  - OBR reassessing productivity growth assumptions
- ➔ Fiscal forecasts likely to be downgraded in November Budget
- Forecasts assume fuel duty increases – breaking 15 years of 'one-off' freezes
- Forecasts also assume planning reforms lead to big increases in housebuilding boosting both demand and supply side of economy but housing held up in cities by BSR
- Govt spending plans assume 1% productivity improvement a year – compared to 0.7% between 2009 and 2019 (and falls during 2000s)

# ... means tax rises expected

- Now seems much more likely than not that tax rises will be announced in Autumn Budget to meet fiscal rules
  - ITV reports HMT's working assumption of £20 – 30 billion per year needed by 2030
  - Will the government continue to rule out increases in rates of income tax, VAT and employee NICs?
    - Threshold freezes, tax bases
  - Will it reform taxes alongside raising revenue to reduce the economic distortions caused by the current tax system?
  - Property tax debate especially relevant for local government
- Changing fiscal rules no panacea
  - UK needs to get its fiscal house in order, and bond markets are nervy



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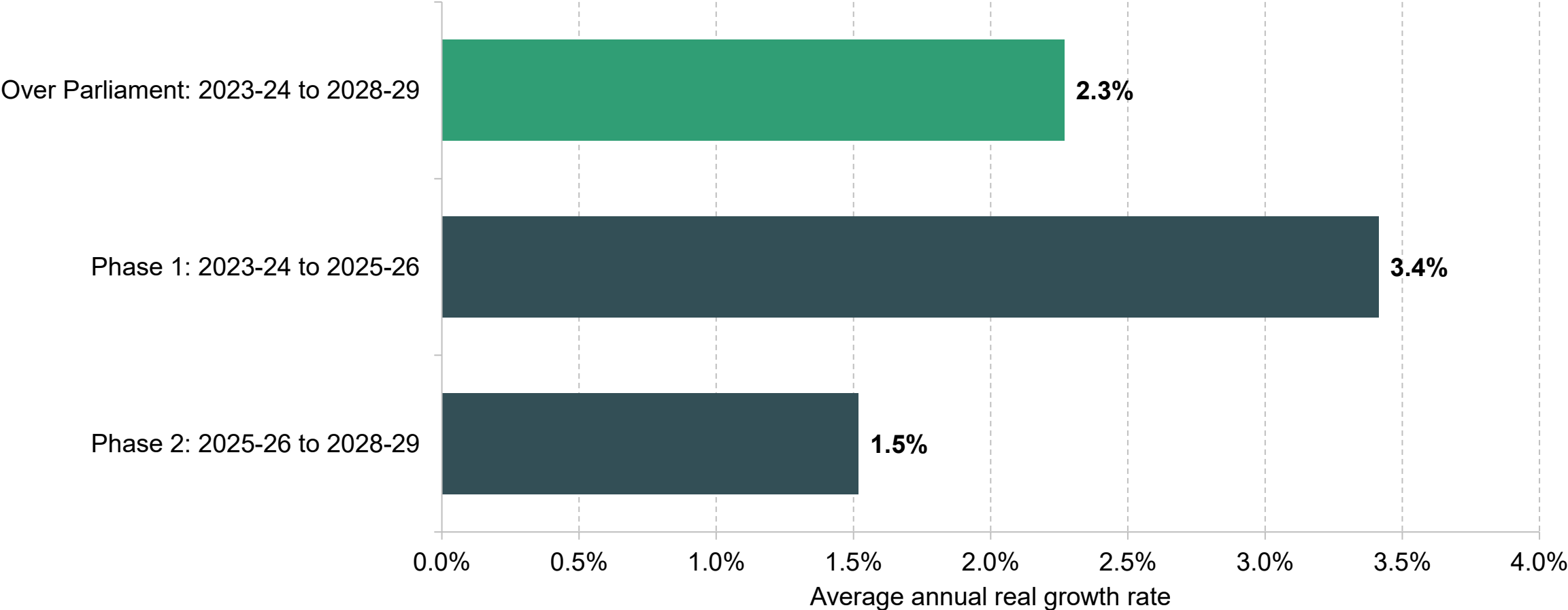
# Spending Review

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# Front loaded increases in spending



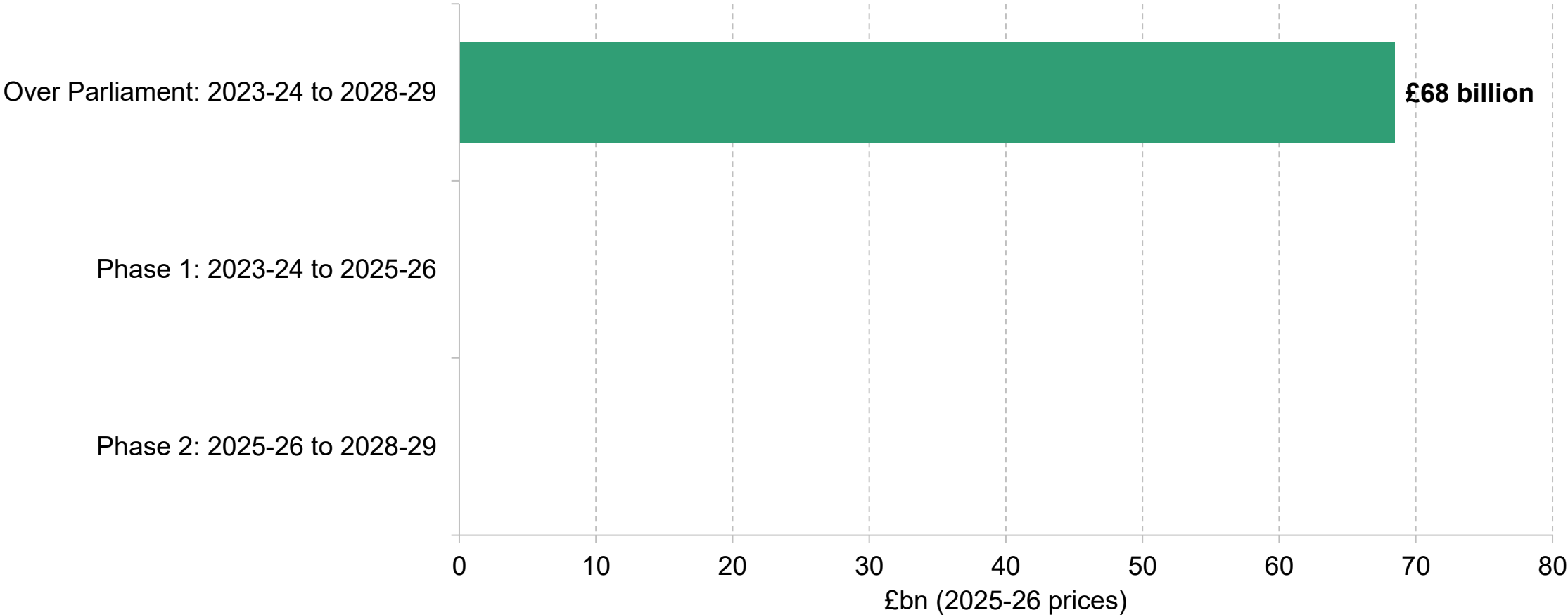
Average annual real growth in total departmental spending



# Front loaded increases in spending

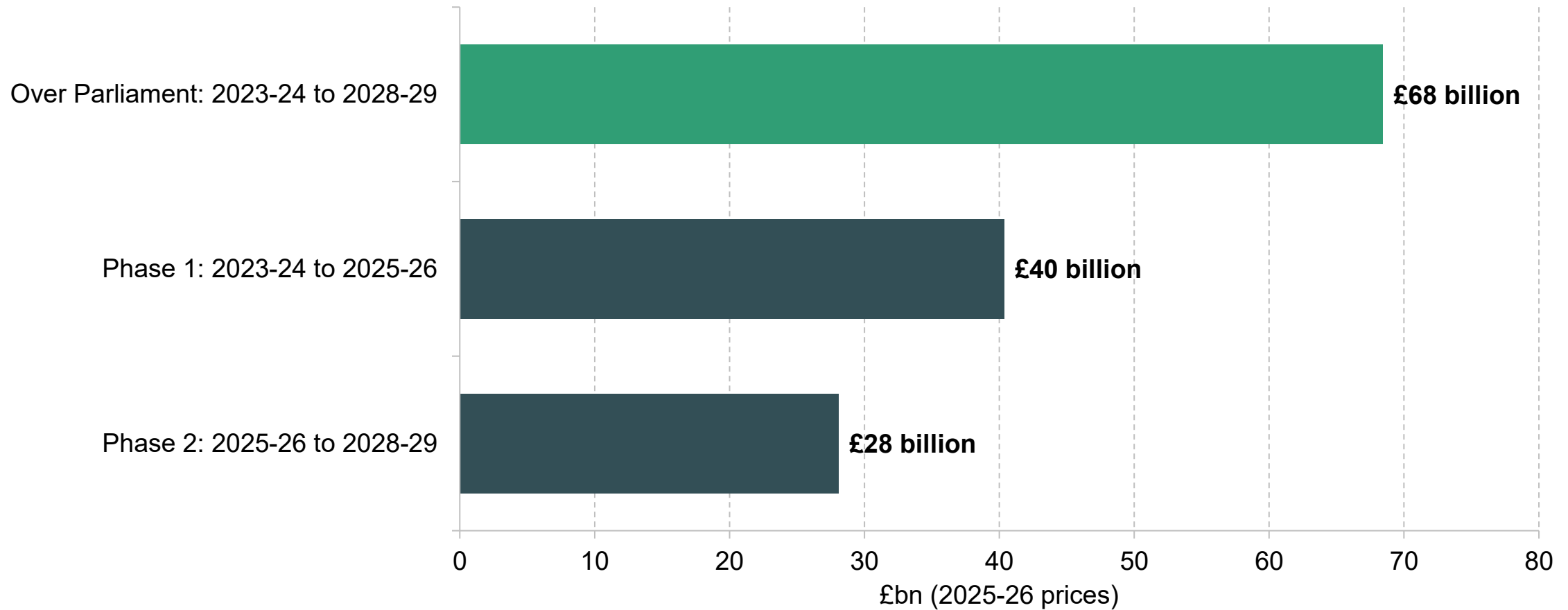


£ billion change in total departmental spending excluding devolved governments, by phase (2025-26 prices)



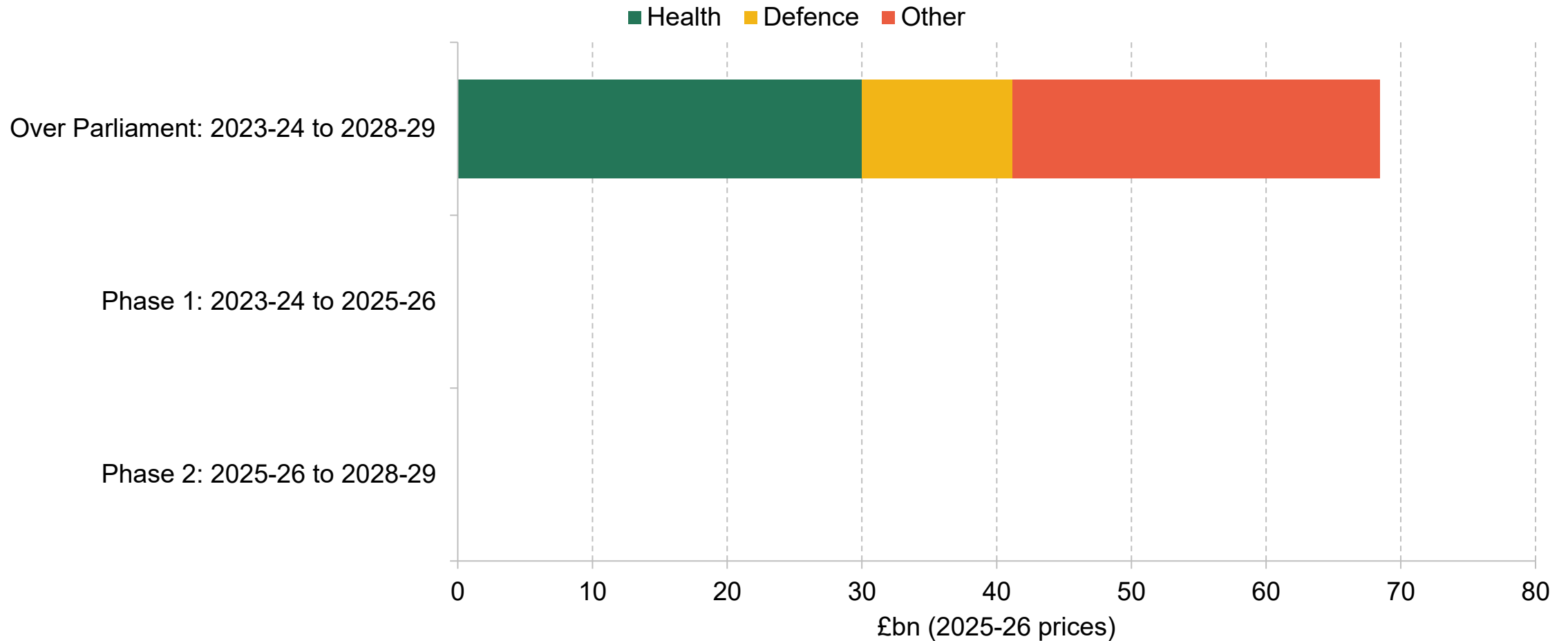
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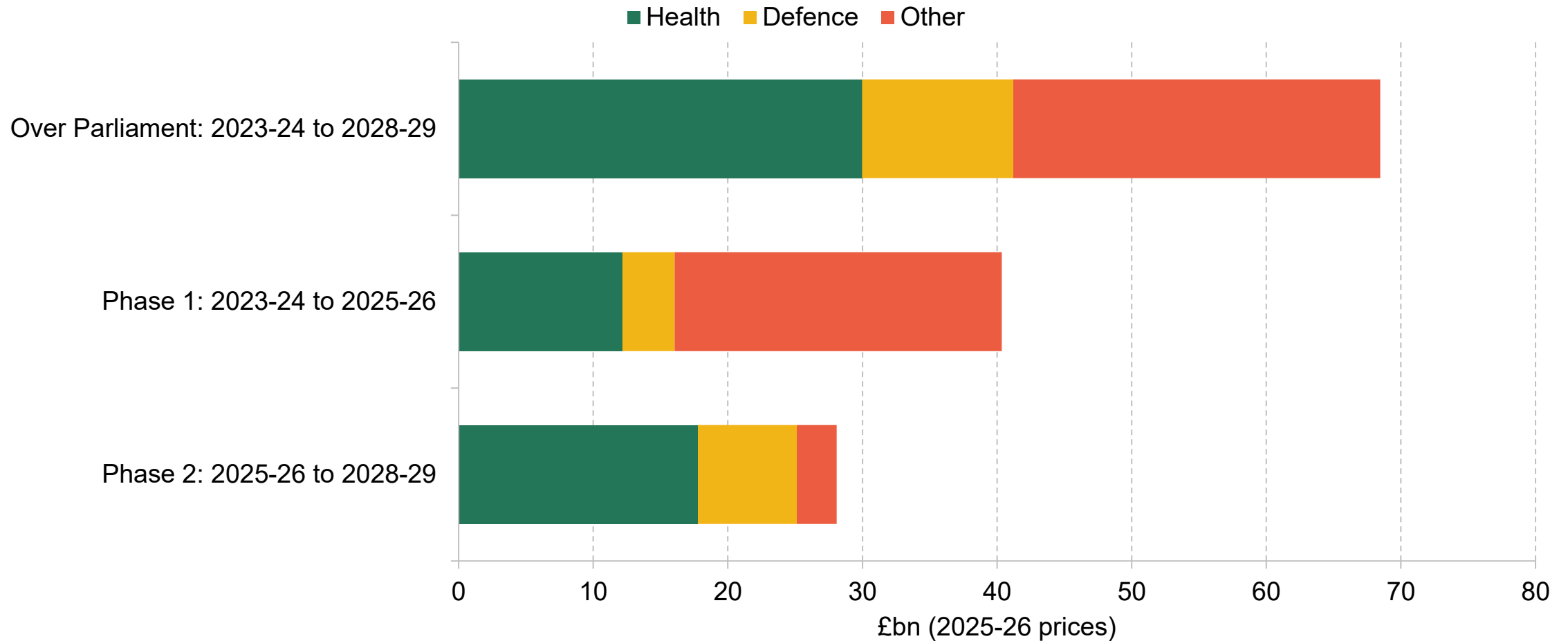
# NHS and defence taking the lion's share

£ billion change in total departmental spending excluding devolved governments, by phase (2025-26 prices)



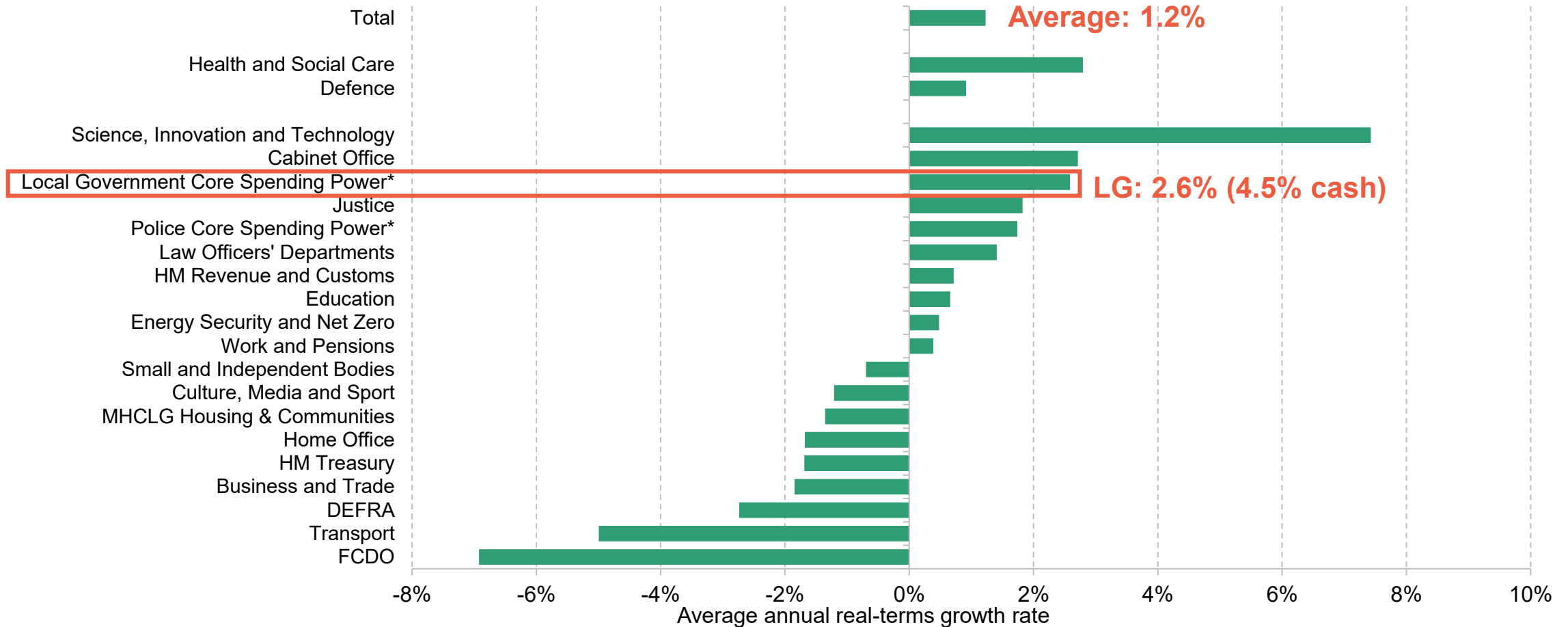
# NHS and defence taking the lion's share

£ billion change in total departmental spending excluding devolved governments, by phase (2025-26 prices)



# Councils doing better than average... if they make full use of council tax raising powers...

Average annual real-terms growth in day-to-day spending by department, 2025-26 to 2028-29



Note: Defence spending combines Ministry of Defence and Single Intelligence Account.

\* Police and Local Government Spending Power also reflects additional revenue from (assumed) increases in local taxes.

# ... but regional growth funding cut

- UK Shared Prosperity Fund being abolished from April
- Several other schemes also coming to end: Town Deals; Levelling Up Fund and so on
- Spending Review highlights instead:
  - 10-year capital settlements for mayoral combined authorities in North and Midlands
    - But is this on top of previous levels of support?
  - 350 deprived communities to receive £20 million each over 10 years
    - So far 244 neighbourhoods selected
    - Based on deprivation, max of 1 per parliamentary constituency
- Lack of transparency over total funding allocated but could be around one-third the amount allocated in early 2020s.

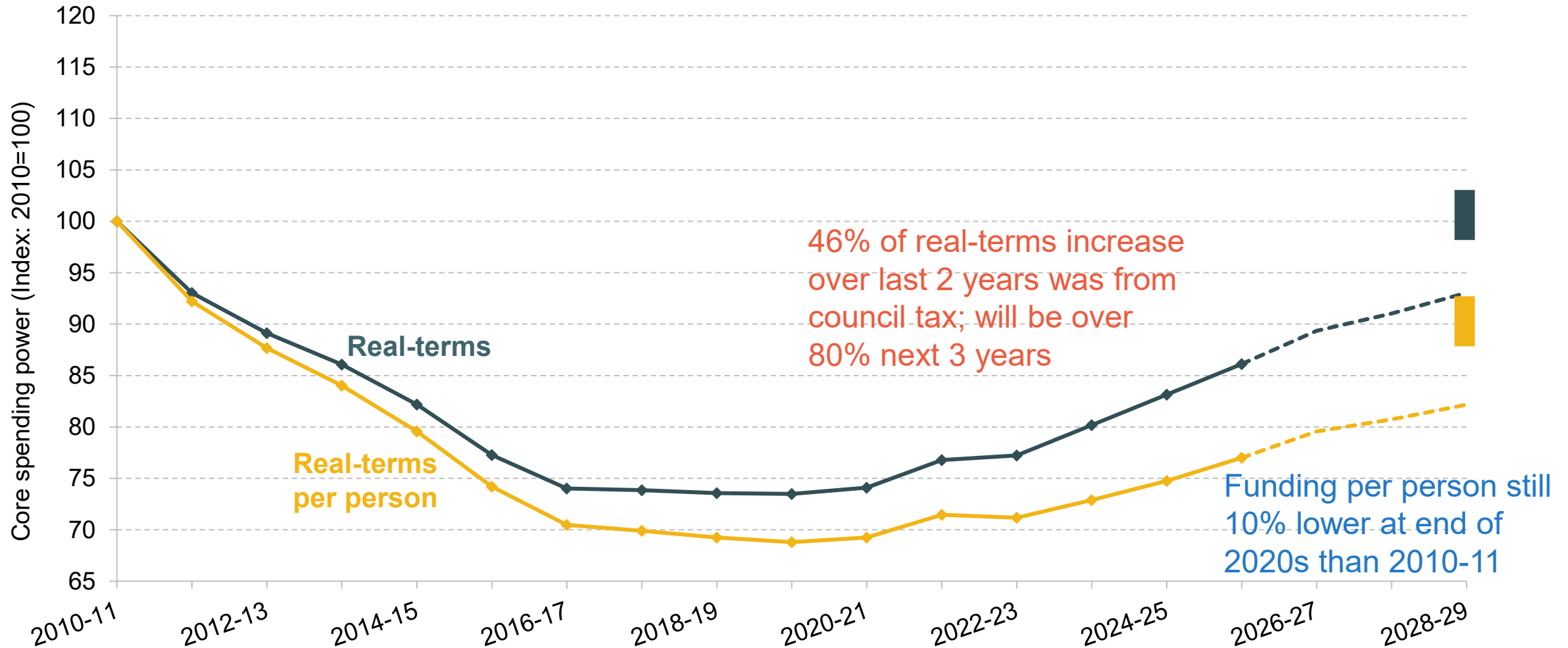


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# Local government funding

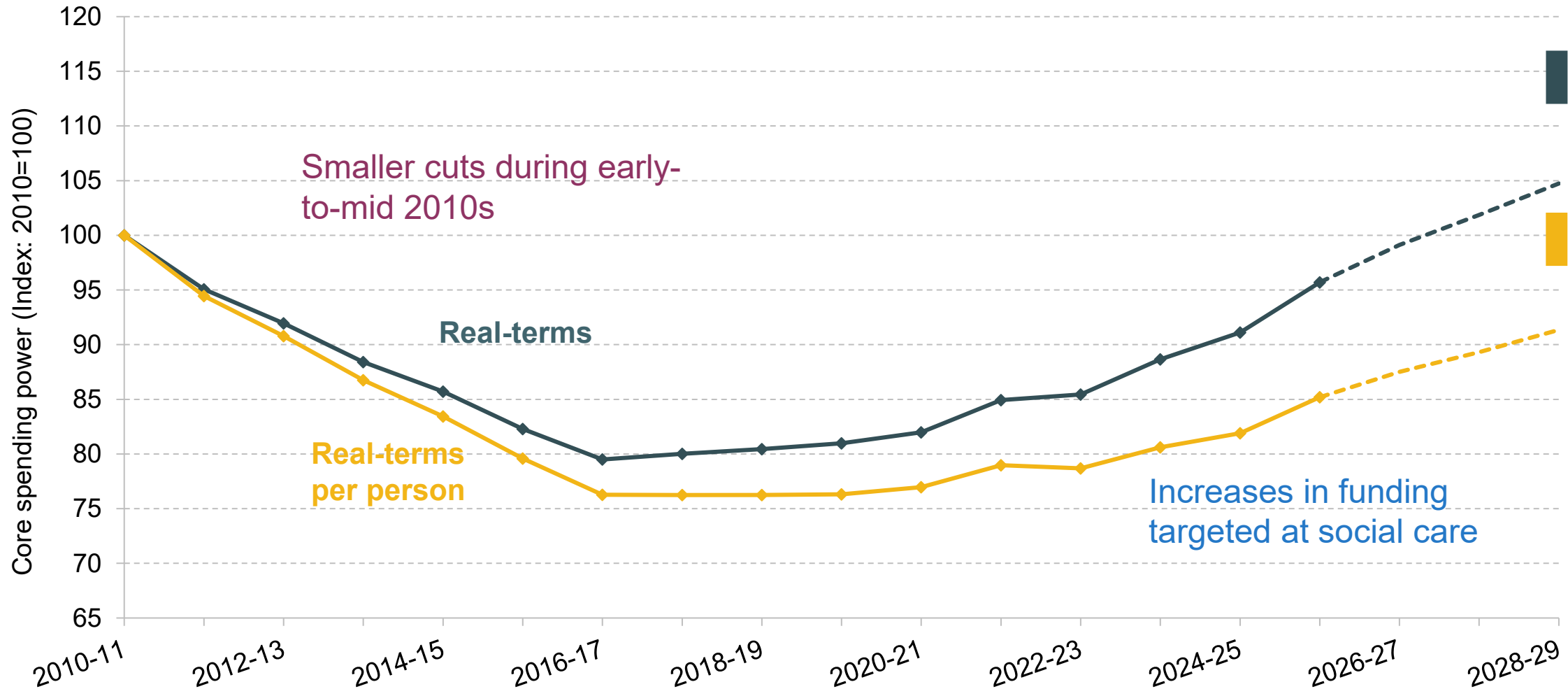
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# Long-run context – main councils



Main results exclude above-baseline business rates growth and funding through the Better Care Fund. The figures for 2025-26 onward are calculated excluding NICs compensation to be consistent with HMT figures. Real-terms figures reflect GDP deflator, and population reflect latest ONS estimates and 2022-based projections. Main councils only. Assumes maximum use of CT rises from 2025-26 onwards.

# Long-run context – SCT members



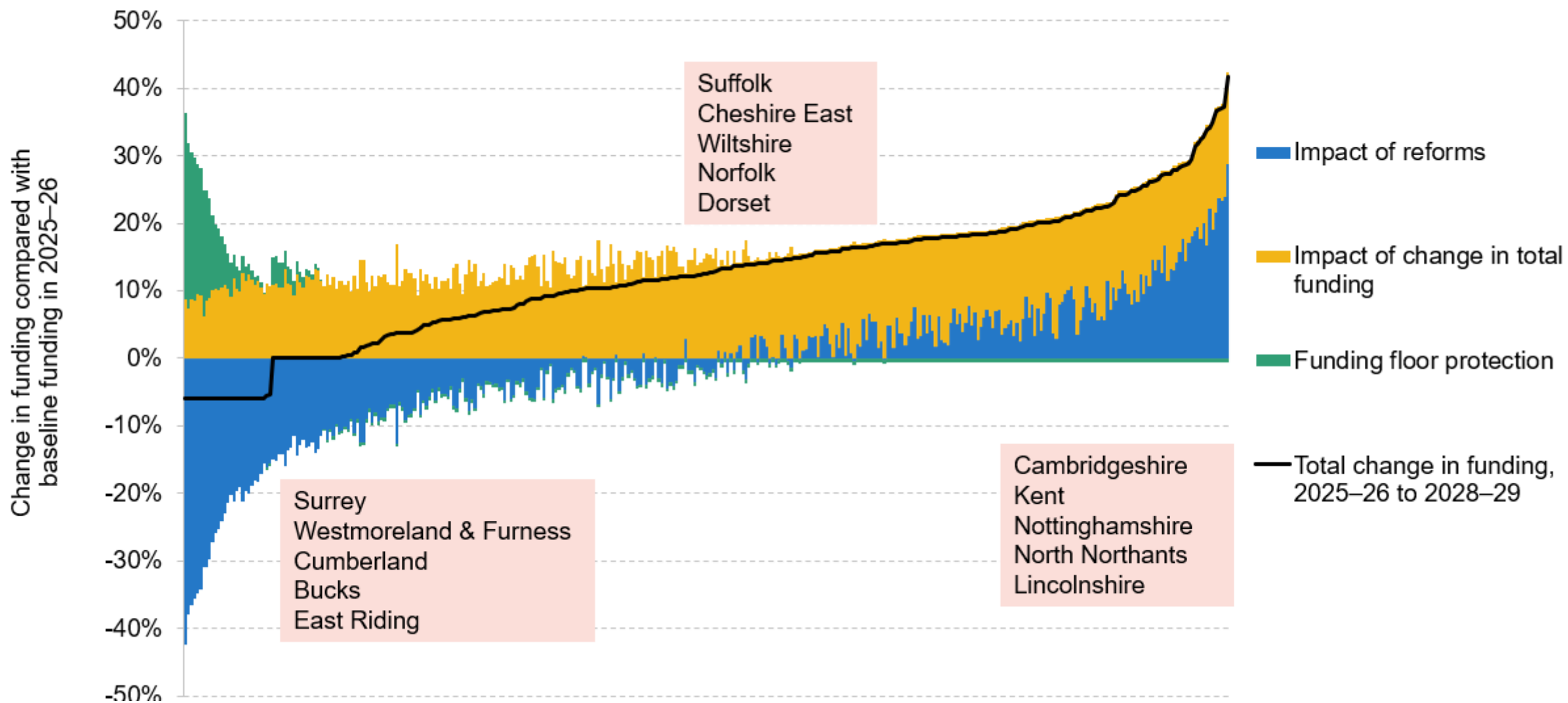
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# Fair Fund Review 2.0



- New system for allocating government funding between councils
  - Revised assessments of needs for and costs of services councils provide
  - Estimate of how much councils can raise via council tax
- Transition over 3 years from 2026-27, with gains & losses both phased in
  - Redistribute retained business rates growth over same timeframe
- Multi-year settlements, consolidating grants, potential SFC flexibilities, etc.
- **Reform is welcome – England has lacked a proper system to allocate funding**
  - Not accounted for population growth for 12+ years, let alone other factors
- But it will create winners and losers, in a context where finances are under pressure

# Fair Fund Review 2.0: estimated impacts



Source: Figure 2.1 of Ogden and Phillips (2025).

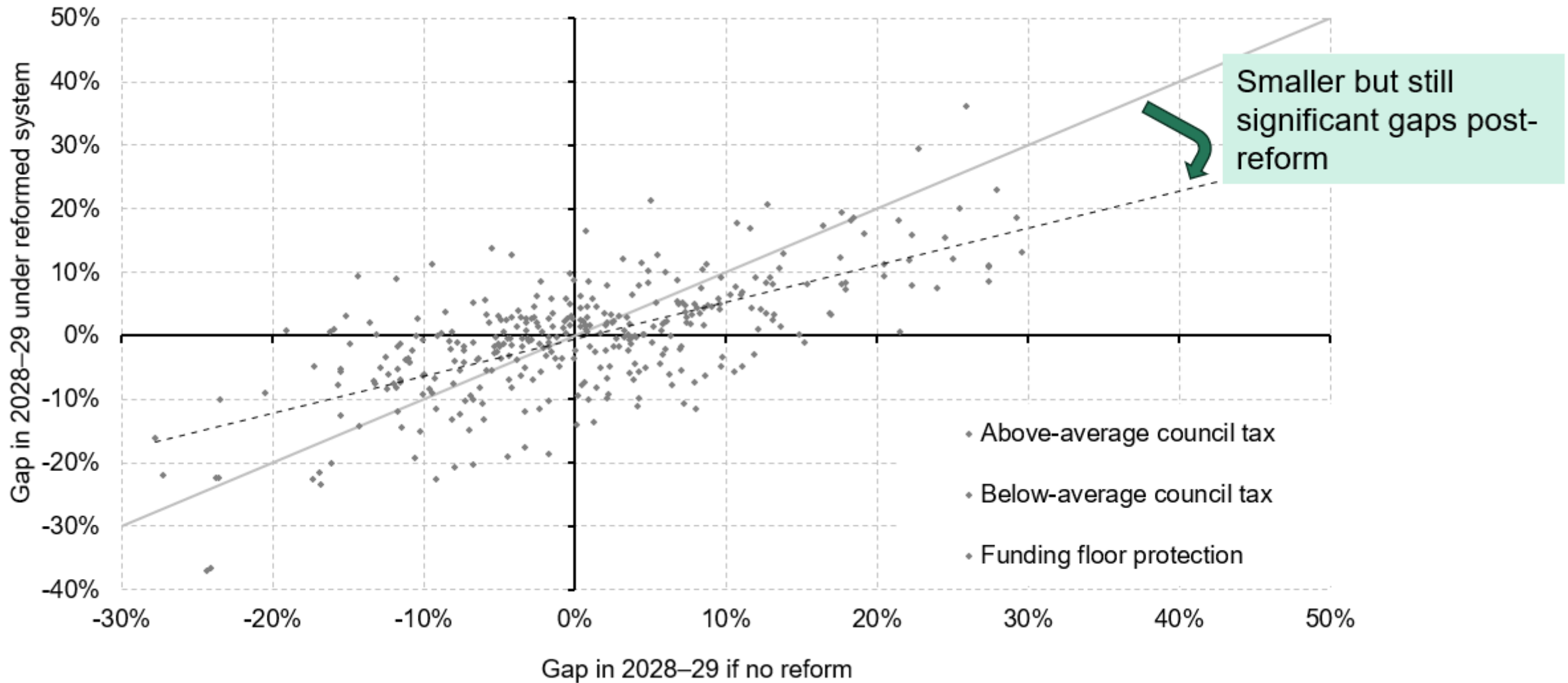
# Average effects by council type

Council type	2026–27	2027–28	2028–29	Reforms
<b>London boroughs</b>	+2%	+5%	+8%	-7%
<b>Inner</b>	-2%	-2%	-1%	-19%
<b>Outer</b>	+6%	+10%	+15%	+2%
<b>Met districts</b>	+6%	+11%	+17%	+3%
<b>Shire areas</b>	+5%	+10%	+15%	0%
<b>Counties</b>	+5%	+11%	+16%	0%
<b>Districts</b>	+3%	+6%	+10%	-3%
<b>Unitary authorities</b>	+6%	+11%	+16%	+2%
<b>Fire authorities</b>	+4%	+8%	+12%	-3%
<b>All</b>	+5%	+10%	+15%	0%

- Most deprived areas do better than least deprived areas
  - But pattern not as striking as 2025
  - Depends on 100% council tax equalisation
- Rural areas do better than expected
  - ‘Remoteness’ adjustment plays a key role
- Factors like population growth, retained rates growth all affect results

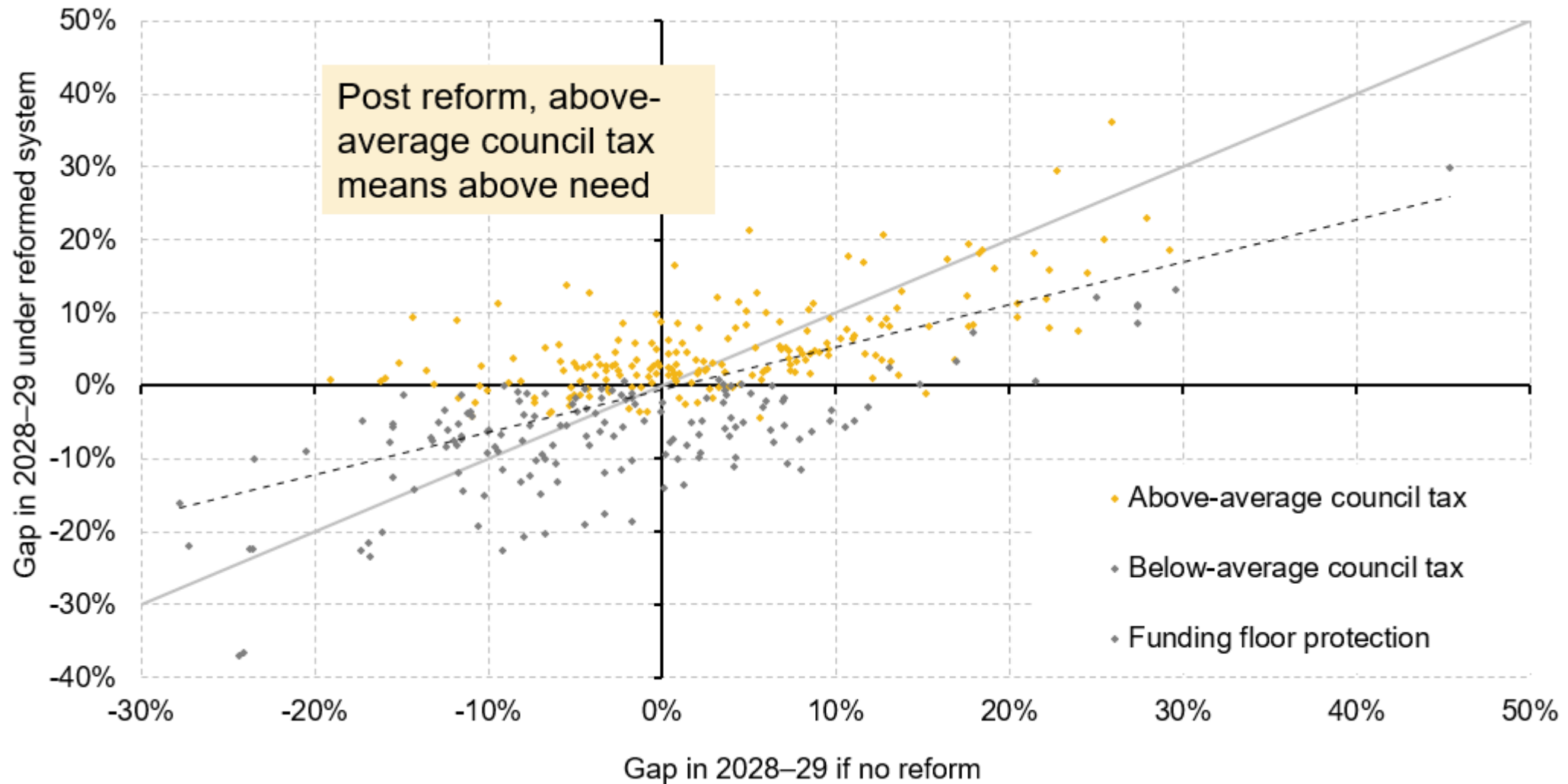
Source: Table 2.1 of Ogden and Phillips (2025).

# Alianina fundina with (assessed) need?



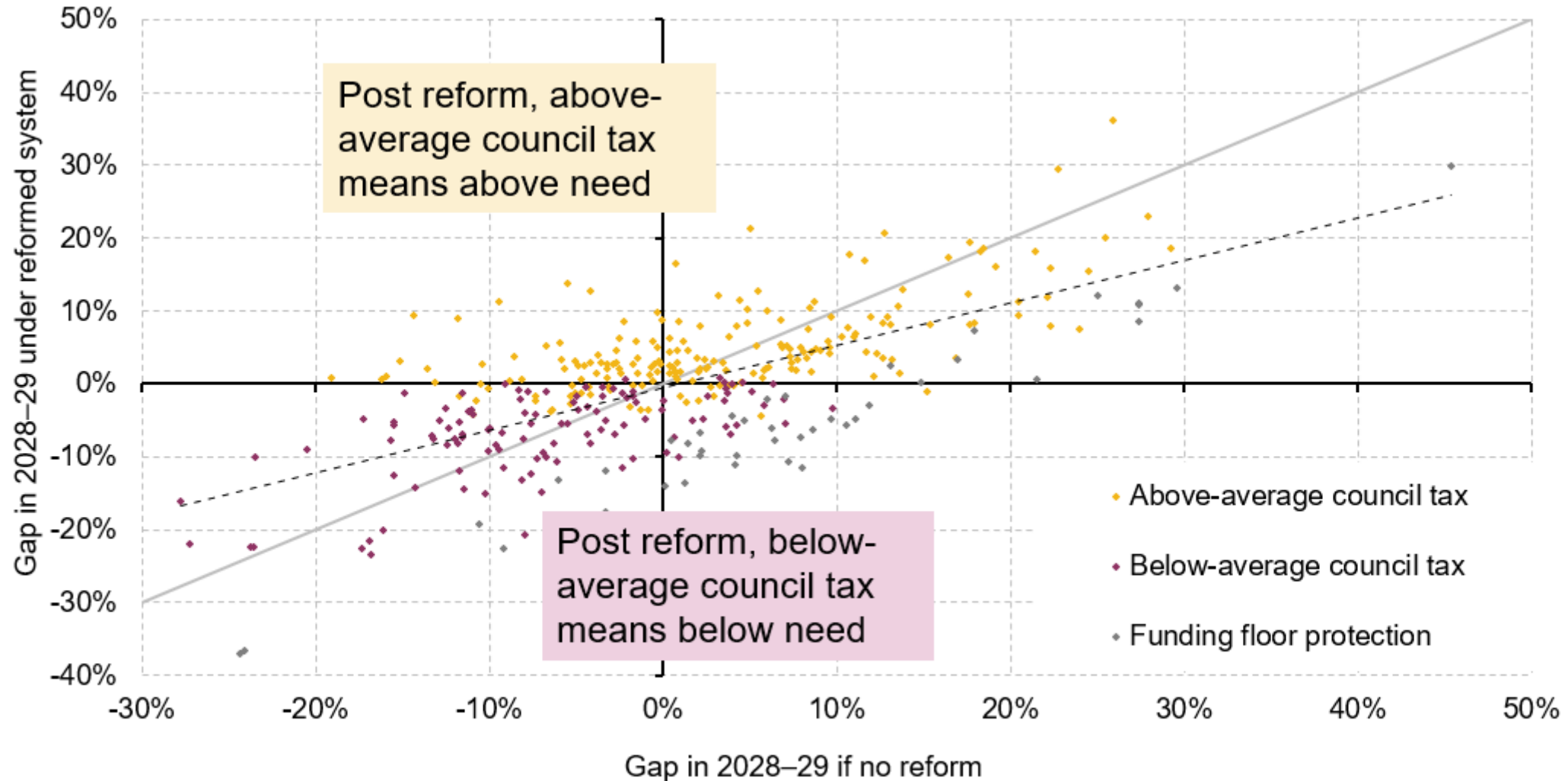
Source: Figure 2.4 of Ogden and Phillips (2025).

# Aligning funding with (assessed) need?



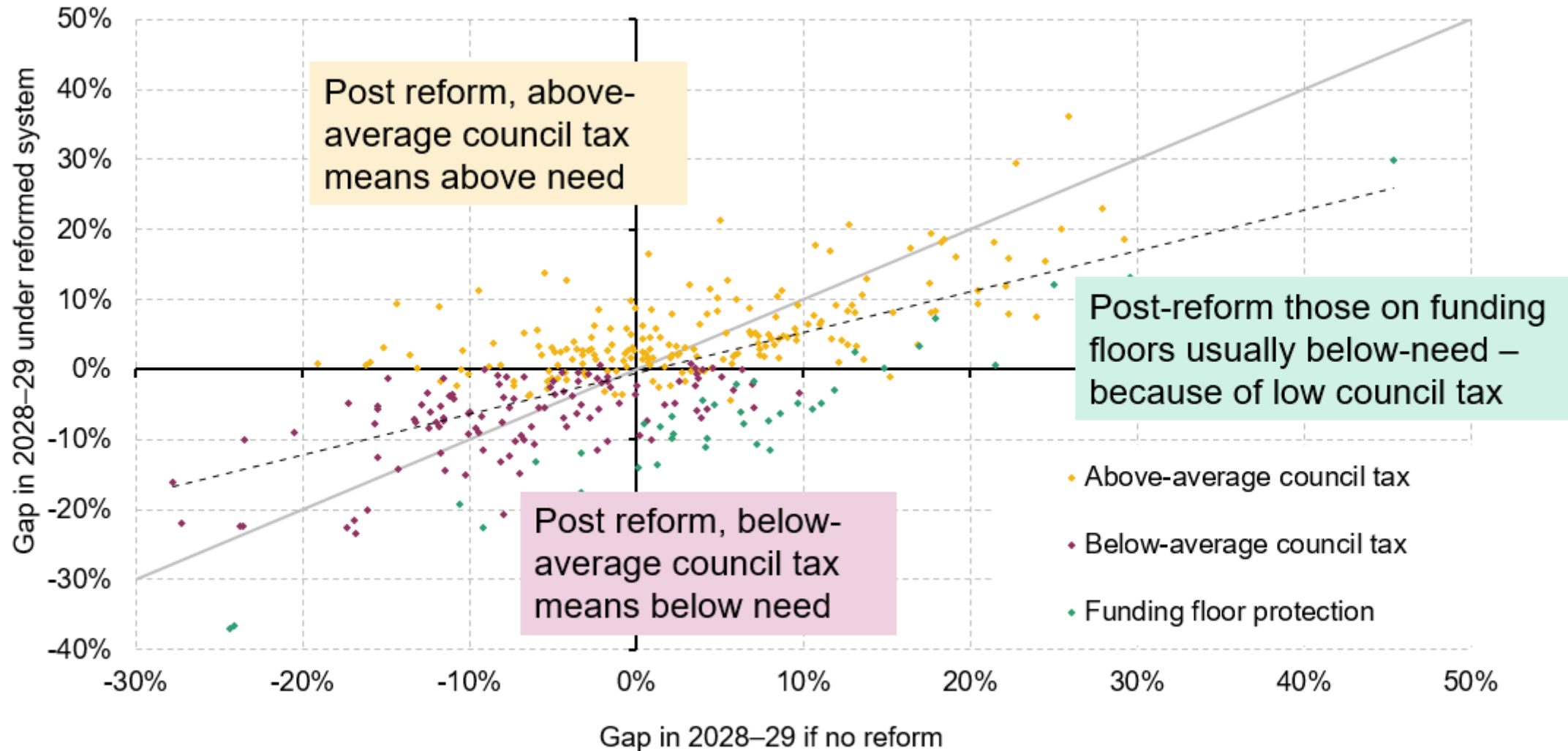
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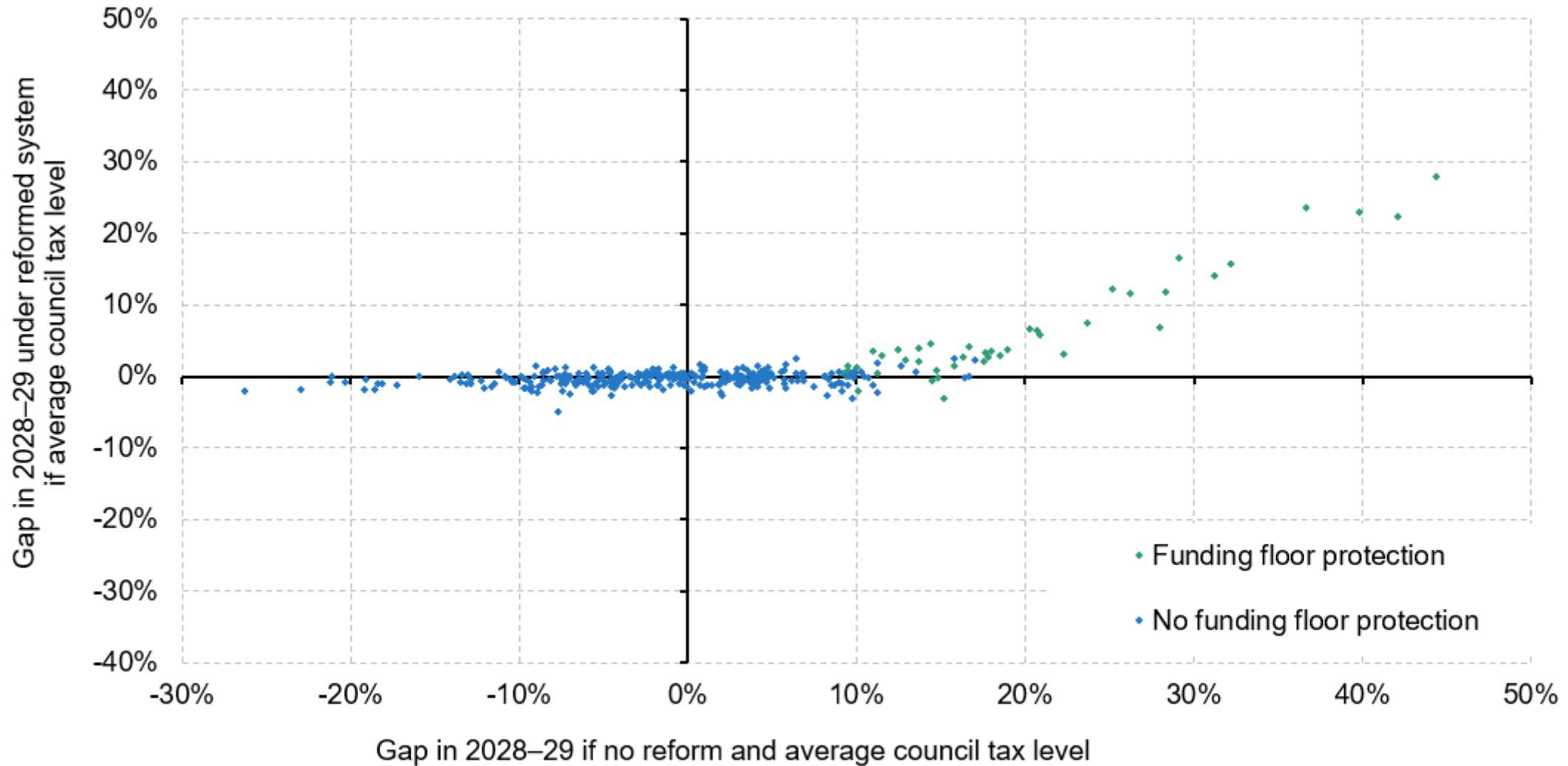
Source: Figure 2.4 of Ogden and Phillips (2025).

# Aligning funding with (assessed) need?



Source: Figure 2.4 of Ogden and Phillips (2025).

# Aligning funding with (assessed) need?



Source: Figure 2.5 of Ogden and Phillips (2025).

# Fair Fund Review 2.0: IFS comments



- Councils facing substantial cuts in funding should be given greater flexibility over council tax, especially where their rates are below average
- Control totals (weights for different service blocks) could quickly become out of date given changing patterns of spending across services
- ACAs could be improved through better understanding of service delivery models
  - Evidence for Remoteness adjustment is fairly weak currently
- Historical accuracy of population projections means its on borderline whether accounting for projected population growth improves or worsens alignment with needs
- More consideration of interaction with LG reform is needed
- Day time populations need to be weighted

More here: <https://ifs.org.uk/articles/response-fair-funding-review-20-consultation-mhclg>.



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# Public services and taxation

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- Adult social care reform unlikely until next Parliament
  - Casey Review will need to consider trade-offs between relaxing the ‘care needs’ test and the ‘financial means-test’
- Children’s social care plans aim to tackle excess profits and re-focus on prevention
  - Placement providers to share financial info, and ‘backstop legislation’ to cap profits
  - Aiming for earlier intervention, better coordination, improved post-care transition
- Special educational needs services changes needed but highly controversial
  - Statutory override extended until 2028
  - Reform to EHCP and associated funding needed to remove ‘cliff edge’

# Property tax reform

- Business rates review continues
  - Initial focus on more support for businesses expanding and losing SBRR
- Reform of residential property taxes?
  - Reported that Govt considering reforms based on an 'Onward' think tank report
  - Onward's proposals would start with replacing stamp duty with an annual property tax on property values over £500k after they have next sold...
  - ...Then replace council tax with an annual property tax on property values of up to £500k, with min £800 payment and 0.44% of value.
    - Some areas see vast majority of properties pay min or max tax: regressive within area
  - Aim of applying only after sale is to ease implementation but this approach could distort property market (undoing much of the benefit of abolishing stamp duty)
  - Little consideration of interaction with LG finance system
  - My view – do this properly both in terms of tax and how it fits into LG funding



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# Summing up

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# Summing up

- National economic and fiscal situation is genuinely very difficult
  - Borrowing and debt high, end of the peace dividend, ageing population
- In this context, local government has done pretty well – assuming 5% council tax increases
  - Very different picture across the sector due to (needed) funding reform
  - Will change in ministerial team mean some change in strategy?
- Need to innovate, prioritise, and improve productivity more vital than ever
  - Capital investment for core public services
- Local government reorganisation will be a challenge given the financial picture but the changes needed to implement can also be used as an impetus for improvement
  - Retain the best from constituent councils, and adopt new tech and approaches

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