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Institute for Fiscal Studies

IFS Green Budget Chapter 7

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What's happened and what's next for councils?

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7. What's happened and what's next for councils?

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Key findings

1 Driven by cuts in central government funding, **English councils' non-education spending per resident fell by almost a quarter in real terms between 2009–10 and 2019–20**. Most of this cut was in the early part of the 2010s, when deep cuts to grant funding were combined with a cash-terms council tax freeze. The lack of a council tax freeze in Wales, as well as smaller cuts to grant funding and Welsh councils using their ability to shift funding from education budgets, means that **Welsh councils' non-education spending per resident fell by more like a tenth over the decade**.

Impact of the pandemic

2 **Overall, the £10.4 billion in additional funding provided by the UK government more than compensated English councils for their estimated in-year COVID-19-related financial pressures in 2020–21.** However, most funding was provided on the basis of relatively rough, up-front needs assessments, and councils were only partly compensated for losses in their incomes, which varied widely. As a result, **underlying the aggregate 'over-compensation', many councils, and particularly shire district councils, were 'under-compensated'**. In contrast, the Welsh Government provided most funding on the basis of *ex-post* claims from councils, which channelled more money to those councils that reported the greatest financial impacts, but could have reduced their incentives to control costs and generate income.

3 **Additional funding is also being provided to councils in 2021–22 to help address the pandemic – but the funding announced so far will likely be insufficient to meet the COVID-related pressures.** In England, around £3.8 billion has been provided to meet higher expenditures and non-tax income losses, but councils forecast that such pressures amounted to £3.2 billion in

the first half of the year alone. We estimate that English councils could face a shortfall in their COVID-19 funding this year of £0.7 billion. This suggests **the government will likely have to provide English councils with additional funding for the second half of this financial year**. The Welsh Government will also likely have to extend its COVID-19 financial pressures compensation scheme, which expired at the end of September.

Medium-term outlook

4 The COVID-19 pandemic is likely to continue to affect councils' spending and income-generating capacity over the next few years. Even as these pressures (hopefully) abate, councils will still face underlying growth in service demands and costs. Under our central projections, English councils would need a £10 billion increase in revenues between 2019–20 and 2024–25 to maintain service levels. **If grant funding for councils moves in line with what current overall spending plans imply, council tax increases of 3.6% a year would be needed to close the funding gap** across the sector as a whole by 2024−25, increasing the average council tax bill by £160 (£77 in real terms) over the next three years. However, **councils will likely face large funding gaps over the next two years without additional grant funding** – unless COVID-19-related spending pressures almost entirely abate by the end of this year. And **uncertainty about the financial outlook is significant, with more of a risk of higher pressures than lower pressures**, not least due to the potential for further significant disruption and long-term impacts from COVID-19**.**

5 **This uncertainty means that setting firm plans for council funding for the next three years is an impossible task.** Instead, the Chancellor and DLUHC should consider setting a baseline amount of funding (plus principles for council tax increases), with a commitment to top this up in later Budgets (or even between Budgets) if necessary. That would allow councils to plan spending on their core services with some degree of certainty, provide them with a degree of assurance that funding will be forthcoming to deal with future COVID-19 surges and potential lockdowns, and minimise the risk of 'locking in' funding that may not actually be needed if COVID-19 pressures abate.

Reforms to funding, and devolution

6 England – unlike Wales – also lacks an up-to-date and coherent system for assessing how much different councils need to spend and how much they can

raise themselves via local taxes. For instance, the allocation of social care funding this year was still based on local populations in 2013. Yet since then, there have been dramatic changes in population: for example, the population of Tower Hamlets has grown by 21%, compared with a 2% decline in Blackpool. **The repeatedly delayed 'fair funding review' aims to address this and should be completed.** Numerous important decisions on the specifics need to be taken separately from the Spending Review, but **it will be easier to transition to the new system if the Chancellor greases the wheels with additional funding** given the potential large cuts some councils could otherwise face. A sensible outcome to the fair funding review would have advantages for the Treasury: by making it easier to target grant funding where it is most needed, it would help reduce the total amount that would need to be provided to councils in future fiscal events.

7 Council tax also needs to be revalued and reformed**, which could contribute to the government's levelling-up agenda**, by ending the current situation where poorer households and poorer parts of the country face taxes that are much higher shares of their properties' values. Unfortunately, the UK government seems to have set itself against reform. The Chancellor should use the opportunity of the Spending Review to at least signal a willingness to reverse this short-sighted decision. If he does not, England could be left behind by Wales and Scotland where welcome reforms to council tax are definitely on the agenda.

8 The UK government has signalled its desire to agree more devolution deals with English councils, with a particular focus on the shire county areas of England that have largely missed out on devolution so far. To help ensure both voters and the Whitehall machinery understand the division of powers in different parts of England, **the government should develop a number of devolution 'packages' rather than have completely bespoke arrangements for each area**, and ensure there is a straightforward and up-to-date central hub for information on what is devolved where.

Social care

9 Perhaps the most significant upcoming reforms for English councils are those planned for the adult social care system. These include a more generous means test, a lifetime cap on the costs people may have to pay privately, and a new right for those paying privately to have their council organise their care – and pay the lower rates councils negotiate with providers. **The £5.4 billion of**

funding the government is providing over the next three years to help roll out these reforms is unlikely to be sufficient to deliver its ambitions in full.

10 **By the second half of the 2020s, the reforms could require up to an additional £5 billion *every year*.** The proposals also leave unaddressed several other concerns with the current adult social care system – including low pay levels for social care workers, and highly stringent needs assessments, which contributed to large falls in the numbers deemed to need social care services in the 2010s. Addressing these issues too would cost billions more per year, and adult social care is likely to remain a financial headache for councils and the Chancellor for years to come.

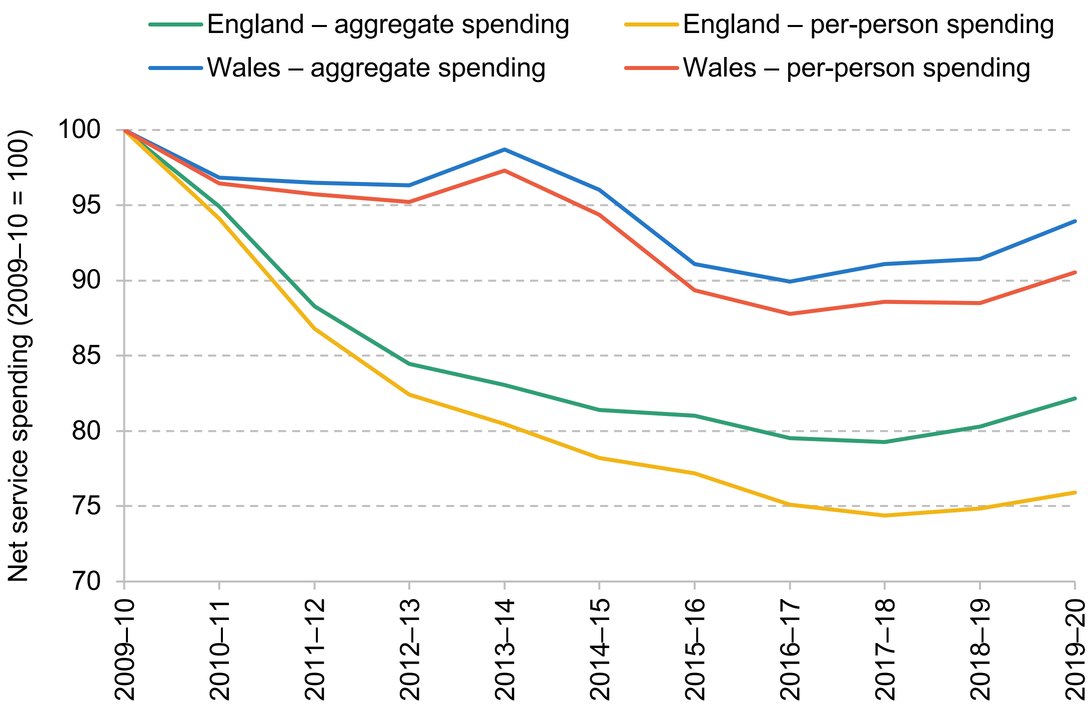
7.1 Introduction

The 2010s were a decade of major financial change for local government across the UK. In England, for example, combined revenues from government grants and local taxes fell by 15% in real terms between 2009–10 and 2019–20, in turn leading to an 18% real-terms fall in spending on non-education services (see Figure 7.1). After accounting for population growth, the fall in spending per person was even larger: nearly a quarter (24%).

Most of these cuts in England took place during the first half of the decade when large cuts to central government grants were combined with financial incentives for councils to freeze their council tax in nominal terms (hence reducing council tax in real terms by 8.5% over the six years between 2009–10 and 2015–16). Since 2015–16, cuts to general grant funding have continued, but significant above-inflation increases in English council tax rates (9% between 2015–16 and 2019–20, undoing previous reductions), combined with increases in grant funding specifically targeted at social care services, have offset most of this. Councils' net service spending was broadly flat over the second half of the decade as a result.

Cuts to local government funding have been smaller in the rest of the UK. In Wales, for example, spending on non-education services in 2019–20 was around 9% lower per person than in 2009–10 – a cut less than half the size of that seen in England. This reflects several factors including: larger council tax increases (up 22% in real terms since 2009–10 in Wales, compared with no change in England); the fact that NHS funding was less highly prioritised in Wales than in England in the early 2010s, freeing up more funding for Welsh councils; and the fact that Welsh school pupil numbers have not increased like in England, allowing more of Welsh councils' budgets to be allocated to non-education services.

Figure 7.1. Councils' real-terms net service spending, England & Wales (2009–10 = 100)



Note: See appendix A to Harris, Hodge and Phillips (2019) for details on adjustments made in England to exclude spending for police, fire and rescue, national park and education services, and other adjustments made to ensure consistency over time. See Siôn (2021) for Wales. Changes in aggregate spending account for general inflation (measured by the GDP deflator); per-person figures additionally account for population growth.

In both England and Wales, cuts in grant funding have meant an increased reliance on council tax revenues. For example, council tax revenues accounted for almost half of non-education funding in England in 2019–20, up from 40% in 2009–10 (and just over a third if we adjust for changes in how bills covered by means-tested discounts for low-income families are recorded).

The 2020s were due to be a decade of both continuity and change for local government. In terms of funding levels, 2020–21 was set to see the largest increase in funding for English councils for well over a decade: £2.8 billion, or 6.6%, in cash terms if all councils increased their council tax by the maximum allowed. This would have more than outpaced underlying increases in costs and demands, and therefore allowed councils to improve the sustainability or quality of services in at least some areas (Harris, Hodge and Phillips, 2019). Similarly, Welsh councils' overall spending power was set to increase by 4.8% – again, the largest increase in more than a decade.

In the end, of course, the UK government's fiscal response to the COVID-19 pandemic meant that the increase in funding was even larger last year. On top of previously planned increases, councils in England received around £10 billion of additional financial support specifically to address the in-year financial impacts of the COVID-19 pandemic, and those in Wales received £0.7 billion.

Councils are being provided with additional COVID funding this year (2021−22), but in England, forecast costs between April and September will absorb nearly all of this, and in Wales, the main financial support scheme finished at the end of September. Moreover, based on the spending envelopes set out by the UK government in advance of the Spending Review, the financial outlook is likely to be very challenging. In particular, the figures imply an average real-terms *cut* in funding for unprotected departments – such as the Department for Levelling Up, Housing and Communities (DLUHC)[1] which funds English councils – of approximately 2.5% in 2022–23, which would not be undone until 2024–25 (see Chapter 5).

Significant reforms to councils' funding arrangement – including to how funding is allocated between councils in England, and to council tax in Wales – are also planned in the next few years. Councils' service responsibilities are also set to see changes, with the aim of further devolution, especially to English counties, and repeatedly delayed plans for adult social care funding finally set to be rolled out. Each of these changes will help tackle issues with current funding and service arrangements but will require careful planning and implementation. And while many of the key decisions will be taken outside the Spending Review and annual budget cycle, the decisions made by the Chancellor – for example, on overall local government funding – could help or hinder these reforms, while their successful implementation could help generate more bang for the Chancellor's buck.

The rest of this chapter proceeds as follows. Section 7.2 looks at the short-term impact of the COVID-19 pandemic on English and Welsh councils' finances, given the additional central government funding they have been provided with. Section 7.3 looks at the medium-term financial outlook, suggesting a tricky trade-off between council tax rises and cuts to service provision – especially in more deprived parts of England – unless more central government funding is forthcoming. Section 7.4 highlights why it is vital to complete the so-called 'fair funding review' for English councils, and discusses the potential for reform to council tax, which is on the table in Wales and should be in England too. Section 7.5 discusses the prospects for further devolution to English councils. Section 7.6 examines the key issues for perhaps the most significant upcoming change of all for English councils: reform of adult social care services. Section 7.7 concludes. In addition, details of the funding streams we count in our analysis of the short-term financial impact of the COVID-19 pandemic and the assumptions underlying our medium-term financial projections can be found in Online Appendix 7A. Online Appendix 7B includes further short- and medium-term analysis.

[1] DLUHC was until recently called the Ministry of Housing, Communities and Local Government (MHCLG).

7.2 The short-term impact of the COVID-19 pandemic on councils' funding

We start by examining the impacts of the COVID-19 pandemic on councils' finances in 2020–21 and 2021–22. This updates our previous analysis for England (Ogden and Phillips, 2020a, 2021) and extends it to Wales. This provides important context for the upcoming Spending Review and subsequent Local Government Finance Settlements and fiscal events, because of the potential for certain short-term impacts to persist, but also because lessons can be drawn for the response to future crises.

Councils have played a key role in helping deliver much of the public sector response to the pandemic. They have taken on new public health responsibilities to tackle the virus, playing an integral role in enforcing restrictions and contact tracing, and more recently in encouraging take-up of vaccines. They have also stepped in to support local businesses and residents, providing practical help to vulnerable families and those shielding, paying grants to local businesses and providing emergency accommodation for rough sleepers. The need for personal protective equipment (PPE) and social distancing has increased unit costs for a range of services, while demand for some services – particularly adult social care for those discharged from hospital – has risen.

The wider economic effects of the COVID-19 pandemic have also meant a decline in revenues from local taxes, although accounting rules mean that these only started affecting councils' budgets from April 2021. Reductions in income from sales, fees and charges (SFCs) as households and consumers used fewer paid-for services such as parking, leisure and cultural facilities, and trade waste schemes had a more immediate impact and one which has varied significantly across councils given their vastly differing reliance on such income.

The impact of COVID-19 on English councils in 2020–21

Focusing first on English councils, their latest estimates are that in total they spent £6.4 billion more than planned as a result of the COVID-19 pandemic in 2020–21 (MHCLG, 2021a). Half of this (£3.2 billion) related to adult social care, mostly in the form of additional funding for private sector providers to meet rising unit costs and higher reported demand, with a further 11% (£0.7 billion) spent on public health services (mostly for COVID-19 testing, contact tracing and outbreak planning). Councils also estimate that they faced costs of a further £0.5 billion associated with forgone savings or delays to projects, and that their non-tax income (from SFCs associated with their services, or commercial ventures, for instance) was £2.8 billion lower than they otherwise would have expected. This takes their total estimates of in-year pressures on their budgets in 2020–21 to £9.7 billion, as shown in Table 7.1, or £171 per person. This is approximately 17% of their pre-COVID net spending on non-education services.

Table 7.1. COVID-related financial pressures and government support for English councils in 2020–21

Pressure or support	Financial impact on councils (£bn)
Additional spending on adult social care	3.2
Additional spending on public health	0.7
Additional spending on other services	2.5
Forgone savings and delays	0.5
Lost income from sales, fees and charges	2.1
Lost commercial and other non-tax income	0.7
Total pressures	**9.7**
Non-ringfenced grants from DLUHC	4.6
Grants for public health	1.8
Support for adult social care providers	1.4
Other government grants	0.8
Estimated compensation for lost sales, fees and charges income	1.3
Other non-grant support	0.6
Total government support	**10.4**
Net financial impact on councils	**+0.7**

Note: Includes only in-year pressures reported by general-purpose authorities, based on councils' latest published forecasts. Other non-grant support includes reimbursement of costs from NHS clinical commissioning groups, recovery of costs through the benefit system and support through the Coronavirus Job Retention Scheme.

Source: See Online Appendix 7A for methodology and sources.

In addition, councils raised less than initially expected from council tax and business rates. As well as compensating for much of this loss, government also provided additional funding to allow councils to increase the generosity of discounts to council tax bills for low-income households. These losses, and the government support, are not included in our main estimates of financial pressures or support in 2020–21, as accounting rules mean that these did not affect councils' main budgets until this financial year (2021–22).

Councils received substantial additional support from government in response to these in-year pressures.[2] This included additional grant funding of £8.5 billion, of which just over half

[2] A full breakdown of this funding, and details of our assumptions, are available in Online Appendix 7A.

(£4.6 billion) was non-ringfenced funding from DLUHC to meet general financial pressures. The rest was largely to fund additional public health responsibilities (£1.8 billion) and support adult social care providers (£1.4 billion), with smaller amounts targeted at other services (such as homelessness prevention and home-to-school transport) and to provide cash and in-kind support directly to vulnerable households (such as those shielding). Moreover, we estimate councils will have received a further £1.8 billion of non-grant support, including around £1.3 billion in compensation for lost sales, fees and charges income – taking total government support in 2020–21 to £10.4 billion.

In aggregate, this support more than compensated English councils for the pandemic-related pressures they reported, to the tune of £0.7 billion across the sector as a whole. Of course, even if councils were 'over-funded' on average, this does not mean every individual council was, given that the COVID-19 pandemic impacted different councils differently. For example, as of December 2020, 35% of councils forecast increases in expenditure and losses in non-tax income in 2020–21 of more than 20% of their pre-COVID spending, while another 24% forecast a combined impact of less than 10% of their pre-COVID spending (National Audit Office, 2021).[3] Some of this variation is likely to reflect councils having made different assumptions about the course of the pandemic over the remainder of the financial year. However, it will also reflect genuine differences in spending and income pressures driven by factors outside of councils' immediate control: differences in socio-economic characteristics, the progression of the pandemic (and the more localised approach to restrictions in Autumn 2020), and their reliance on different income sources (such as SFCs and commercial income), for instance.

The government could have based its financial compensation plans directly on each council's estimates of the financial impacts of the COVID-19 pandemic. However, it instead chose to base most funding on formula-based needs assessments,[4] and to only partially compensate for reported shortfalls in SFCs income,[5] in order to ensure that councils still had an incentive to control their spending and maximise their income (albeit less of one than if they bore lost income in full). Of course, this approach also meant that councils facing above-average increases in spending and, in particular, above-average shortfalls in SFCs income were more likely to be left with a funding shortfall. For example, shire district councils – the lower tier of local government in shire county areas – on average faced forecast financial pressures of £46 per person, and received government support of only £34, leaving them with a shortfall of £12 per

3 Unfortunately, DLUHC has not published council-level figures based on councils' final year-end estimates.

4 Several different methodologies were used to allocate general grant funding during the course of 2020–21 (see Phillips (2020)). Eventually, a bespoke needs assessment was undertaken based on the relationship between the additional COVID-19 spending forecast by councils and their population and deprivation levels. Other grants were subject to separate needs assessments (e.g. public health funding was initially based on historical public health needs assessments but later simply on population).

5 In particular, the scheme compensated councils for 75% of losses above 5% of pre-COVID forecasts for the period April 2020 to June 2021, covering around 60% of lost SFCs income.

person. This 'unfunded pressure' reflects their high reliance on SFCs, especially from parking and culture & leisure facilities, and is equivalent to 6.6% of their average pre-COVID budgets.[6]

In addition to the general financial support schemes available to all councils, DLUHC has allowed those facing particular financial difficulties to borrow to help cover day-to-day spending via 'capitalisation directives' (usually borrowing is only allowed for capital investment). These councils are: Croydon, Luton, Nottingham, Peterborough, Wirral, Eastbourne and Bexley (for both 2020–21 and 2021–22); Redcar & Cleveland (for just 2020–21); and Slough and Copeland (for just 2021–22).

In some cases, the support has been very substantial: Eastbourne's £12.8 million of borrowing is equivalent to three-quarters of its pre-COVID adjusted revenue expenditure, while Croydon's £120 million is equivalent to 32% of its pre-COVID adjusted revenue expenditure. Specific factors have played a role: Croydon had invested in a property development company which had hit problems; Redcar & Cleveland was recently subject to a ransomware attack; Luton owns Luton Airport; and Eastbourne relies significantly on income from tourism and conferences. However, our risk and resilience dashboard, published last year, suggests that most of the councils subsequently requiring support shared one or more of the following features: low levels of reserves, high debt servicing costs, and high reliance on at-risk SFCs, commercial and investment income (Ogden and Phillips, 2020b).

Two councils (Croydon and Slough) have issued so-called Section 114 notices, which are issued when a council is unable to balance its budget (including via use of reserves) and suspends all non-essential expenditure. The only other council to issue such a notice in over two decades was Northamptonshire in 2018. The significant amounts of financial support provided by DLUHC will have averted many more councils from having to issue such notices. In June 2020 (at which point approximately £4.2 billion of funding had been announced), for example, the BBC reported that at least five councils anticipated having to issue a Section 114 notice (BBC, 2020). However, this funding could have been better targeted and thus used more efficiently. It remains the case that a more general relaxation of borrowing rules and *ex-post* compensation of financial losses – as suggested by IFS researchers (from Phillips (2020) onwards) and, in the latter case, akin to what has happened in Wales – could have allowed the government to more closely target financial support to those councils facing the biggest financial impacts. This is an important lesson for the response to future crises. As we hopefully move into the 'recovery' phase from the COVID-19 crisis though, formula-based grant funding, combined with councils' usual tax and capital borrowing powers, is probably the best approach given the potential for more significant

6 As shown in Figure 7B.1 in Online Appendix 7B, other types of council have received more COVID funding than their estimated financial pressures, although the scale of this 'over-funding' varies from only £4 per capita on average in London to £28 per capita in shire counties.

differences in the scale and nature of recovery measures that will be undertaken by different councils.

Impact in England in 2021–22

Turning to the current financial year, 2021–22, the government has so far announced grant funding to address COVID-19 financial pressures of approximately £3.6 billion.[7] In addition, the SFC compensation scheme was extended to partially cover income shortfalls up until June, potentially providing an additional £200 million of funding. This would take the total value of financial support to address in-year COVID-19 pressures in 2021–22 to £3.8 billion.

This is just over one-third as much funding as was eventually provided to English councils in 2020–21. In part, this is likely to reflect the not unreasonable expectation that there will be a lower level of disruption to councils' services and income-generating activities than in 2020–21 as a result of the vaccination programme and reopening of the economy. It is also possible that government is again taking an incremental approach to funding, and may announce further funding later in the year as evidence of whether it is needed becomes available, drawing on remaining funds in the Chancellor's 'COVID-19 Reserve'.[8]

However, many of the financial pressures faced by councils last year – including increases in the cost of adult social care services, contact tracing and outbreak control measures, and reduced income from parking and leisure facilities – will have persisted. As with the health and school systems, new demands for areas such as children's services and homelessness prevention may have arisen as lockdown has eased and temporary measures to limit evictions have expired.

Councils' latest estimates of the scale of pressures they will face in 2021–22 suggest that the funding provided so far will not be sufficient. As of May, councils expected to incur additional expenditure of just under £1.4 billion between April and June and just over £0.9 billion between July and September: £2.3 billion in total over the first half of 2021–22 (MHCLG, 2021a). Together with forecast losses of non-tax income of £0.9 billion, this takes councils' forecasts of pressures between April and September 2021 to just under £3.2 billion, around one-third of their estimates for 2020–21 as a whole. This would use up 84% of the COVID-related funding announced so far, meaning there is very little room left for any pressures to persist beyond September 2021. Indeed, for shire district councils, estimated financial pressures from the first

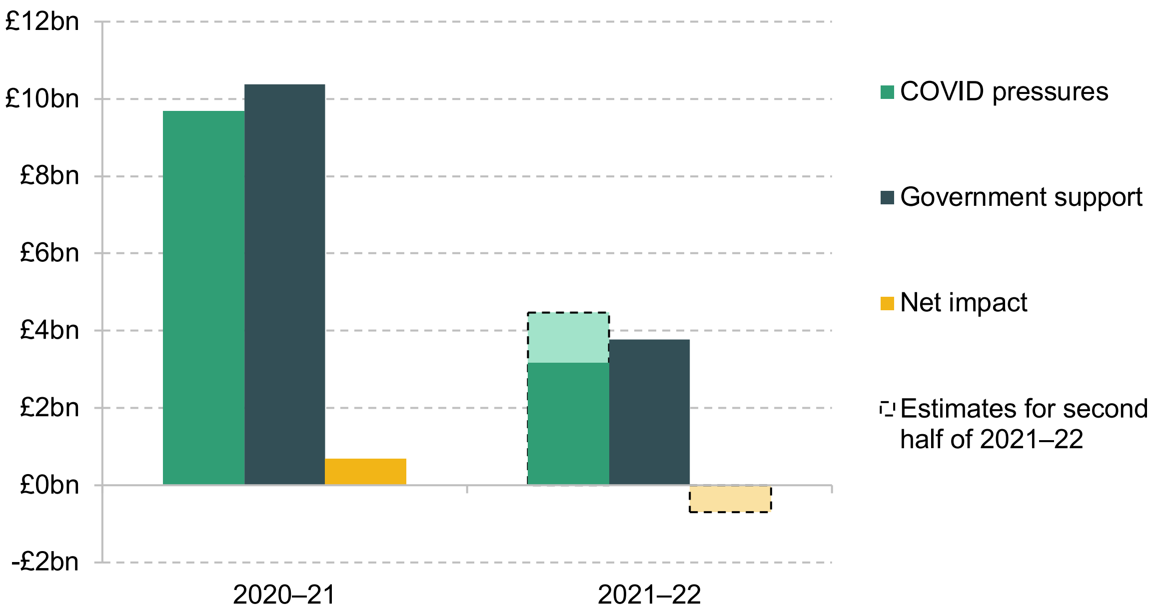
[7] A full breakdown of this funding, and details of our assumptions, are available in Online Appendix 7A.
[8] Indeed, this funding includes a Household Support Fund worth £421 million to English councils, which the government announced on 30 September 2021.

half of the year (£15 per person) are already estimated to significantly exceed the funding provided for the full financial year (£10 per person).[9]

If total pressures persist for the rest of the year at half of the level forecast for the second quarter (July to September), the total funding gap facing the sector as a whole would be £0.7 billion over 2021–22 (as shown in Figure 7.2), or £12 per person. If they instead persisted at the same level, the total funding gap would be £2.0 billion, equivalent to £35 per person. This strongly suggests that the Chancellor is likely to need to provide additional funding to English councils to cover COVID-19-related pressures in the second half of this financial year.

However, a second potential source for understanding COVID pressures in 2021–22 is councils' budgets for the year, as we may expect forecasts for ongoing costs to now be reflected in their regular budget processes. This paints a rather different picture.

Figure 7.2. Estimated net impact of in-year COVID pressures and government support for English councils, in 2020–21 and 2021–22



Note: For 2021–22, the dark green bar shows forecast COVID-related financial pressures for the first half of the financial year. The paler dashed areas show estimated impact on council finances if financial pressures persist during the second half of 2021–22 at half the level forecast for the second quarter (July to September). Government support in 2021–22 includes funding announced as of 30 September 2021, and an estimate of SFCs compensation.

9 Figures for other council types can be found in Figure 7B.6 in Online Appendix 7B.

Councils' budget returns suggest they expect to spend an additional £350 million on COVID-19-related measures in public health and adult social care in 2021–22 (MHCLG, 2021b). These figures are significantly lower than reported in councils' COVID-19-specific financial returns, which relate just to the first half of 2021–22. Moreover, the growth in budgeted total service spending since 2019–20 is broadly in line with pre-crisis trends, suggesting little upwards pressure as a result of the COVID-19 pandemic.[10] That would suggest, on the face of it, that councils may already have sufficient funding for the remainder of 2021−22.

There may be several reasons for the discrepancy between these two data sources. First, whereas councils' initial budgets were set in March 2021, their COVID-19-specific forecasts date from May. If expectations about the continuing impact of the pandemic on councils' services worsened over these months, councils may have revised their spending estimates up. Second, additional funding of £0.8 billion was announced during March, April and May, and our analysis last year suggests councils updated their spending forecasts when new funding was announced (Ogden and Phillips, 2020a). Third, councils may be budgeting to make significant cuts to some non-COVID-19 spending. Responding to a National Audit Office survey in December 2020, 94% of single-tier and county councils and 81% of district councils stated that they expected to reduce spending on some services in order to balance their 2021–22 budgets (National Audit Office, 2021). Finally, whereas their budget returns are subject to strict legal requirements, their COVID-specific forecasts are not certified or audited. It is therefore possible that councils have over-forecast expenditures in these returns given that they have previously been used as an input into decisions by the government on whether to provide councils with additional funding.

Thus, while councils' specific COVID-19 forecasts suggest the Chancellor may need to stand ready to provide English councils with additional funding to meet ongoing COVID-19 financial pressures in the second half of this financial year, their formal budgets are less clear on this need.

The impact in and lessons from Wales

Like their English counterparts, Welsh councils have had to contend with increased spending and reduced revenue-raising capacity as a result of COVID-19.

However, the main mechanism by which funding was provided to compensate for these impacts has been very different from that in England. Rather than relying on *ex-ante* estimates of spending needs, councils in Wales have retrospectively submitted returns to the Welsh Government detailing actual expenses and income losses incurred in a range of areas. A 'Hardship Fund' has then compensated for 100% of qualifying expenditure and income loss

[10] See Online Appendix 7A for a comparison of 2021–22 budgets with 2019–20 out-turn spending.

claims, with £452 million paid out in respect of non-education claims in 2020–21.[11] By design, this arrangement has ensured that compensation equals councils' self-reported funding needs. To the extent that they consistently and accurately report these needs, this both provides Welsh councils with greater insurance than their English counterparts, and targets funding to where it was most needed. However, it also provides a stronger incentive for Welsh councils to overstate their funding needs (as the funding they receive directly depends on their stated needs) and means weaker incentives to control expenditures and maintain incomes (as any reduction in spending or increase in income would be offset by lower compensation).

The fact that reductions in SFCs have been fully rather than partially compensated for means Welsh councils were provided with £46 per person to address non-tax income losses in 2020–21, compared with £23 in England. Including an additional £138 million of ringfenced formula-based grant funding to address the impact of the COVID-19 pandemic on non-education services, the additional funding provided to Welsh councils was approximately 7% (£14) higher per person than that provided to English councils – although this includes funding provided following a decision by the Welsh Government to improve social care workers' pay and conditions.[12]

The Welsh Government was able to provide this greater degree of support for councils partly because of its lower costs for other areas of pandemic-related spending in 2020–21. Having received a COVID funding guarantee based on a population share of planned UK government spending in England, the Welsh Government allocated substantially less per person towards procurement of PPE and the devolved element of the Test, Trace and Protect programme (Ifan, 2021; Audit Wales, 2021). This meant that the Welsh Government was able to allocate relatively more funding to councils (and business support), and in addition was allowed to carry forward almost £500 million of funding into 2021–22 to bolster this year's COVID-19 response, as a result of HM Treasury waiving the usual limits on funding transfers between years.

Turning to the current year, formula-based COVID-19-related grants totalling £36 million had been allocated at the time of the final Welsh Local Government Finance Settlement, with the potential for top-ups during the year. However, the Hardship Fund has continued to be the primary means of supporting council finances during the first half of the financial year. An

11 The Hardship Fund functioned as the primary means of supporting the adult social care sector, funding the response to excess deaths, providing homelessness support and helping with general council finances. It was later expanded to cover the costs of schemes set up in-year, including self-isolation payments to individuals and enhanced statutory sick pay for care workers. Education-related expenditure, funding and income losses for Welsh local authorities have been excluded from the analysis in this section to maintain consistency with the analysis on England.

12 The Welsh Government provided councils with £47 million (equivalent to £15 per person) to improve care workers' pay and conditions through a one-off £500 bonus payment and statutory sick pay enhancements. A further £735 bonus payment for all health and social care workers was announced in March 2021.

initial allocation of £206 million has been made available by the Welsh Government to cover income losses and additional costs incurred up until the end of September, which would equate to £160 million for non-education services if the distribution is the same as in 2020–21. Like in England, this is around a third as much funding as was provided through the Hardship Fund in 2020–21.

Also as in England, it is likely that the Welsh Government will have to provide further support for the second half of this financial year, given it has so far confirmed funding for the Hardship Fund only up until September. It would seem to have at least some scope to do this: when its First Supplementary Budget was published in June 2021, it included £1.3 billion in unallocated day-to-day spending for 2021–22.

However, unless HM Treasury again bypasses the usual budgetary arrangements, the Welsh Government will have only limited flexibility to carry forward any unspent funds into 2022–23. From next year, funding for Welsh councils will, as for their English counterparts, depend very much on the upcoming Spending Review.

7.3 The medium-term outlook for council funding

In the Spending Review, the Chancellor is expected to set out plans for public service spending for the three years to 2024–25. These plans will in turn affect the level of central government grant funding available to councils across the UK.

It is clear that funding for councils will need to rise in real terms if councils are to maintain service provision. Even before the pandemic, they faced a range of spending pressures, stemming from demographic changes, increases in wage costs, and difficulties in raising the productivity of often labour-intensive services. The Office for Budget Responsibility is also clear that even after the immediate public health risks have abated, the pandemic is likely to leave behind a legacy of medium-term pressures on public services (OBR, 2021a).

In this section, we consider how English and Welsh councils’ funding requirements are likely to change over the medium term, given changes in the likely demand for and costs of providing council services. We also consider the different ways in which councils may be able to fund this spending and, in England, the implications for different parts of the country of relying on council tax to increase overall funding levels. Full details of the assumptions underlying our projections can be found in Online Appendix 7A.

The medium-term outlook for English councils

Changes in spending needs can reflect changes in the demand for council services (e.g. the number of people in care homes funded by councils) and changes in the 'unit costs' of delivering those services (e.g. the cost per care home resident). While both can be affected by the policies of central and local government, such as eligibility rules and service standards, we focus in this section on the spending required to deliver the same level of service as in 2019–20.

As discussed above, councils' spending needs increased massively in 2020–21 as a result of the COVID-19 pandemic, and forecasts suggest they will remain substantially elevated in 2021–22. In future years, we assume there will be some ongoing impact on councils' finances as a result of the health and economic impacts of the pandemic.[13] However, these pressures seem likely to fall significantly over time, and we assume they fall to £1.5 billion in 2022–23 and almost disappear by 2024–25 (as shown in Figure 7.3). There remains considerable uncertainty over this profile, and survey evidence suggests there is not consensus across the sector as to when councils' finances are likely to recover.[14]

While the impact of the COVID-19 pandemic on council finances may recede over time, other demand and cost pressures will continue. We assume that demand for most council services, which are 'universal' and available to all residents, rises in line with projected population growth, which averages 0.5% a year over the period.[15] Other demographic trends – the ageing population, the survival of people with more complex social care needs for longer, and increases in the number of children requiring protection or care – mean demand for adult and children's social care services are likely to grow more quickly. Drawing on projections by Wittenberg, Hu and Hancock (2018), we assume demand for adult social care grows by 2.2% a year, and that growth in demand for children's social care services moves part-way back from recent rapid growth towards longer-run trends and averages just over 2.0% a year (four times the rate of overall population growth). The costs of delivering services are also likely to increase over the next few years, reflecting slow growth in productivity, increases in average earnings, and planned increases in the National Living Wage (NLW). In particular, we assume general inflation and wage pressures increase costs by an

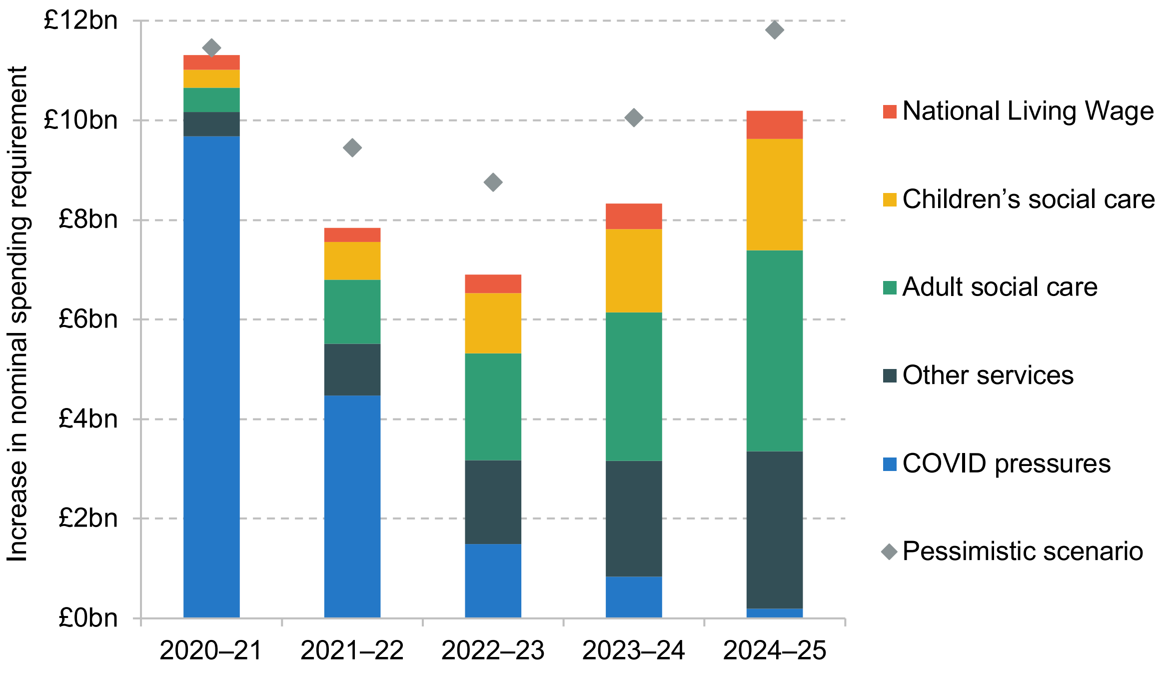
[13] Councils are likely to see increases in demands for some services, as residents affected by repeated lockdowns, job losses or rent arrears may be in greater need of support to avoid homelessness or to retrain, and the implications of long COVID for council services are still poorly understood. Some changes to how services are delivered – such as the use of PPE in social care settings – may continue, increasing unit costs. If any changes in shopping or commuting habits persist, councils' income from some sales, fees and charges (such as parking) may not fully recover for several years (increasing their net spending on services).

[14] Of those responding to a survey in December 2020 / January 2021, around half of councils did not expect their finances to recover until at least 2023–24. This includes 6% of single-tier and county councils and 17% of districts expecting this to be 2025–26. A further 27% and 35% of councils respectively indicated they did not know when their finances may return to pre-COVID levels. (National Audit Office, 2021, p. 63.)

[15] In its submission to the Spending Review, the Local Government Association (2021a) assumes demand for 'other services' (and especially housing and homelessness services) to grow substantially faster than the population, implying an increase in the population's need for these services.

average of 2.1% each year, accounting for £5.6 billion (55%) of the increase in spending required by 2024–25. We estimate the additional impact of planned increases in the NLW to be £0.6 billion by 2024–25, via direct impacts on wages in the adult social care sector.[16]

Figure 7.3. Increase in English councils' spending requirement relative to 2019–20 (£ billion)



Note: Spending requirement measures the expected cost to councils of delivering the same level of services to their residents as they did in 2019–20. 'Other services' includes all non-education services councils provide, except for adult and children's social care.

Source: See Online Appendix 7A for details of assumptions and sources.

Together, these various pressures mean that our central projection is for English councils to need to spend £10.2 billion more in 2024–25 than they did in 2019–20 to maintain service provision levels. This increase of 20.5% is equivalent to an average annual increase of 3.8%, or 1.9% in real terms.

Of course, the assumptions underlying this are uncertain, and the pressures facing councils could be several billion higher, or somewhat lower, than this. For instance, if productivity in the adult social care sector declines slightly over time (as it is estimated to have done historically), children's social care demand continues to rise at recent rates (by 2.6% a year) rather than

[16] The direct impact on councils' own labour costs is minimal as local government pay scales have been set so that the lowest rung is some way above the level of the NLW. If the pay of all directly employed staff were increased in line with the the NLW (which would be required to fully maintain differentials), we estimate this could add an additional £1 billion per year to councils' labour costs by 2024–25.

moving back towards longer-run trends, and some COVID pressures are more persistent, English councils could need a further £1.6 billion in 2024–25 (shown as the 'pessimistic scenario' in Figure 7.3).

Reforms to adult social care services announced on 7 September will also increase councils' spending. As discussed in more detail in Section 7.6, we have doubts over whether the £5.4 billion the government is set to provide between 2022−23 and 2024−25 as these reforms are rolled out will be sufficient to meet its aims in full. However, we abstract from both the additional responsibilities and funding for now, in effect assuming that councils will make improvements to provision in line with the government's aims using the funding that has been made available. In that case, the £5.4 billion would not help address underlying demand and cost pressures,[17] but neither would additional unfunded pressures arise.

But how could £10 billion of revenue be found by 2024−25?

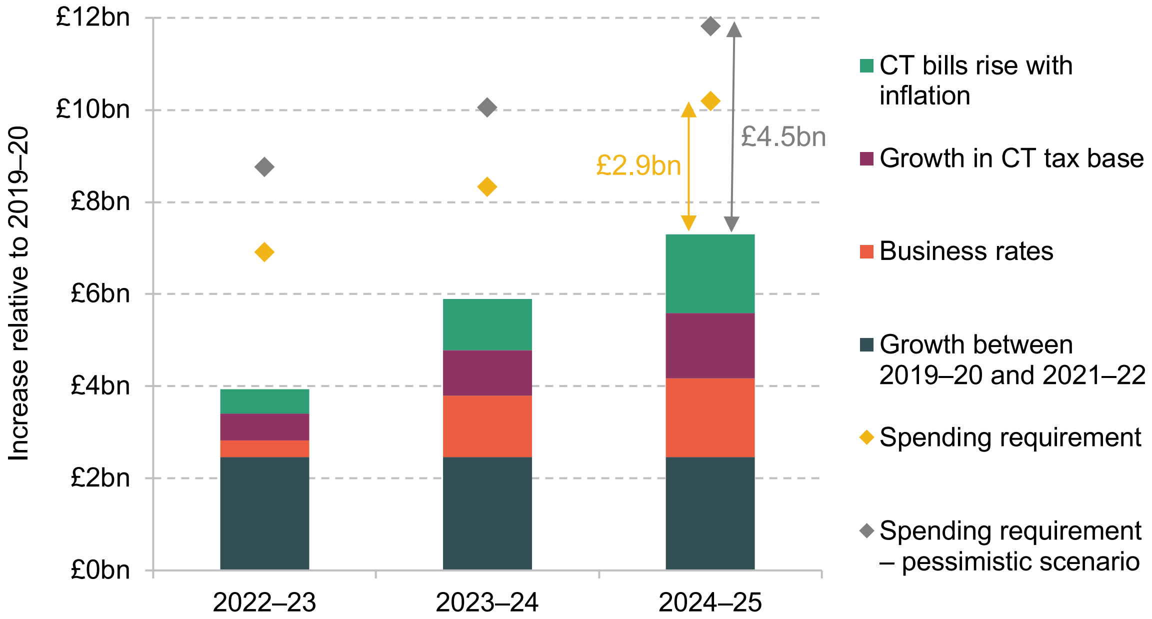
Some of the required growth has already been achieved: English councils' budgets for 2021−22 suggest their revenue from council tax, business rates and non-COVID central government grants will have increased by £2.5 billion (4.9%) compared with 2019–20.[18] The majority of this increase (£1.8 billion) is attributable to a rise in council tax revenues, as a result of large above-inflation increases in average council tax bills.

Without any change in policy, we might expect growth in business rate revenues to have increased revenues by a further £1.7 billion by 2024–25, and growth in the council tax base (effectively the number of properties liable for council tax) to raise another £1.4 billion. If council tax bills were increased in line with forecast CPI inflation (i.e. held fixed in real terms), which the OBR forecasts will average 1.9% a year, this would bring councils an additional £1.7 billion in 2024–25. Together, this would amount to an increase in revenues of £7.3 billion, leaving councils £2.9 billion short of what they would need to maintain service provision under our central scenario, and £4.5 billion short under our more pessimistic scenario, as shown in Figure 7.4.

[17] Indeed, the government's plan for health and social care states: 'We expect demographic and unit cost pressures will be met through Council Tax, social care precept, and long-term efficiencies; the overall level of Local Government funding, including Council Tax and social care precept, will be determined in the round at the Spending Review in the normal way' (HM Government, 2021, para. 36).

[18] With a further £3.7 billion of COVID-19-related funding on top, as discussed in Section 7.2.

Figure 7.4. Projected increase in councils' revenues and spending requirement since 2019–20 (£ billion)



Note: Assumes council tax bills rise each year with the OBR's forecast for consumer price inflation, and government grant funding is fixed in cash terms after 2021–22. Growth between 2019–20 and 2021–22 reflects actual changes in councils' revenues over these two years, including growth in the council tax base and levels, a decline in retained business rates revenues and an increase in grant funding.

Source: Authors' calculations. See Online Appendix 7A for details of assumptions and sources.

How could further funding be raised? Increases in business rates bills are legally capped at the rate of inflation, and while the government could increase the proportion of revenues councils get to keep (indeed, it has been planning to do so, as discussed in Section 7.4), when it has done so previously it has reduced its grant funding by the same amount. This means that there are two main ways under the current local government finance system to raise additional revenues and avoid a funding gap and cuts to service provision:

1 **Above-inflation council tax rises.** Since 2011, the government has effectively capped council tax rises by requiring a council to win a local referendum if it wishes to increase its council tax by more than a set percentage. In recent years though, it has allowed those councils with social care responsibilities to increase council tax bills by 4% or 5%.[19] As a

[19] Such councils have been allowed to increase bills by 2%, the revenues from which are unringfenced, and (since 2016–17) have been permitted an additional 'social care precept', typically a further 2% or 3%, the revenues of which have been formally ringfenced to fund adult social care services. Shire district councils, the lower tier of local government in shire county areas, have been allowed to increase their bills by 2% or £5, whichever is the greater.

result, the average band D council tax rate has increased by an average of 4.2% a year since 2015–16, 2.4% above inflation.

2 **Additional government grant funding.** The scope for increases in grant funding will be determined by the departmental expenditure limits (DEL) for departments paying grants to councils – most notably DLUHC and, via the Public Health Grant, the Department of Health and Social Care – set by the Chancellor at the upcoming Spending Review. As discussed in Chapter 5, the overall spending envelope pencilled in by the Chancellor implies that, on average, the DELs for 'unprotected' departments – including DLUHC – will decrease by 2.6% in nominal terms in 2022–23. They are then expected to grow by 4.4% in 2023–24, and to rise substantially by 10.8% year-on-year in 2024–25 (8.5% above inflation) as the growth in NHS funding slows.[20]

There is a clear trade-off between funding increased council spending through council tax rises (which directly affect billpayers) and providing additional grant funding to councils (instead of to the NHS or other service areas). For instance:

- **If councils' grant funding follows the same profile as the average 'unprotected' DEL**, councils could expect their grant funding to fall next year, but to be receiving an additional £1.4 billion in grants in 2024–25.[21] In that case, focusing on that final year, council tax bills would need to be 11.2% higher in cash terms in 2024–25 than they are in 2021–22 to meet our central projection for councils' spending needs. This could be achieved through **annual council tax increases of 3.6% each year** for the next three years, similar to the maximum allowed rises in recent years for social care authorities. This would increase the average council tax bill paid by households by £160 (£77 in real terms).
- However, recent history shows that spending on the NHS is usually higher than planned (Zaranko, 2021). **If the NHS requires top-up funding and the government returns to its previous commitment on overseas aid spending**, councils could expect only £0.3 billion more grant funding in 2024–25 than they received this year if such funding moved in line with the average unprotected resource DEL.[22] This would imply **council tax bills would have to rise by 4.7% each year**. The average council tax bill would have to be £211 higher (£128 higher in real terms) in 2024–25 than it is now.
- Even if councils do receive an additional £1.4 billion in grants by 2024−25 (as implied by the Chancellor's latest spending plans, in the absence of any future top-ups for the NHS), the cost and demand pressures facing councils could be higher. **If councils' spending**

[20] This is based on spending totals implied by the March 2021 Budget, accounting for existing spending commitments which 'protect' the budgets in some areas (such as the NHS and schools), the consequences of changes for devolved budgets (the Barnett consequentials) and the impact of recent fiscal announcements.

[21] This excludes the additional grant funding to pay for social care reforms discussed above and in Section 7.6.

[22] This assumes the NHS requires a top-up of £5.1 billion in 2024−25, and the government returns to its previous commitment of spending 0.7% of gross national income on overseas aid that year, reducing the resource DEL of 'unprotected' departments. See Chapter 5 for full details.

requirements instead grow in line with our pessimistic scenario, council tax bills would need to rise much more quickly to avoid councils facing a funding gap in 2024–25 – by the equivalent of **5.3% a year** in each of the next three years, increasing the average council tax bill by £240 (£156 in real terms).

If the government caps council tax bills at a level insufficient to meet spending pressures given the grant funding provided, councils will face a 'funding gap' and have to cut back at least some services. Some illustrative potential scenarios, based on our central projections for spending needs, are provided in Table 7.2. For instance, if councils with social care responsibilities are allowed to increase their council tax by 4% a year (and other councils 2% a year), and grant funding moves in line with average 'unprotected' DELs, our central projections imply that councils would have just more than enough funding to maintain service provision in 2024–25 (row 2). However, there would be a funding gap in each of the two years before that, given our assumption that COVID-19 pressures will persist (but shrink over time) and the much tighter short-term trajectory for unprotected DELs. For example, the projected funding gap for 2022−23 would be £2.7 billion under this scenario, equivalent to almost 5% of councils' projected spending needs.

Table 7.2. Combinations of changes in council tax bills and grant funding, and the resulting funding gaps for English councils, 2022–23 to 2024–25

	Scenario for council tax bills	Scenario for government grant funding	Projected spending needs less revenues (i.e. 'funding gap')		
			2022–23	2023–24	2024–25
1	Rise by 2% each year, with no additional increase for social care	Rises with the overall envelope for 'unprotected' departments	£3.2bn	£2.2bn	£1.4bn
2	Rise by 2% each year, plus an extra 2% 'social care precept'	Rises with the overall envelope for 'unprotected' departments	£2.7bn	£1.0bn	–£0.3bn
3	Rise by 2% each year, plus an extra 2% 'social care precept'	Rises with the overall envelope for 'unprotected' departments, but the NHS receives a £5.1 billion top-up in 2024–25 and ODA returns to 0.7% of national income in 2024–25	£2.7bn	£1.0bn	£0.7bn

Note: Central spending needs projections. ODA is official development assistance.

Source: Authors' calculations. See Online Appendix 7A for details of assumptions and sources.

The table also shows, unsurprisingly, that the funding gap would be larger each year if council tax increases were capped at 2% (row 1), and would be larger in 2024–25 if additional money was provided to the NHS and overseas aid in that year, reducing the amount available to increase councils' grant funding (row 3). The funding gap would still decrease over the next three years as COVID-19 pressures abate, but would grow in the longer term (as underlying demand and cost pressures drive trends).

It is important to note that these projections are subject to significant uncertainty. For example, if councils' spending needs rose in line with our more pessimistic scenario, then the funding gap in each scenario would be higher – by £1.9 billion in 2022–23, £1.7 billion in 2023–24 and £1.6 billion in 2024–25.

This uncertainty means that setting firm plans for grant funding and council tax increases for the next three years is an impossible task. Instead, the Chancellor and DLUHC should consider using the Spending Review and subsequent Local Government Finance Settlement to set a baseline amount of grant funding and principles for council tax increases that they consider sufficient to meet underlying demand and cost pressures over the Review period. As in the one-year 2020 Spending Round, some temporary funding to address COVID-19-related financial pressures could also be provided for the coming financial year – with a commitment to top up funding in later Budgets (or even between Budgets) if necessary. That would allow councils to plan spending on their core services with some degree of certainty, provide them with a degree of assurance that funding will be forthcoming to deal with future COVID-19 surges and potential lockdowns, and minimise the risk of 'locking in' funding that may not actually be needed if COVID-19 pressures abate.

Variation in council tax revenue-raising capacity across England

Should the Chancellor rely on additional grant funding or higher council tax bills to meet spending pressures? The answer to this question is inherently political, involving views on issues such as which parts of the population tax increases should fall on, which public services should be prioritised, and how much government borrowing is appropriate. However, one factor that will need to be borne in mind is the fact that differences in the tax bases and levels of different councils mean that a given percentage increase in council tax levels raises very different amounts in different parts of England.

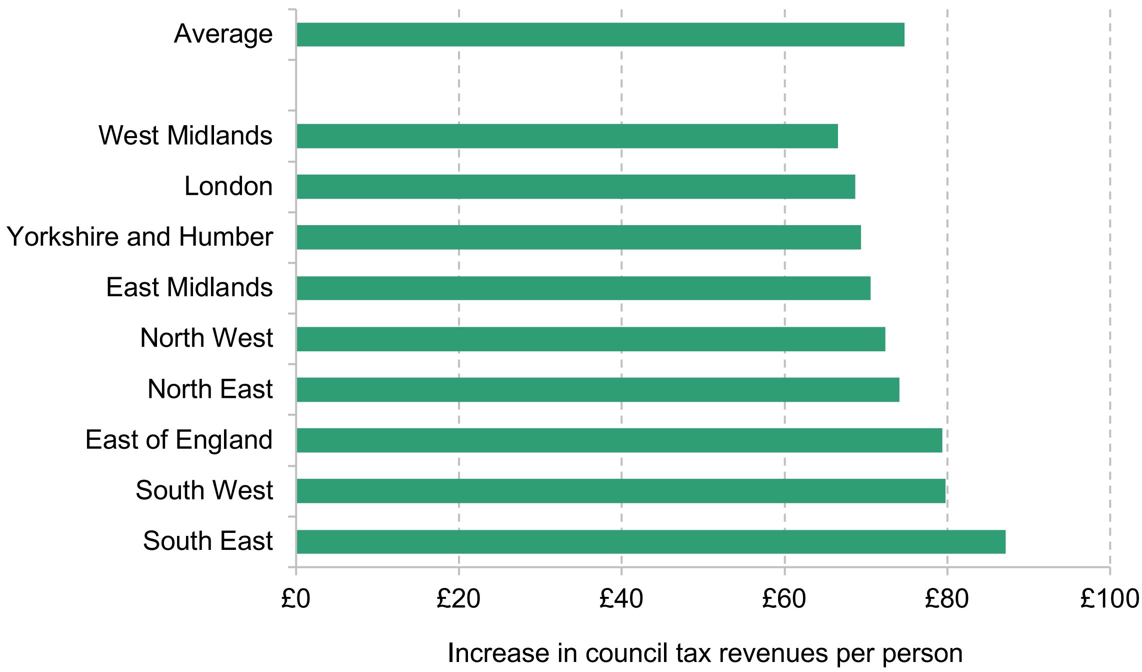
For instance, whereas more than 50% of properties in the North East are in the lowest council tax band (band A), fewer than 10% of properties in the South East or London are, reflecting differences in property prices when council tax was introduced in the early 1990s (although these differences are now even bigger (Adam et al., 2020a)). This means a given level of council tax (usually quoted as the tax applied to a band D property) will raise less revenue in the North East than in the South East or London. However, while properties in London are less likely to be in a low tax band, councils in London set relatively low council tax levels: the average council tax bill on a band D property was £1,622 in London in 2021–22, compared with £1,898 across England as a whole. This means that a given percentage increase in council tax levels raises relatively less, compared with areas where existing levels are higher.

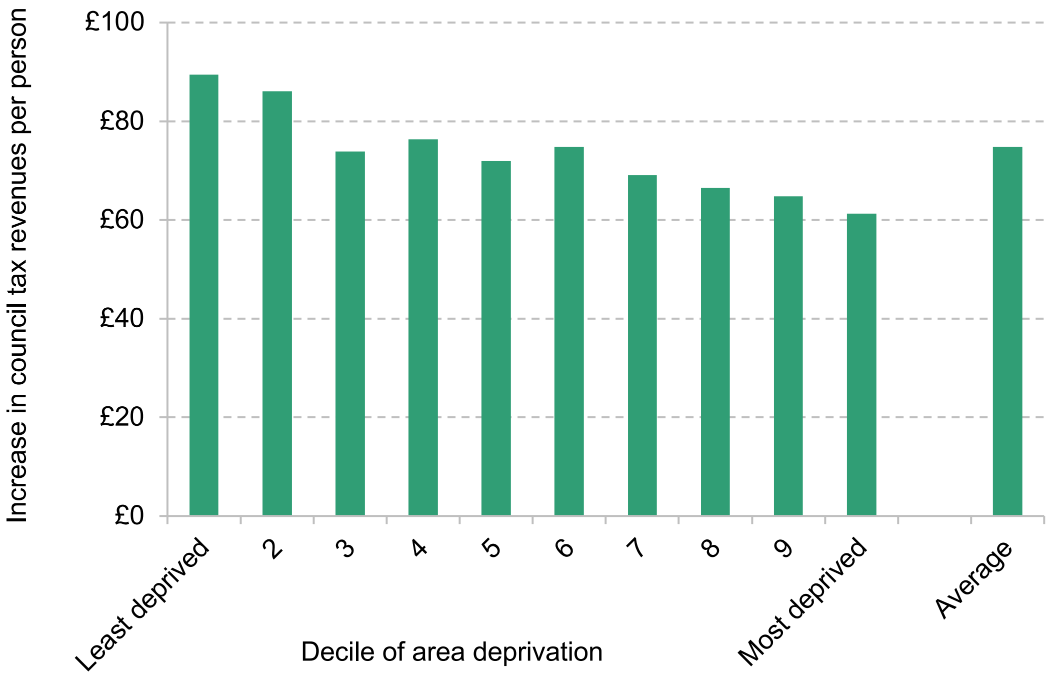
Together, these factors – as well as differences in the share of households eligible for discounts (such as for single adults), exemptions (such as for students) or means-tested reductions in council tax bills – drive notable differences in the revenues that can be raised through council tax rises across the English regions, and between more and less deprived areas. For example, Figure 7.5 shows that continuing to allow councils with social care responsibilities to increase their bills by 4% a year and others by 2% a year would raise an additional £87 per person in the South East by 2024–25, but only £69 in London and £67 in the West Midlands. Similarly, the same council tax rises would raise £89 per person on average in the least deprived tenth of council areas by 2024–25, compared with only £61 per person in the most deprived tenth of council areas.

This means that to fund the same growth in spending, councils in poorer areas would need to make larger-than-average percentage increases to council tax bills, which in turn would mean bigger increases in the bills levied on properties in any given council tax band, than councils in richer areas. Alternatively, they would be less likely to be able to meet their spending pressures and hence more likely to have to cut back on service spending. If the government wanted to avoid this outcome, it would have to increase the grant funding it provides to councils in poorer areas by more to offset their lower revenue-raising capacity. This is something it has done in recent years – cutting their grants by less when grants are being cut across the board, and increasing them by more when they are being increased across the board (Ogden and Phillips, 2020c).

But the government has baulked at cutting grant funding to richer areas while increasing it in poorer areas, which it might have to do if overall grant funding is broadly flat. If it does not overcome this squeamishness, councils in poorer areas may find themselves facing particular financial difficulties if the Chancellor decides council tax should continue to take nearly all the strain in meeting English councils' growing spending needs (Amin-Smith, Phillips and Simpson, 2018b).

Figure 7.5. Increase in English council tax revenues per person between 2021–22 and 2024–25 if council tax levels are allowed to rise by 4% for councils with social care responsibilities and by 2% for other councils, by region and by deprivation level





Note: Council tax revenues are by upper-tier local authority area, so in shire areas include revenues due to both the shire county and shire districts.

Source: OBR, 2021b; MHCLG, 2019, 2021d; ONS, 2020, 2021. Figures for historical average tax base growth in each area provided by officials from MHCLG.

The funding outlook for Welsh councils

A tricky trade-off between grant funding increases, council tax increases and cuts to service provision will also face the Welsh Government and councils over the next few years.

Our central projection for Welsh councils' underlying (non-COVID) spending needs are for an increase of £817 million (21.4%) between 2019−20 and 2024−25. This increase is equivalent to 3.9% each year, slightly faster than the growth in spending requirements for English councils (3.8%), with larger assumed increases in demand for children's social services only partially offset by Wales's slower population growth.[23]

Accounting for increases in unit costs because of inflation and higher wages, children's social care spending needs are projected to increase by 6.2% a year in cash terms, adult social care spending needs increase by 4.5% a year, and other services by a more modest 2.5% a year. In addition, some pandemic-related costs and income losses are likely to persist into 2022–23 and beyond, but, as in England, we assume these almost fully abate by 2024–25.

Turning to funding, as in England, the outlook for Welsh councils' grant funding will be informed by the upcoming Spending Review. If the Chancellor sticks to his indicative spending plans, the Welsh Government's core (non-COVID) funding is projected to grow by 3.9% a year, on average, over the period to 2024–25 (Ifan, 2021). Three further assumptions are made in order to project the grant funding available to Welsh councils:

1. the Welsh Government uses projected consequentials from NHS spending in England to fund equivalent services in Wales, and passes on projected consequentials from school spending in England to Welsh councils in full;[24]
2. an additional £106 million a year is passed on to councils from 2022–23 as a result of the new health and social care levy (assuming the proceeds are split between NHS Wales and councils according to the same ratio as in England) but this is met by new responsibilities and cannot be used to fund existing pressures;
3. other grant funding for councils grows in line with the rest of the Welsh budget.

Despite the slightly higher spending requirements for non-education services, the medium-term financial outlook for Welsh councils may be less challenging than that in England because of both demographics and differences in the way councils are funded in Wales. First, the school-age

[23] Demand for children's social care is assumed to increase by 3.8% a year in Wales, in line with recent trends. If we instead assumed the same growth in demand as in England (2.0%), non-education spending pressures would be expected to grow at a slower rate of 3.5% each year between 2019–20 and 2024–25.

[24] The Welsh Government typically pledges to pass on funding received as a result of increases in English health spending to the Welsh NHS. Welsh councils fund nearly all state schools in Wales, with the vast majority of this funding being from their unringfenced Revenue Support Grant.

population in Wales is projected to fall by 2% between 2019–20 and 2024–25 but the Welsh Government will receive its population share of funding increases for English schools – where pupil numbers are expected to remain broadly flat – under the Barnett formula. Of course, any cost savings will depend on the extent to which decreased demand for school places feeds through into lower inputs, such as the size of the schools' workforce. Nevertheless, since most funding for schools is provided to councils as part of their general grant funding, councils in Wales could potentially fund pressures in other service areas using funding that is notionally for schools. In this context, when education spending is included, Welsh councils' spending needs are projected to grow by a more manageable 3.1% a year (in nominal terms), under our central projections.

Table 7.3. Combinations of changes in UK government spending plans and schools consequentials scenarios and the resulting funding gaps for Welsh councils, 2022–23 to 2024–25

	Scenario for UK government spending plans	Scenario for schools consequentials	Projected spending needs less revenues (i.e. 'funding gap')		
			2022–23	2023–24	2024–25
1	March 2021 spending envelope, plus September announcements	Treated as general council funding	£34m	£36m	–£1m
2	As in row 1	Passed on to schools in full	£319m	£335m	£310m
3	As above, but English NHS receives a £5.1 billion top-up in 2024–25 and ODA returns to 0.7% of national income in 2024–25	Treated as general council funding	£33m	£36m	£126m
4	As in row 3	Passed on to schools in full	£319m	£335m	£437m

Note: Council tax bills are assumed to grow by 2.0% each year in all scenarios.

Source: Authors' calculations. See Online Appendix 7A for details of assumptions and sources.

In such a context, annual council tax increases of 2.0% for the next three years would be sufficient to avoid a funding gap for Welsh councils in 2024–25,[25] much smaller than the increases in England (3.6%). Central government grants are a particularly important source of revenue for Welsh councils – accounting for 80% of total revenues compared with 17% in England. As a result, the funding outlook for Welsh local authorities is more sensitive to changes in central government

[25] This assumes that councils could reallocate any funding received as a result of Barnett consequentials received in respect of English schools spending that is not needed by Welsh schools to other services from 2020–21 onwards. If we instead assume that they are only able to shift such funding from 2022–23 onwards, the increase in council tax would have to be 4.7% a year.

funding and, by implication, UK government spending plans than for their English counterparts. As shown in Table 7.3, councils would still face a small funding gap in the intervening years (row 1).

However, like in England, there is significant uncertainty. As well as the potential for both COVID-19 pressures to persist to a greater extent and underlying demands and costs to rise more, Welsh Government and UK government policy will matter. For example, if the Welsh Government required councils to pass on funding triggered by schools spending in England to Welsh schools in full, Welsh councils would be unable to transfer funding to help meet their other spending pressures. In that case, annual council tax increases of 2.0% would imply a funding gap of £310 million (equivalent to 4.0% of their funding requirement) in 2024–25 (row 2). Bills would need to increase by 8.3% a year to avoid a funding gap in the final year. If, as discussed in Chapter 5, the NHS requires top-up funding and the UK government returns to its previous commitments on overseas aid spending, Welsh councils would face a funding gap of £437 million (equivalent to 5.6% of funding requirements) in 2024–25 if council tax bills rose by only 2.0% a year (row 4). Council tax bills would need to rise by 10.6% a year to meet spending needs in 2024–25 under this scenario combination.

7.4 Funding reform

As well as a potentially challenging outlook for funding *levels*, councils in England and to some extent Wales are set to face important reforms to their funding *systems* and to the scope and nature of their service responsibilities over the next few years. In England, long-delayed reforms to how funding is allocated between councils may begin to be implemented in 2023, something which is long overdue but will involve a range of challenges, not least how to transition to new allocations, which could in some cases differ from current ones by 10%, 20% or even more – and especially so in what could be a tight funding environment. And while the UK government unfortunately seems unwilling to reform the absurdly out-of-date council tax in England, the Welsh Government is committed to its reform, with the aim of making the system ‘fairer’ and more progressive: details are expected soon.

Many of the key decisions will be taken outside the Spending Review and Budget. However, the decisions the Chancellor takes on funding allocations, and his openness to reform of England’s local tax system, will play a key role in determining both the ambition of reforms and the potential to smooth their introduction with extra cash. At the same time, reforms that enable funding to be better targeted at areas where it is most needed while maintaining councils’ financial incentives to boost growth and tackle spending needs will help ensure the biggest bang for the Chancellor’s buck.

The English fair funding and business rates retention reviews

England currently lacks up-to-date formulas for assessing the relative spending needs of different councils. This has had unfortunate consequences during the COVID-19 pandemic.

In particular, it meant that the government used estimates of spending needs from 2013–14 (calculated using formulas initially devised in the mid 2000s) to allocate the first tranche of COVID-19 funding to English councils last April[26] and to allocate social care funding to councils in the 2021–22 Local Government Finance Settlement (MHCLG, 2021c). Since 2013–14, the overall and older adult populations have changed in drastically different ways in different council areas, and other factors (such as the health and wealth of residents) will have changed also, so such estimates are increasingly arbitrary and unrelated to contemporaneous needs (Phillips, 2020). For example, while the overall population of Tower Hamlets is estimated to have increased by 21.3% between mid 2013 and mid 2020, that of Blackpool is estimated to have fallen by 2.3%, while the change in the number of adults aged 80 or over is estimated to vary between –13.4% in Barking & Dagenham to +35.6% in Hart in Hampshire.

There is also currently no agreed method to weight the spending needs assessments for each service area to arrive at an overall assessment, or to calculate the revenue-raising capacity of each council. Of course, reasonable people will disagree on the weights and how much to offset differences in how much councils can raise themselves. But the lack of a framework such judgements can be plugged into means that England currently lacks a rational basis for allocating funding between councils, and a way of properly addressing the concern illustrated in Figure 7.5 above: that spending needs and revenue-raising ability are generally negatively correlated (so that, for example, poorer areas typically have both higher needs and lower revenue-raising capacity).

It was not meant to be like this. The so-called 'fair funding' and business rates retention reviews were launched in late 2015, with the following aims:

- to update the formulas and approaches used to assess English councils' relative spending needs and ability to raise revenues via council tax;
- to design and implement a simple and transparent system of allocating funding between councils that takes account of these assessments, with appropriate transitional arrangements at the point of introduction and when assessments are updated; and
- to reform the Business Rates Retention Scheme (BRRS) to facilitate a move from 50% retention of marginal increases/declines in revenue to 100% retention, in order to provide

[26] The guidance note explaining the allocation of the first £1.6 billion of additional funding has been deleted by the government. However, as discussed in Phillips (2020), 85% was allocated in line with councils' assessed relative need for adult social care spending as of 2013–14.

councils with stronger financial incentives to support local growth. This included changes to how the scheme treats reductions in revenue as a result of successful business rates appeals, how revenues are shared between different tiers of local government, how insurance and redistribution mechanisms work, and the powers councils have to vary rates bills.

Initially, the aim had been to begin using the chosen formulas, funding system and reformed business rates retention scheme in April 2019. However, this was progressively delayed to April 2020, April 2021 and then April 2023 at the earliest. Plans to move to 100% business rates retention were also watered down to 75% retention after the Bill required to implement 100% retention was not resurrected following the snap 2017 general election – and a final decision on whether to go ahead at all is still to be taken.

It is understandable that the government chose not to finalise and implement the reviews during the ongoing COVID-19 crisis: both it and councils have had many more pressing things to do than consult on, respond to and finalise quite technical changes to funding arrangements. Potentially significant changes to funding could also be particularly disruptive and difficult to respond effectively to in the midst of a major crisis. It also makes sense to delay making final decisions on the future of the BRRS until the fundamental review of business rates themselves that has been commissioned by HM Treasury has been completed (HM Treasury, 2020).

However, it is vital that the fair funding review is completed so that future funding allocations can be made on a more rational basis that reflects councils' contemporaneous circumstances – not their historical (and potentially very different) circumstances. It is therefore important to ask: what are the key issues that need to be considered if the fair funding review and business rates retention reviews are to be completed? While decisions on these will be led by DLUHC rather than the Chancellor, there will be important two-way interactions between the outcomes of these reviews and the Spending Review. Clarity on the government's thinking on funding reform – even if full details are unavailable – would help councils plan for the future (Local Government Association, 2021a).

Choosing the balance between incentives and redistribution

There is no single 'right' answer to how the new funding system should be structured or how much different councils should receive. In particular, there is a trade-off between redistributing funding in line with the updated estimates of councils' spending needs, and providing councils with financial incentives to boost their revenues and to address the factors that drive spending needs. Many of the key decisions to be taken in the review relate to this trade-off, including:

- **Whether, at the point of implementation, funding is distributed so as to reflect 100% or some lower fraction of the differences between councils' estimated spending needs and their revenue-raising capacities.** Note that even a full initial redistribution of funding, if credibly one-off, would not have implications for the financial incentives that councils face to boost revenues and tackle spending needs in future.
- **The extent to which funding is redistributed in subsequent years to reflect changes in revenue-raising capacities and assessed spending needs.** The choices made here *will* affect the incentives councils face – the greater the extent to which increases in revenue-raising capacity and falls in assessed spending needs lead to reductions in funding, the weaker the incentive councils have to achieve these goals. There is therefore a trade-off between providing incentives and allocating funding on an ongoing basis in line with needs. How to balance these is partly a subjective question about priorities, but should also reflect the extent to which councils can influence their revenue-raising capacity and the drivers of spending needs.

The technical details of such arrangements will matter both for the incentives that councils will face and for the funding specific councils will receive. In its most recent consultations on the fair funding and business rates retention reviews, the government makes both sensible suggestions that help make the trade-off between incentives and redistribution less onerous, and some suggestions with more questionable rationales (MHCLG, 2018a, 2018b).[27] The final decisions taken will have implications for the wider public finance landscape too: the better the system targets funding at the councils that need it (while maintaining incentives as far as possible), the less funding the Chancellor will have to provide overall to the sector in the Spending Review or subsequent fiscal events.

Two examples help illustrate this. First, the consultation documents propose to take account of projected population growth when estimating spending needs but not when estimating revenue-raising capacity. This would penalise areas with declining populations – which are likely to be disadvantaged or struggling in other ways – and benefit those with rapidly growing populations. Second, a decision needs to be taken on whether to update the weights applied to different spending areas in overall funding decisions over time. This matters because one might expect adult social care needs, for example, to rise rapidly because of an ageing population, whereas this will not be the case for all other service areas. Accounting for such differences in projected spending need by service would channel additional funding to councils projected to see relatively large increases in their spending needs, but would not affect their incentives to tackle the factors driving these spending needs.

[27] Full responses to these consultations by IFS researchers can be found in Amin-Smith, Harris and Phillips (2019) and Amin-Smith and Phillips (2019).

Transitioning to the new funding system

Decisions the Chancellor makes could also ease or hinder transition to the new funding system and allocations.

By the earliest date the reviews will be implemented (April 2023), there will have been no proper system for redistributing funding between councils for at least 10 years. There will also have been a decade or more of accumulated business rates growth, and significant changes in the socio-economic characteristics of different council areas. Together, this means that the changes in funding allocations when the reviews are implemented could be very large for some councils. A range of analyses suggest that councils in inner London in particular could see large falls in funding following the fair funding review, given relatively large declines in their levels of deprivation in recent years, likely changes in the factors the new formulas will account for, and the reintroduction of a system accounting for council tax revenue-raising capacity (Phillips, Harris and Amin-Smith, 2018; Local Government Association, 2020). The redistribution of growth in retained business rates since 2013–14 when the new system is introduced will also see some councils lose a substantial part of their funding. For example, as of 2019–20, we estimate that eight councils (seven shire districts and the City of London) received at least 20% more funding than they would have if above-inflation business rates growth had been distributed in line with existing spending needs assessments. A further 52 (including 51 shire districts) are estimated to have received between 10% and 20% more.

Cutting councils' funding by such large amounts overnight would likely cause significant difficulties, especially for those councils with limited reserves that could be used to smooth the adjustment. Transitional arrangements will therefore be needed to implement funding cuts over a period of years. The government faces two key choices: the pace at which the transition should take place; and how to fund the transitional payments for losers from the reviews. The former should certainly be guided by the scale of funding changes the reviews eventually result in: bigger changes should have longer transitions. For the latter, the government faces a choice of whether to phase in increases in funding for the winners, perhaps in order to make the transitional scheme revenue-neutral (which is how transitional protection works for business rates taxpayers, for instance). Alternatively, it could top-slice funding from its overall budget for local government funding, spreading the cost across the entire local government sector. This would allow winners to benefit from their gains more quickly, but would mean that the losers would be implicitly funding part of the transition scheme. In either case, the trade-offs will be easier the more funding the Chancellor provides to DLUHC either in the Spending Review or in subsequent fiscal events.

How to account for COVID-19 and other major changes

As discussed above, the COVID-19 crisis has affected and is likely to continue affecting the spending needs and revenue-raising capacity of local government, necessitating continued increases in grant funding from central government if very large increases in council tax or cuts to service provision are to be avoided. But the crisis has affected, and will likely continue to affect, different councils in different ways. For example, differences in disease prevalence and population vulnerability to disease may have led to different changes in the need for social care services across England. On the income side, different degrees of reliance on income from SFCs will mean that any medium- to long-run effects of the COVID-19 crisis on these sources of revenue will differentially affect the relative need for additional funding across different types of places.

This is a challenge for the fair funding review as the ‘new’ spending needs formulas will not easily be able to account for such changes. The development of formulas for social services, for example, has been a complex process, and has utilised data from several years before the COVID crisis. And even for the simpler formulas that are planned to be used for other service areas, for which data from 2020–21 could potentially be used to make updates, it is not clear that this would be appropriate: spending patterns in 2020–21 may be even less informative about future spending needs than pre-COVID patterns.

Rather than try to update spending needs formulas now, the government should instead update both the formulas and the assessments of relative spending needs (and local tax revenue-raising capacity) more frequently in future than it has previously been minded to. This would, of course, have implications for the financial incentives councils face, but the trade-off between incentives and redistribution will have changed if the changes in needs and revenue-raising capacity are larger and less under councils’ control than normal.

As discussed in more detail in Section 7.6, the government will also have to consider how to update how it assesses councils’ relative needs for adult social care spending, which could be quite different under a reformed system of care. This will likely require a bespoke calculation in advance of the introduction of changes, before being integrated into the general needs assessment process when formulas are more fully updated post-implementation.

Whether to increase councils’ share of business rates revenues

Changes in the commercial property market that have been accelerated by the COVID-19 crisis might also prompt the government to reconsider plans to increase the rate of local business rates retention from its current 50% to 75%. Retail vacancy rates have increased substantially (British Retail Consortium, 2021) and shifts to online shopping and home working are likely to prove at least somewhat persistent (Alvarez & Marsal, 2020; Felstead and Reushke, 2020), potentially reducing demand for high-value commercial property and especially so in some city centres. Any resulting demolition or conversion of commercial property would lead to a decline in business rates revenues, necessitating additional grant funding.

As previously mentioned, HM Treasury is also conducting a fundamental review of business rates as a tax, which could potentially result in changes that make it less attractive as a source of revenue for local government. For example, efforts to make tax bills more responsive to the economic cycle would make revenues more volatile for councils, while changes to the tax base (e.g. to focus on land values rather than property in order to avoid discouraging investment) could mean rates retention provides less of an incentive for councils to support property development. A decision on whether to progress with increases in the rate of business rates retention should therefore take account of the result of this broader review, which is likely to be influenced by the Chancellor.

Reform of local taxation

Business rates are not the only local tax that need reform, though. Council tax, the other major tax collected and retained by local government, has been almost unchanged in its near-30 years of existence. In England it is still based on the same property values it was when it was first introduced: values as of April 1991. While Wales has used updated estimates of property values since 2005−06, these April 2003 values are now almost 20 years out of date as well.

In two reports last year, IFS researchers set out the case for and potential impact of revaluing and reforming council tax in England and Wales (Adam et al., 2020a, 2020b). Revaluing and particularly reforming England's council tax so that it is proportional (or at least less regressive) with respect to property value could contribute to the government's levelling-up agenda, reducing average bills across the Midlands and North and indeed much of the South West and parts of the East and South East far from London, while increasing average bills in London and its environs.[28] More proportional council taxes would also on average benefit households with lower incomes, those headed by younger adults, and those containing someone on disability benefits in both England and Wales.

Unfortunately, the UK government – like its recent predecessors – seems disinclined to revalue let alone reform council tax, despite its large majority (which makes beneficial but politically difficult changes easier), and public support from a number of its northern MPs and Conservative-leaning think tanks.[29] In a letter to the Fairer Share campaign, which argues for

[28] This would depend crucially on central government funding for different councils being reallocated in line with the updated property valuations and council tax system. If this funding were not adjusted, each council would need to raise as much council tax as now if it wanted to maintain spending. This means while some households would see their bill go up and others go down, the average bill charged by each council would be unchanged.

[29] See, for example, the letters by Kevin Hollinrake (https://www.conservativehome.com/platform/2020/09/kevin-hollinrake-conservatives-must-consider-a-proportional-property-tax.html), and John Stevenson (https://www.conservativehome.com/platform/2021/02/john-stevenson-property-tax-reform-is-key-to-levelling-up-the-country-and-the-conservatives-electoral-chances.html), as well as articles in the Daily Telegraph (https://www.telegraph.co.uk/news/2020/12/11/launching-property-research-group-mps-fight-reform-outdated/) and on Conservative Home (https://www.conservativehome.com/platform/2020/12/sam-robinson-the-case-for-comprehensive-property-tax-reform-is-long-standing-and-crystal-clear.html).

reform of council tax and stamp duty land tax, Jesse Norman, until recently Financial Secretary to the Treasury, argues that a revaluation would be 'expensive', 'controversial' and any values could be perceived as 'unfair or inconsistent as a result of in-year or regional disparities in the property market'.[30] Unless we plan to use 1991 values for evermore, the nettle of revaluation will eventually have to be grasped, with further delay meaning that the changes in bills at the eventual revaluation may be even larger. The 1991 values currently used are also even more clearly unfair and inconsistent – not only do they reflect in-year or regional disparities in the property market as of 1991, they bear increasingly little relation to property values that have changed very differently in different parts of the country over the last 30 years. Moreover, advances in computing mean automated valuation processes can significantly reduce the costs associated with valuing most properties. The UK government's timidity on this issue is therefore disappointing, especially given the focus it claims to place on reducing geographical inequalities. It means that council tax reform is unlikely to feature in this autumn's Spending Review and Budget (or indeed subsequent Budgets) – but it undoubtedly should.

In contrast, the Welsh Government has committed to reform of council tax to make it 'fairer' and less 'regressive'. The First Minister of Wales has highlighted it as an 'early priority' for the Senedd term that started in May 2021,[31] and recently suggested it could form part of a planned deal between Welsh Labour and Plaid Cymru.[32] Just how radical the reforms will be remains to be seen; however, the First Minister has said options such as replacing council tax with a land value tax or revaluing and making council tax more progressive, as analysed in the aforementioned IFS report (which was commissioned by the Welsh Government), are on the table.[33] Furthermore, Plaid Cymru supports a revaluation and moves to make council tax proportional to property value, also citing the IFS report in its 2021 Senedd election manifesto (Plaid Cymru, 2021).

The impact of Welsh reforms on the debate in England will depend not just on their nature, but also on their implementation and the political reaction to this. The political controversy around the fact that many more properties went up bands rather than down bands in Wales's 2005 revaluation (because the band thresholds were set in advance of the valuations, and prices were rising very rapidly) was likely a factor in the then UK government shelving plans for revaluation in England. A move towards a more proportional property tax would mean many more winners than losers, especially among those with low to moderate incomes. But some households – including a small number of low-income households living in highly value properties – could

30 See https://fairershare.org.uk/response-to-fairer-share-from-jesse-norman-mp/.
31 See https://www.wrexham.com/news/fairer-council-tax-early-priority-for-this-term-says-first-minister-204520.html.
32 See https://www.bbc.co.uk/news/uk-wales-58618177.
33 See https://www.thenational.wales/business/19385758.mark-drakeford-wants-council-tax-reform-tourism-levy/.

see very large increases in bills. Transitional arrangements and mitigation measures (such as deferral schemes) will therefore be particularly important for the successful implementation of reform in Wales – and whether the reforms catalyse or stymie reforms elsewhere in the UK.

7.5 Devolution deals

While we are unfortunately unlikely to see changes to local taxes in the upcoming Spending Review, changes to the areas of public spending under local government control may feature. In particular, the UK government has already highlighted devolution of additional responsibilities and associated funding streams to English councils as a key element of its 'levelling-up agenda'. This agenda is likely to be at the heart of the upcoming Spending Review, with plans expected to be set out in detail in a separate White Paper this autumn.

The last several years have seen a series of devolution deals agreed between the UK government and councils or new 'combined authorities' (covering groups of councils), largely but not exclusively in urban areas. The responsibilities and funding devolved are agreed on a case-by-case basis and vary between areas, but typically cover adult education, business support, and elements of employment support, transport funding, planning and economic development. Specific examples include:

- the Greater Manchester Combined Authority, whose various deals cover: a devolved and consolidated transport budget; bus service franchising; strategic and spatial planning; housing investment; adult education; business support; selection of projects for EU funding; joint commissioning of the Work Programme; involvement in decisions over prison and probation services; oversight of an integrated health and social care system; and the retention of 100% of business rates revenue growth (compared with a standard 50%);[34]
- the North of Tyne Combined Authority,[35] whose deal covers: adult education and the integration of skills and employment programmes; and agreement to collaborate with central government on international trade and investment, digital infrastructure and low-carbon energy;[36]
- the West Midlands Combined Authority, whose two deals cover: a devolved and consolidated transport budget; bus service franchising; adult education; business support; joint commissioning of Work Programme support for those hardest to help into employment;

[34] https://www.gov.uk/government/publications/devolution-to-the-greater-manchester-combined-authority-and-transition-to-a-directly-elected-mayor.
[35] Which covers Newcastle-upon-Tyne, North Tyneside and Northumbria.
[36] https://www.gov.uk/government/publications/north-of-tyne-combined-authority-devolution-deal.

and the retention of 100% of business rates revenue growth (compared with a standard 50%);[37]

- Cornwall Council, whose deal covers: bus service franchising; selection of projects for EU funding; agreement to collaborate with central government on reshaping further and adult education; integrating business support; promoting energy efficiency and making best use of publicly owned buildings and land; the potential integration of health and social care (although how this differs from the integrated care systems now in place across England is unclear); and the retention of 100% of business rates revenue growth (compared with a standard 50%).[38]

Estimates of the total quantum of funding devolved or subject to new joint commissioning arrangements are unfortunately unavailable, perhaps reflecting the complex and ad-hoc nature of arrangements.[39] However, allocations have been published for ‘single pot’ investment funding provided alongside devolution deals (around £250 million per year across the areas with deals) and, for those areas with metro mayors, from the Transforming Cities transport fund (just over £1 billion between 2018–19 and 2022–23, out of a total of £2.45 billion across England).

The former Secretary of State for Housing, Communities and Local Government, Robert Jenrick, recently wrote to English councils and combined authorities stating that they will be invited to approach the government with proposals for new or expanded devolution deals.[40] No details have yet been given on what specific responsibilities and funding may be devolved but Mr Jenrick’s letter suggests two key objectives from further devolution: supporting economic recovery from the COVID-19 crisis and the government’s ‘levelling-up agenda’ by focusing on powers and plans related to the economy and skills; and improvements in governance and service delivery efficiency and cost-effectiveness, including via joint-working, merger of services and merger of councils.

The letter also highlights there will be a focus on devolution to county areas, very few of which have agreed a deal so far. Deals will not be predicated on particular modes of local governance (e.g. directly elected mayors) or the merger of councils, but ‘the nature and appropriateness of proposed governance structures will impact on the nature of the deal and the types of powers and flexibilities provided in a deal’. This suggests that by linking powers to governance and local government structures, the government may wish to incentivise (rather than mandate) changes. New unitary authorities are due to be created next year in Cumbria, North Yorkshire and

[37] https://www.gov.uk/government/publications/west-midlands-devolution-deal.
[38] https://www.gov.uk/government/publications/cornwall-devolution-deal.
[39] One of the areas for which figures are available is adult education: £810 million in 2020−21 (https://www.gov.uk/government/publications/adult-education-budget-devolved-grant-determination-letters-2021).
[40] See https://www.lgcplus.com/politics/devolution-and-economic-growth/exclusive-jenrick-sets-out-framework-to-widen-devolution-beyond-cities-15-07-2021/.

Somerset,[41] and plans are being mooted by county councils in Oxfordshire and Surrey, and district councils in the south of Essex.[42]

Until more detailed information is made available, it is difficult to say much about the potential impact of devolution on English councils or policy outcomes. A number of existing devolution deals have been evaluated, but lack credible strategies for identifying what would have happened in the absence of devolution.[43] One issue that should be addressed for both existing and any future deals is ensuring that there is clarity about what is being genuinely devolved (versus involving collaboration and consultation) and that up-to-date information is available on progress with devolution (deals often highlight ambitions to 'explore'). It is vital for accountability purposes that the electorate know which tiers of government to engage with and hold to account for different service areas. It has been difficult to find clear information about these issues when putting this analysis together, which suggests that there is some way to go in ensuring clarity.

It is also important to note that there may be a trade-off between the extent to which deals are bespoke (and based on local priorities, capacity and accountability processes) and the extent to which the electorate can understand how responsibilities are divided and shared between tiers of government in their area. Complex, bespoke arrangements may also increase the costs for central government departments and agencies in managing their interactions with local government in different parts of the country. It may therefore be useful for the government to develop a number of devolution 'packages' rather than completely bespoke deals for each area. As highlighted in a recent report from the House of Commons Housing, Communities and Local Government Committee (2021), this could be formalised in a 'framework for devolution', identifying the objectives of devolution, and the associated various packages of powers and funding streams that are considered suitable for devolution to help achieve these objectives.[44]

41 See https://www.gov.uk/government/news/next-steps-for-new-unitary-councils-in-cumbria-north-yorkshire-and-somerset.

42 See https://cratus.co.uk/unity-on-unitaries-the-drive-to-set-up-more-unitary-authorities.

43 See, for example, Cornwall Council, CIOS LEP and Kernow CCG (2019) and Greater Manchester Independent Prosperity Review (2018).

44 The report suggests that underlying such a framework should be a presumption in favour of devolution, with all policy areas potentially devolvable unless a clear and strong rationale for central control can be articulated. Furthermore, it suggests that such an approach could be formalised by adopting the 'reserved powers' model used for devolution to Northern Ireland, Scotland and Wales, where powers are automatically devolved unless explicitly reserved to the UK government. Whether such an approach is tenable is unclear though: the UK government will continue to have an interest and likely want to implement policies and spend money directly in areas such as transport, skills and local economic development. It may be easier to coordinate with local government, and avoid costly duplication or gaps in provision, if certain areas are explicitly recognised as 'shared powers'.

7.6 Reform of adult social care services

The council service that is likely to see the most significant reforms in England over the next few years is adult social care. Presently, this is subject to both a stringent care needs assessment and means-testing. Cuts to funding during the 2010s saw councils progressively raise the level of care needs someone must have to be eligible for support, contributing to a 30% fall in the numbers receiving care in their own home between 2009–10 and 2013–14 (Crawford, Stoye and Zaranko, 2021), despite the older-age population increasing.[45] The asset limits used in means tests are low and have been frozen for several years: those with assets of £23,250 or above must pay for their care costs in full irrespective of their income (although the definition of assets excludes the primary residence if care is being provided at home or a spouse or dependant still resides there). And those with sufficient assets and income can face potentially huge costs if they require costly social care for a long period of time. This is in contrast to those requiring costly medical care, which is provided free of charge by the NHS, irrespective of one's income or assets.[46]

Reforms and the quantum of funding

Reforms announced on 7 September mean council-funded adult social care services in England will still be subject to an initial means test (HM Government, 2021). However, this test will be substantially more generous: the upper asset threshold will be increased to £100,000 (from £23,250) from October 2023, meaning those with assets up to that level will be entitled to some support with their care costs if their incomes are insufficient. The threshold to be potentially eligible for full support (depending on one's income) is also increasing to £20,000 (from £14,250). At the same time, a lifetime cap of £86,000 will be placed on the amount any individual has to pay for personal care, subject to that care being deemed necessary as part of a council care needs assessment. Once eligible costs exceed £86,000, an individual's council will pay in full for any further personal care costs deemed necessary irrespective of their assets or income – although funding for accommodation and food for those in care homes will still be means-tested, and there will be the option of topping up the personal care services deemed necessary by their council. In total, the government estimates that around 150,000 adults in England will be entitled to state-funded support at any one time as a result of these two changes once they are fully rolled out.

[45] Changes to how care recipients are classified for statistical purposes in 2014–15 prevent longer-run comparisons, but numbers in receipt of care have been broadly stable since then – although in the context of an ageing population, this still represents a fall in the share of older adults receiving care.

[46] The NHS also funds some social care services on a non-means-tested basis as part of its Continuing Healthcare programme. This is available to those who are assessed by their NHS Clinical Commissioning Group as requiring both healthcare (such as services from a nurse) and social care (such as assistance with daily activities), and for which the majority of the care they require is 'focused on addressing or preventing health needs'.

The government also announced £5.4 billion of funding between 2022–23 and 2024–25 to begin the roll-out of these reforms, and help pay for several other initiatives including:

- £0.5 billion for workforce development and support, via additional certified training, a focus on mental health well-being, and efforts to improve recruitment and retention of staff.
- Investment in housing adaptations and supported housing, to support more people to live independently.
- Increased delivery of advice, support and respite services for informal carers caring for family and friends.
- The ability for those paying privately for care to ask their council to organise their care services at the same price the council pays care providers for services. As of 2016–17, for example, the Competition and Markets Authority (2017) estimated that those paying privately for a care home paid 41% more, on average, than councils for the same care home. While subsequent increases in fees paid by councils are likely to have narrowed this gap somewhat, this still suggests a significant saving for care users. We might therefore expect high take-up of this offer, and hence a significant new administrative burden for councils.
- Increases in the amount councils pay providers for services to reflect the fact that there will be less scope for cross-subsidy from those paying privately, given more will be entitled to council-funded care and those paying privately will be able to access the lower council-negotiated rates.

Taken together, this is a big ask from a funding package averaging £1.8 billion a year – around 11% of councils' net spending on adult social care services in 2019–20. Indeed, reports suggest that the costs of the more generous means test and care cost cap may amount to £2.5 billion up to the end of 2024–25 (Local Government Association, 2021b), meaning less than £1 billion a year for the other mooted increases in service provision. This is in the context of a shortfall between what councils pay for social care packages and industry estimates of minimum benchmark fees that would allow for cost recovery and what they deem an 'appropriate' profit. This shortfall was estimated at £1.34 billion across England in 2018–19 (Ogden, Phillips and Spiliotis, 2020) – a figure that increasing demand and the planned expansion in eligibility for council-funded care will almost certainly push up in future.[47] It therefore seems unlikely that the funding will be sufficient to meet the government's aims in full over the next three years.

Furthermore, the government has not published estimates of how much the reforms will cost in the longer term. However, costs will grow as more people reach the care cost cap, and the Health Foundation has previously estimated that the costs of a similar cap and higher capital threshold would amount to around £2 billion a year in today's prices once fully rolled out (Idriss et al., 2021). This excludes any increase in fees paid to providers, and the other aforementioned

[47] Even in the absence of the planned reforms, the cost was projected to grow to £1.7 billion per year by 2023–24.

improvements, which taken together could eventually push costs towards £5 billion a year, almost three times the average annual funding planned over the next three years.

The government plans to fund the reforms via earmarked tax increases – specifically, a new and unnecessarily complex ‘health and social care levy’ levied on employers, employees and the self-employed, and higher dividend tax rates (Johnson et al., 2021). Between 2022–23 and 2024–25, this will raise a net £36 billion,[48] most of which will go to the NHS to increase its capacity, in part to treat a backlog of care resulting from disruption due to the COVID-19 pandemic. The Chancellor seems to hope that more of the funding will be available for social care services in the longer term, although history suggests that the NHS is likely to require further budget top-ups in later years, potentially making that difficult (Zaranko, 2021).

Without further increases in central government funding to pay for the reforms, councils would face the unenviable choice between very large council tax increases (potentially requiring winning local referendums), cuts to other services, and failure to improve adult social care services in the way the government and the electorate will expect. Even if the funding required for the reforms announced is made available, adult social care services are likely to remain a financial and policy challenge for councils and the government, for three main reasons.

First, the government has been explicit that underlying demand and cost pressures – due to a growing and ageing population and rising labour costs, for example – will have to be funded from councils’ core resources, consisting of revenues from council tax and business rates and existing central government grants. These pressures are likely to amount to more than 5% a year in cash terms (over 3% a year in real terms) and, as discussed in Section 7.3, the outlook for council funding over the next few years looks challenging, even if council tax continues to increase by 4% a year.

Second, while there is funding for workforce development, there is no funding for higher pay for social care workers, which an increase in provision and demand for care workers in the context of a tightening labour market may require. Each 1% increase in wages would cost over £200 million across the adult social care sector as a whole, for example, with 50–60% of this currently being associated with council-funded care (although that share will increase as a result of the reforms).[49] And, for example, the Department of Health and Social Care has estimated that raising the pay of adult social care workers to at least the bottom of the main NHS pay scale would cost around £1.2 billion per year (NHS Pay Review Body, 2021).

[48] The gross revenues are forecast to be approximately £41 billion, but just over £5 billion of this is estimated to be due from public sector employers, who will be compensated with higher funding allocations.
[49] Authors’ calculations using Skills for Care (2020) data.

Third, there is no funding to enable councils to relax care needs assessments alongside the changes to financial means testing. The Health Foundation has also estimated that a funding boost of 10% to expand provision could increase the number of people in receipt of long-term care by 25% relative to current forecasts (the average cost per additional recipient would be much lower than the average cost of existing recipients as they would have less severe needs, on average), undoing around half of the decline in the number in receipt of care during the 2010s (Idriss et al., 2021). This would cost approximately £2.3 billion a year in today's prices in 2023–24, rising to £2.8 billion by 2030−31. Moreover, the Local Government Association (2021a) estimates that addressing all unmet care needs could cost £6 billion per year. Without sufficient funding, we could instead see councils respond to the costs of more generous means-testing by further tightening needs tests.

The government is still planning to publish a full adult social care White Paper later this autumn. This will flesh out the plans for the reforms already announced and, alongside the Spending Review, hopefully provide an indication of if, and if so how, the government will address underlying demand and cost pressures, low pay, and stringent care needs assessments.

Funding allocations and the role of councils

The government will also have to develop and consult on a method for how to allocate additional funding across councils. Existing social care spending needs assessments – which are already in dire need of updating, as discussed in Section 7.4 – will be unsuitable as they are predicated on the existing means-tested system. In particular, a higher share of the costs of reforms will be in parts of England where higher levels of income and wealth mean more people currently pay for their care privately. And these differences can be stark – as of 2017, for example, approximately 22% of older adults in care homes in the North East of England were paying in full themselves, compared with around 40% in the rest of the North and 62% in the South East of England (Jarrett, 2018).

The government may not have to start from scratch with this: allocation formulas for both a cap (albeit set at £72,000) and higher asset floor for those requiring residential care in a care home (albeit set at £118,000) were estimated by Vadean and Forder (2018) for a previous failed attempt to reform the adult social care system. These formulas could potentially be updated to account for the new cap and threshold levels at relatively low cost, although a full update (including using new data on care users and fees too) would be costlier and more time-consuming.

With people across the entire country paying the same 'health and social care levy', it also seems likely that government and public expectations for more consistent standards and eligibility criteria across councils will intensify. However, as highlighted by Amin-Smith, Phillips and Simpson (2018a), there is a tension between a desire for greater consistency in social care services across England, and local government funding reforms over the last decade, which have shifted the emphasis from redistribution according to needs towards greater local revenue retention to provide incentives for revenue growth. If this tension is not addressed, councils with high and/or rising needs for adult social spending and low and/or falling revenue-raising capacity will either be unable to meet expected standards of social care services, have to cut back other services, or have to substantially increase local tax rates (which might require winning a local referendum).

One way to address the tension would be, as part of the fair funding and business rates retention reviews discussed in Section 7.4, to halt any further move towards making funding dependent on local revenue-raising capacity. The government could also potentially partially reverse course by more frequently and more fully updating the redistribution of funding as councils' spending needs and local revenue-raising capacities change.

Another way would be to move towards providing a much larger share of social care funding to councils in the form of needs-based and ringfenced funding. This is the approach effectively taken with schools funding in the mid 2000s, and would build on the growing pot of social care funding that is already ringfenced, including the Better Care Fund, Improved Better Care Fund and, soon, the proceeds of the health and social care levy. However, that would effectively remove over one-third of what councils currently spend from local control, reducing residents' say in local spending decisions. Of course, if we want greater consistency in the provision of social care services across England then a reduction in local discretion is more or less a given.

Such a change would also likely see some areas of England receive big increases and others big decreases in their relative levels of funding given that historically assessments of spending need and actual spending have only been relatively weakly correlated (Phillips and Simpson, 2017). This means any move to needs-based ringfenced funding would need to be slowly phased in to help ensure efficient adjustments are made. To the extent that this weak correlation reflects shortcomings in needs assessments or differences in efficiency as opposed to differences in service offerings, centrally determined needs-based funding might not even lead to smaller differences in service provision than existing arrangements.

At an operational level, both the newly published plans and the Health and Social Care Bill (2021–22) envision councils maintaining their central role as commissioners of the majority of state-funded social care services in England. However, they will have to work in partnership with local health bodies as part of Integrated Care Systems to agree joint priorities and integrated approaches to health and social care. To enable this, the Health and Social Care Bill will make it easier to collaborate in this way by removing legal restrictions on formal joint decision-making boards and pooled budgets that currently exist as part of the commissioner–provider split within the NHS.

The aims of integration are laudable: helping ensure people receive the most appropriate care from the provider and in the setting best suited to deliver it; earlier intervention and a focus on preventative care; and a reduced burden for health and social care recipients and their informal carers in coordinating their care. These aims will be supported by ensuring every adult in England has a single digital health and social care record to be used by the NHS, councils and social care providers. But integration is likely to take several years and significant effort and up-front investment from the government, NHS, councils and care providers as new formal structures and assurance regimes are put in place, and new collaborative working arrangements developed and put into practice.

Evidence on the extent to which integration could improve outcomes and/or reduce costs (e.g. via less-costly early intervention) is limited, and the evidence that does exist is mixed at best. For example, a review commissioned by the Department for Health (Mason et al., 2015), which examined 38 integration schemes from eight countries, found no evidence of a sustained reduction in hospital use from any of them, and in only three found a statistically significant reduction in broader secondary healthcare service usage. Of the 24 schemes for which health outcomes were evaluated, only five saw statistically significant improvements overall. Based on this and other evidence, the National Audit Office (2017) concluded that the government had 'not yet established a robust evidence base to show that integration leads to better outcomes for patients'. More recently, evidence from the devolution and integration of health and social care to Greater Manchester suggests that performance fell relative to the rest of England for most health usage and outcome indicators tracked, despite additional funding to aid integration (Williams, 2021).

Mason et al. (2015) found that poor outcomes from integration often result from difficulty in properly integrating budgets, from differences in performance frameworks and priorities, and from difficulties in linking information systems – issues the Health and Social Care Bill (2021−22) aims to tackle. However, the evidence available to date suggests that the Chancellor should not bank on savings from integration making a significant contribution to tackling the rising costs of health and social care services, and hence the need for additional funding for English councils.

7.7 Conclusion

Pre-COVID, 2020–21 was meant to be something of a financial turning point for English councils, with a sizeable boost in funding set to allow a modest expansion in service provision after a decade of austerity. Welsh councils were also set to see the biggest increase in funding in more than a decade.

In the end, the increase in funding and spending has been several times greater than anticipated as councils saw increased costs and demands and took on new responsibilities as a result of the COVID-19 pandemic. Analysis suggests that across the sector as a whole, the government provided slightly more than enough funding for English councils to address the in-year financial pressures resulting from the pandemic. In Wales, councils were compensated for most pressures on the basis of their own estimates of the scale of those pressures. However, it seems likely that later this year and almost certainly in future years, the Chancellor will have to stump up more cash for English councils to address both underlying spending pressures and the longer-term effects of the COVID-19 pandemic if he wishes to avoid an ongoing need for very large council tax rises and/or renewed cuts to service provision. The Welsh Government will likely need to do the same, although falling pupil numbers in Welsh schools may allow Welsh councils to reallocate some funding to areas with rising demand such as social services.

Reliance on council tax would raise several issues. First, more deprived areas can raise less via council tax than more affluent areas, and England currently lacks a coherent system for redistributing grant funding to compensate for this. The delayed fair funding review is designed to help tackle this, though, and concluding it should be a priority. Second, council tax is increasingly out of date and regressive with respect to property values. Increases in it fall relatively heavily on low- to middle-income households and in parts of England where property prices are low and/or have increased less than average in the last 30 years. The Chancellor could help address both issues: by providing councils with additional funding to more easily smooth the potentially large changes in funding resulting from the fair funding review; and by utilising the greater freedom of action a large majority brings to tackle the politically difficult but eventually necessary revaluation and reform of council tax. The Welsh Government has already committed to some reforms, although their nature and scale are not yet clear. The political reaction to them will matter for England too, as it could help persuade or dissuade the UK government from following suit east of Offa’s Dyke.

Uncertainty about the path of the pandemic, its long-term effects, and the resulting impacts on councils’ revenues and spending requirements makes setting firm funding plans for the next three years an impossible task. That suggests using the Spending Review to allocate a baseline amount, assuming some medium-term financial impacts of the pandemic (e.g. modest increases in unit costs and demand, and some additional funding for test and trace schemes), but to top up funding in later Budgets (or even between Budgets) if necessary. That will allow councils to plan spending on their core services with some degree of certainty, provide them with a degree of assurance that funding will be forthcoming to deal with future COVID-19 surges and potential lockdowns, and minimise the risk of ‘locking in’ funding that may not actually be needed.

At or around the time of the Spending Review, White Papers on 'levelling up' and social care reform are promised and will matter greatly for councils.

Spending on 'levelling up' is likely to be a focus of the Chancellor's narrative at the Spending Review, and further devolution of spending related to skills and economic development seems likely, especially to the shire county areas that have largely missed out so far. In doing this, it will be important to be clear how much money is 'new' and how much is rebadged or from existing centralised spending. And while there may be benefits of agreeing bespoke devolution arrangements with different areas, it may make sense for devolution deals to draw from a limited menu of options to help ensure clarity to both local electorates and the Whitehall machinery.

The main elements of planned reforms to the adult social care system – a more generous means test, a lifetime cap on what individuals must pay themselves, and the right to request councils to organise privately funded care – were published on 7 September. However, the funding promised by the government over the next three years – an average of £1.8 billion a year – to help roll out these reforms and fund other improvements in services is unlikely to be enough to deliver these ambitions in full. The Chancellor seems to hope that more of the revenues from the health and social care levy will be available for social care from 2025–26 onwards, by which point the aim is to have addressed COVID-19-related NHS backlogs – but experience suggests shifting funding from the NHS may be difficult to achieve.

Without further increases in central government funding to pay for these reforms, councils would face the unenviable choice between very large council tax increases (potentially requiring winning a local referendum), cuts to other services, and failure to improve adult social care services. And even if additional funding is forthcoming, other issues – such as raising the pay of social care workers, and relaxing the needs assessments to undo some of the previous reductions in the numbers receiving care – would cost billions per year more. Adult social care services are therefore likely to remain a headache for both councils and the Chancellor for years to come, unless substantial additional funding is found in the upcoming Spending Review.

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