

# A time of revolution: British local government finance in the 2010s

26 October 2016

Broadway House, London

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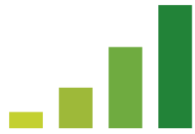
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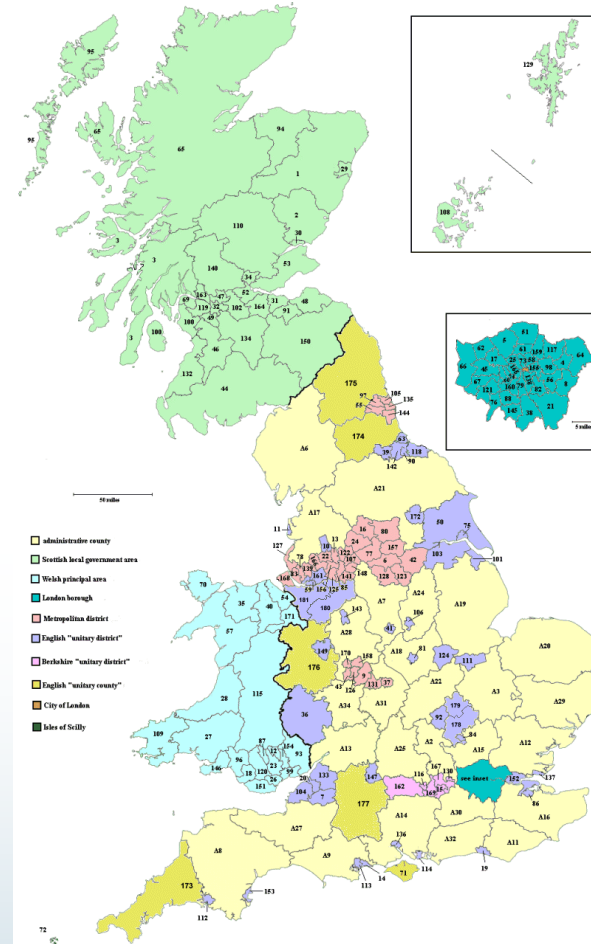
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# A time of revolution? British local government finance in the 2010s

David Phillips



# A new IFS research programme

- IFS is launching a major programme of research on local government finance and devolution to local areas
  - To inform and learn from the revolution taking place
- Examine the impact of changes so far
  - On budgets, budgetary risk, and wider policy and socio-economic outcomes
- In-depth analysis of main issues for upcoming reforms
  - Timed to contribute to policy developments
- Consider the opportunities and challenges what would arise from alternative (or broader) fiscal devolution

# IFS Local Govt Finance and Devolution Consortium

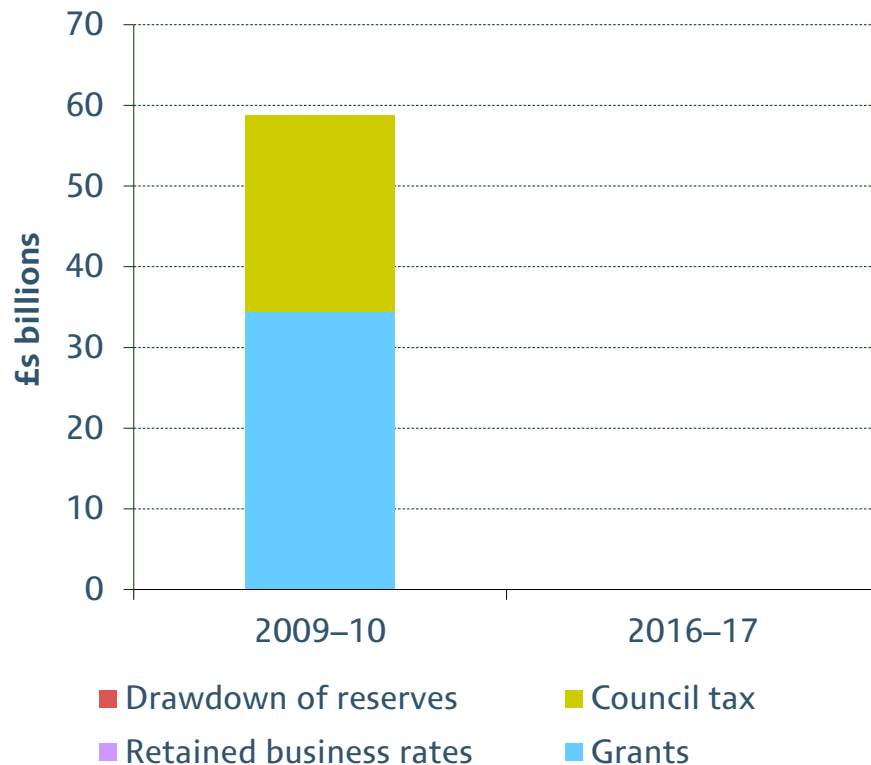
- Programme is supported by a consortium of funders and stakeholders:
  - Economic and Social Research Council (ESRC)
  - Chartered Institute for Public Finance and Accountancy (CIPFA)
  - Capita
  - PwC
  - Municipal Journal
  - The Society of County Treasurers
  - And a range of other councils across England
- Consortium contributes expertise and dissemination opportunities
- We aim to engage with other key stakeholders too
  - Including DCLG and LGA

# Coming up

- Key insights from our first report
  - Changes in councils' revenues and spending
  - Reforms to grant allocation in England
  - The current English business rates retention scheme (BRRS)
  - Moves to a 100% BRRS in England
  - What about reforms in Scotland and Wales?
- What kinds of questions might our programme look at?

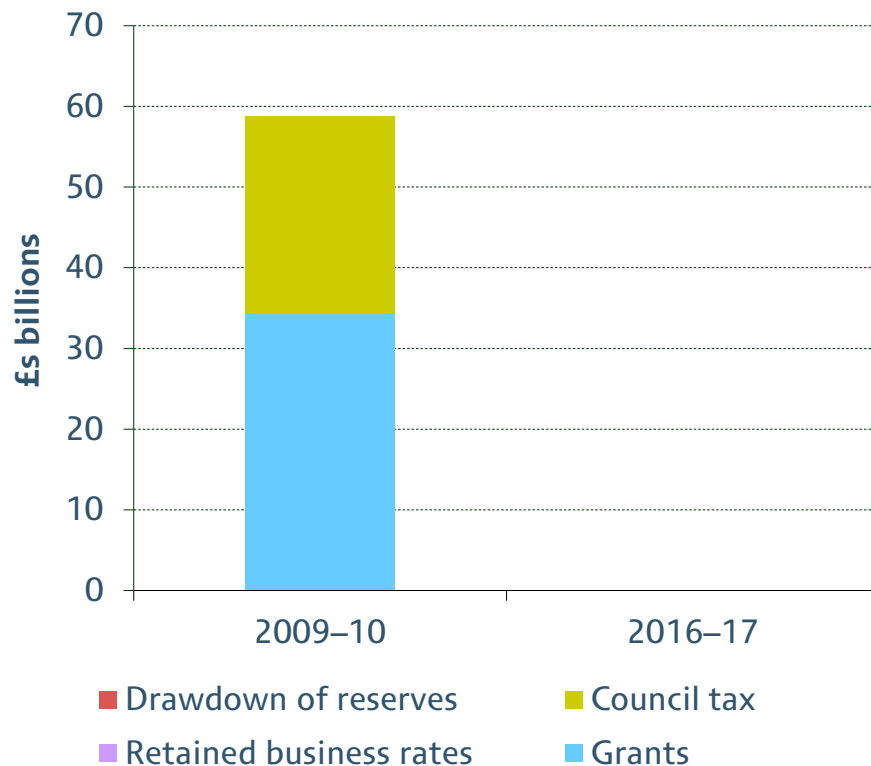
# English councils' revenues

- Excluding grants for education, police and fire services, councils' revenues in 2009-10 were £59 billion (in today's prices)



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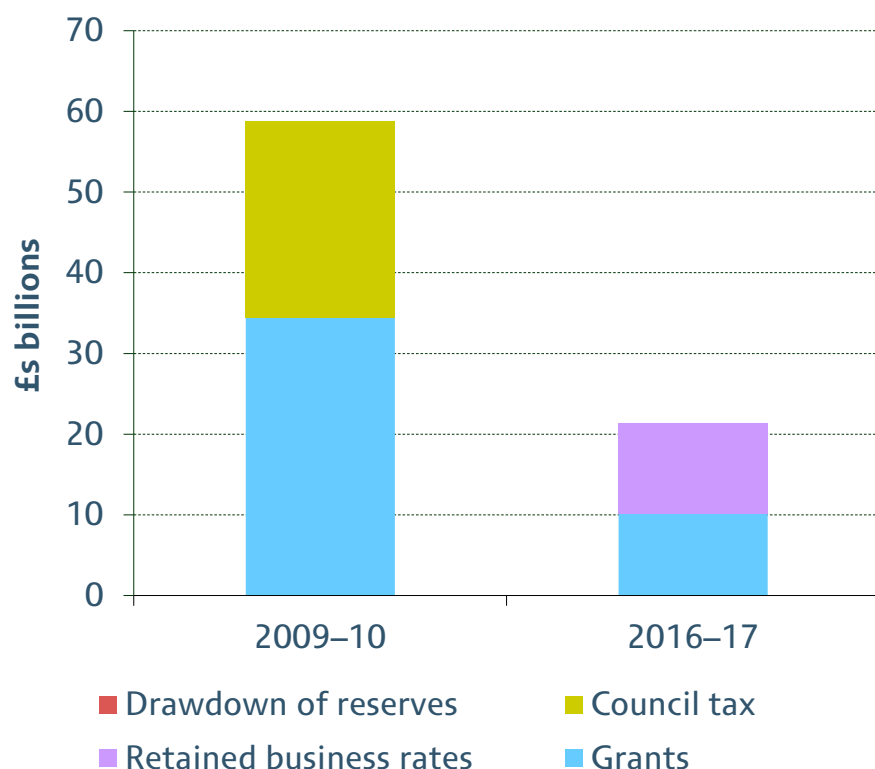
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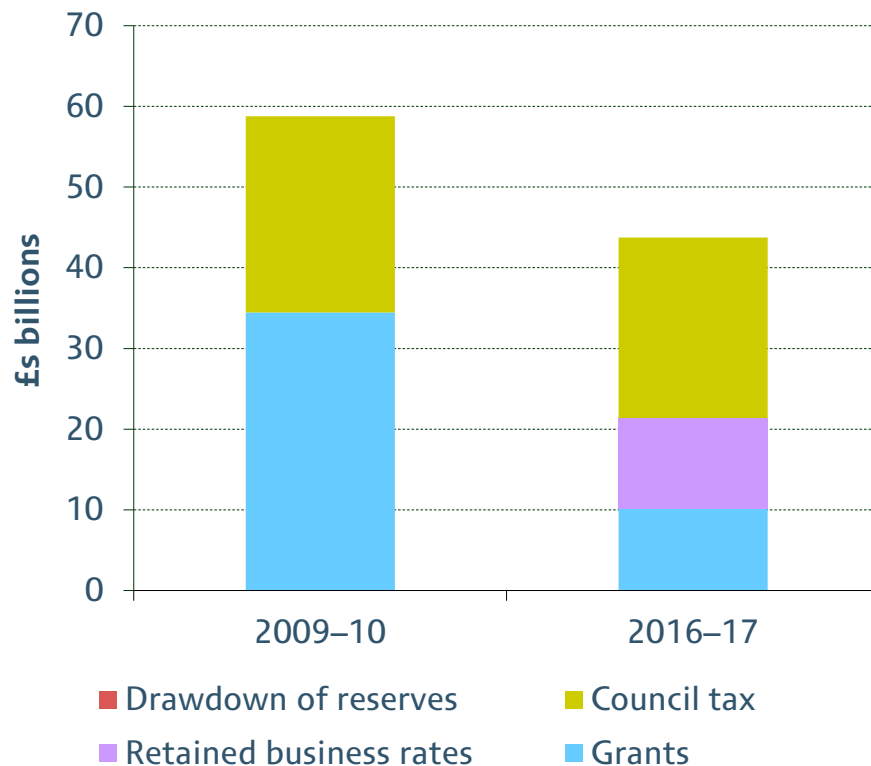


- In 2016-17, measured consistently, councils revenues will be £44 billion, 26% lower
  - Together, grants and newly part-localised business rates revenue down 38%



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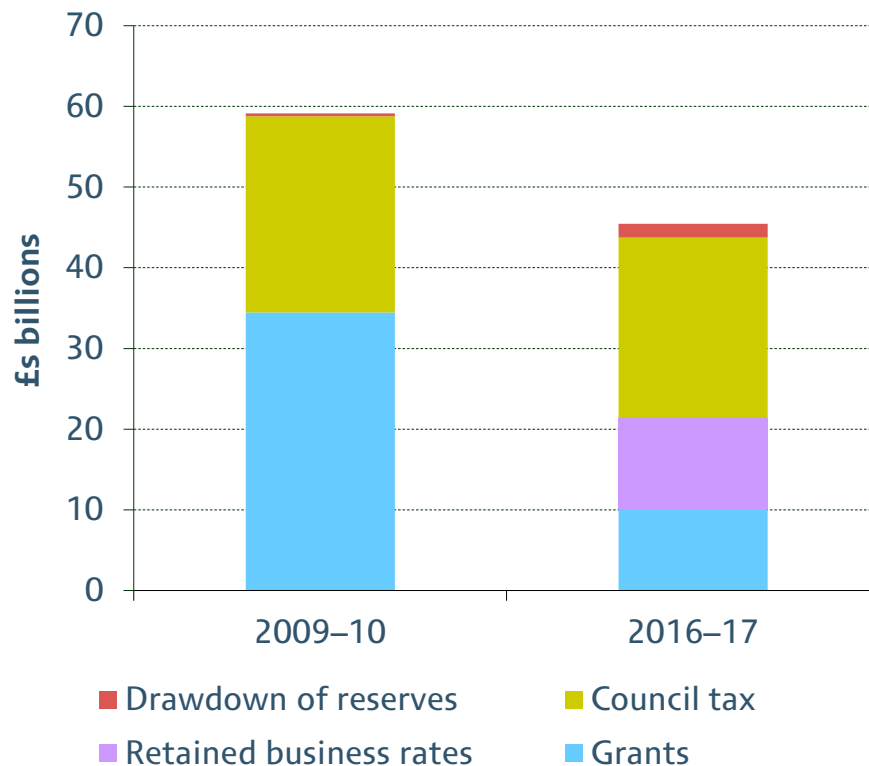
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  - Council tax revenues down 8%

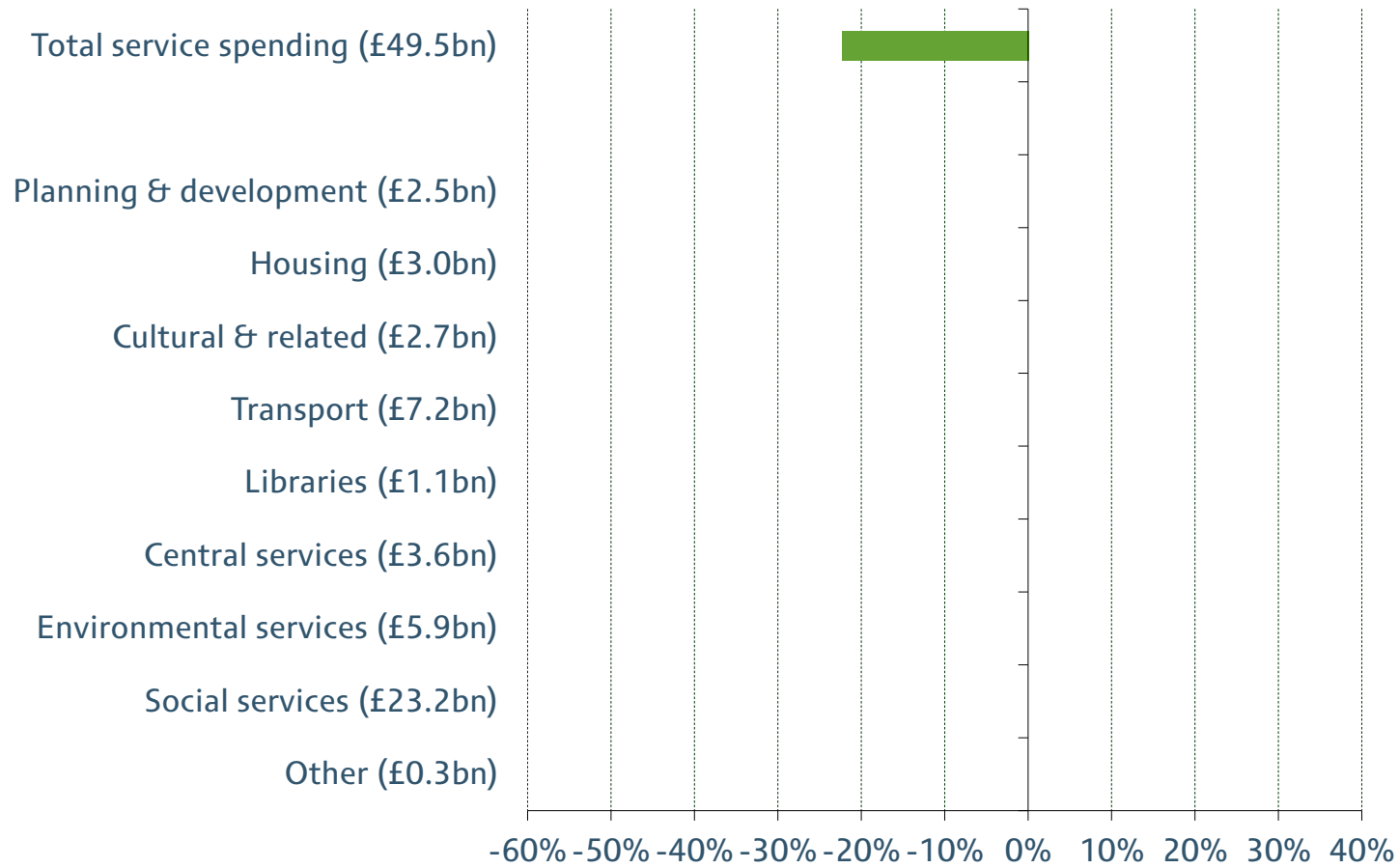
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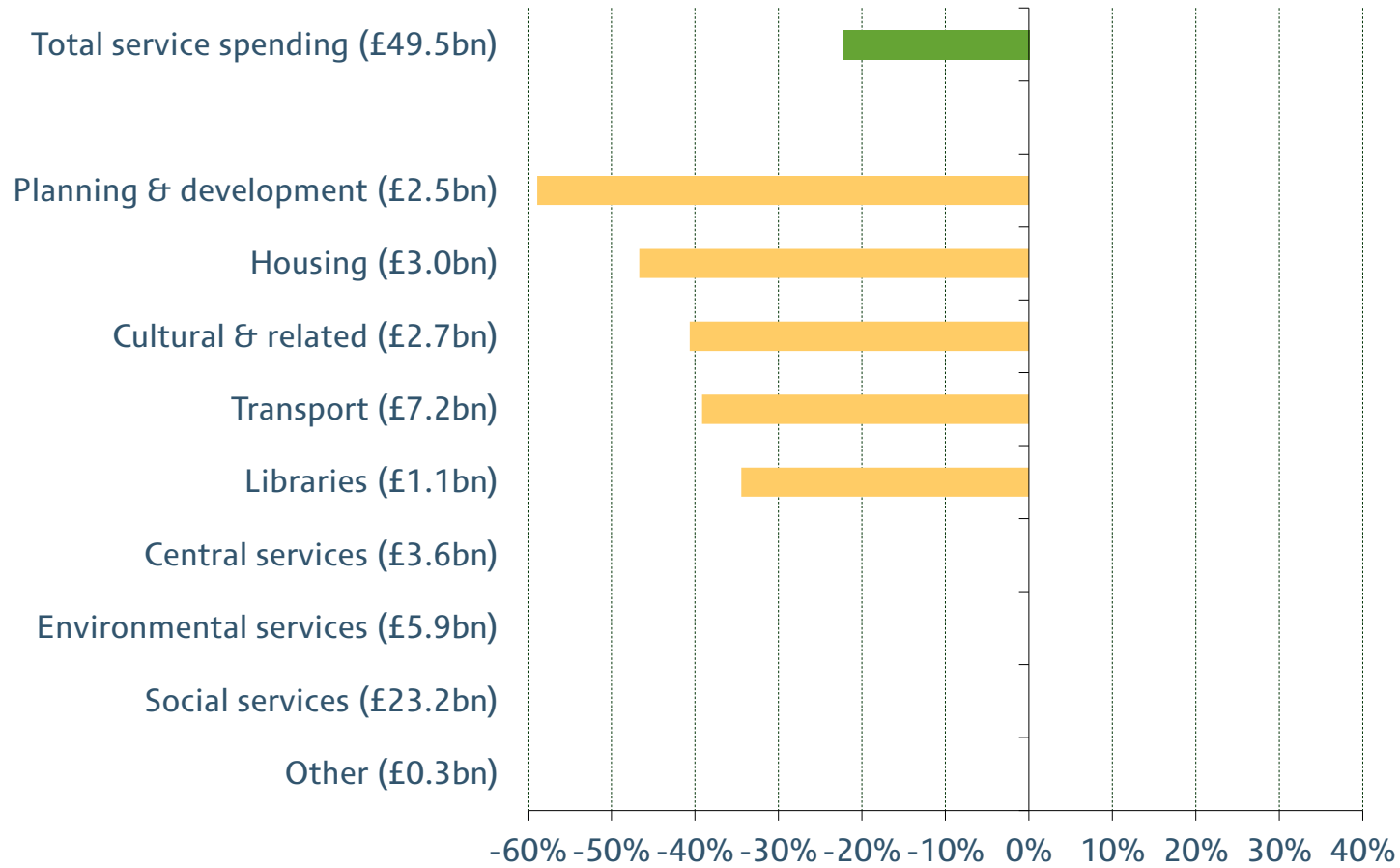
- In 2016-17, measured consistently, councils revenues will be £44 billion, 26% lower
  - Together, grants and newly part-localised business rates revenue down 38%
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- Accounting for reserve draw-down: spending power down 23%

# Cuts to council spending by service area in England between 2009-10 and 2016-17



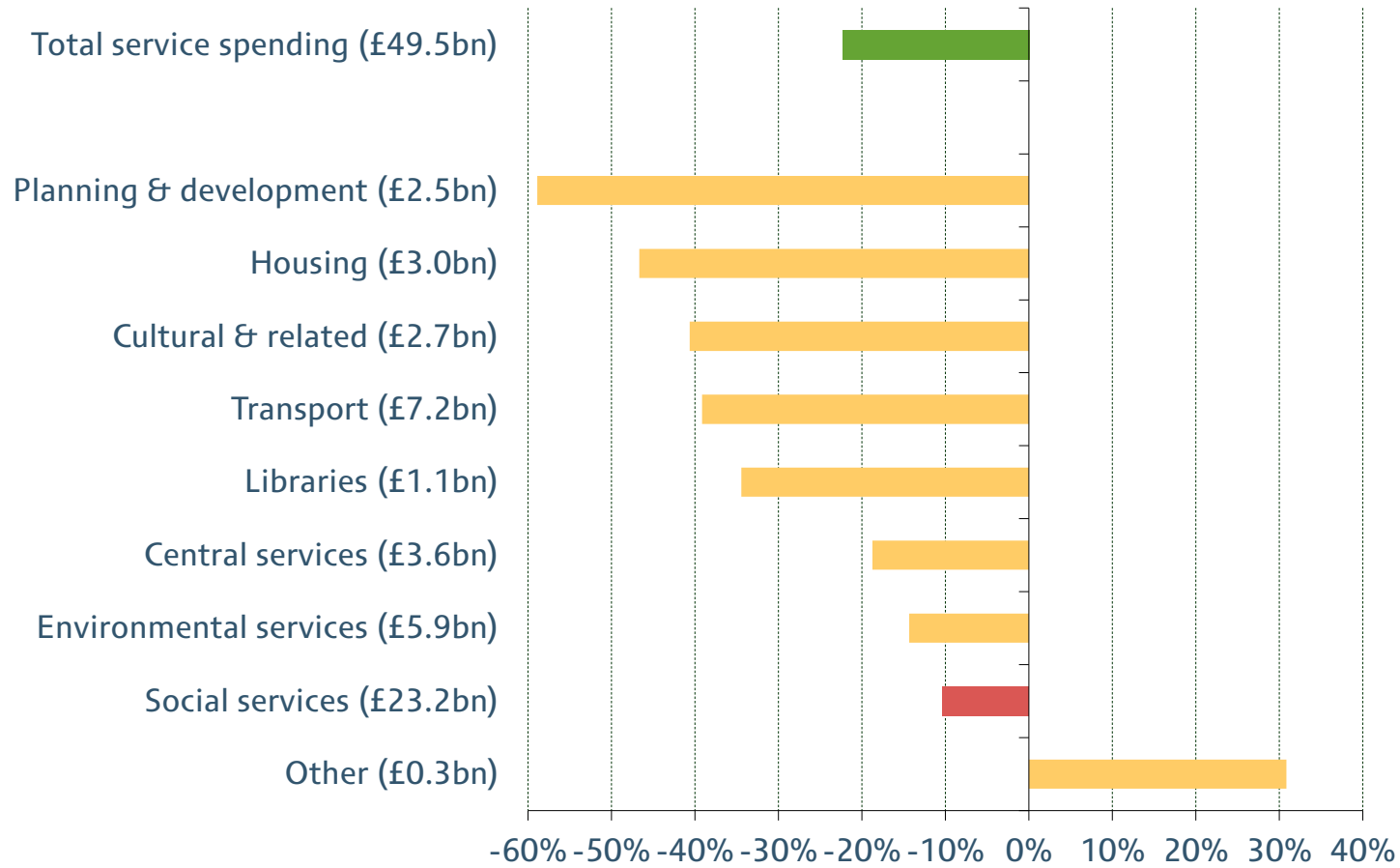
Figures in brackets are amount spent in 2009-10

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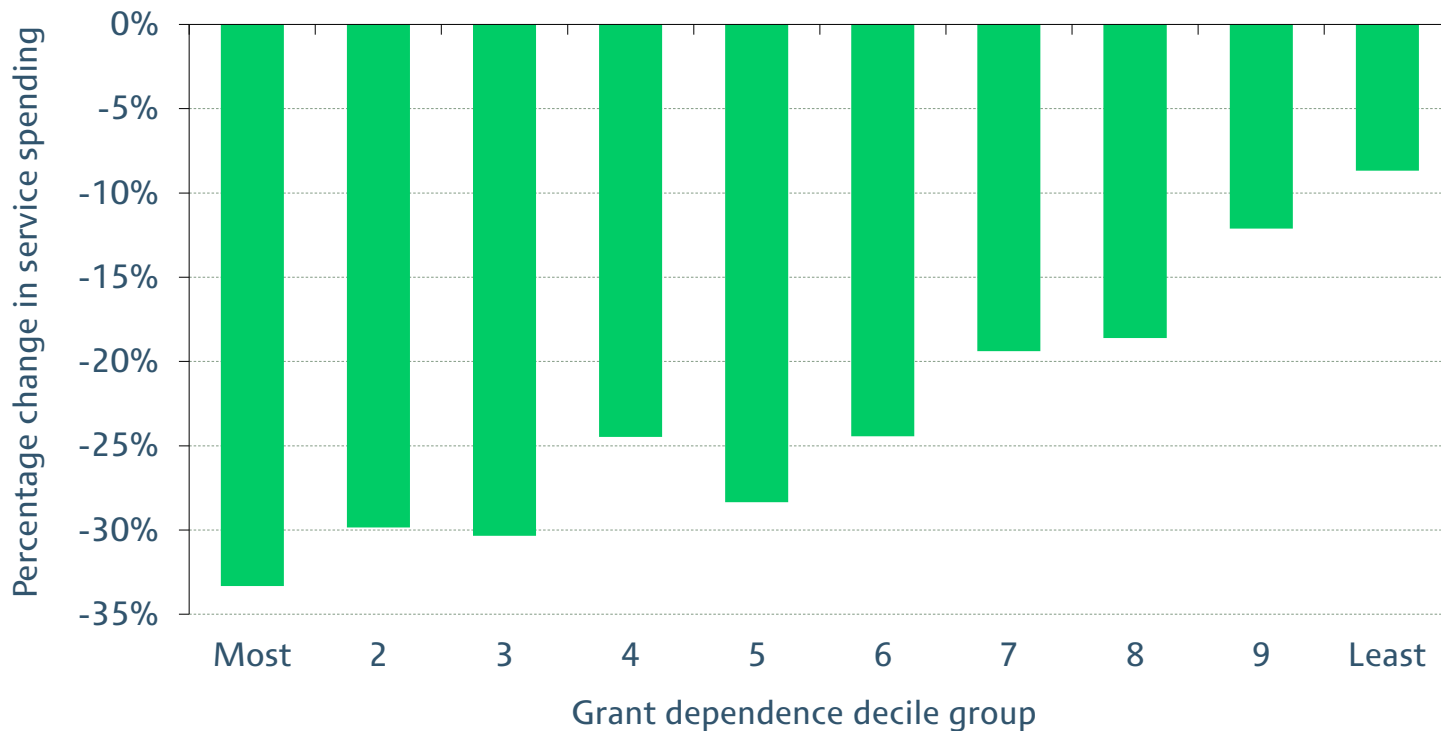
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# Cuts in Scotland and Wales (2009-10 to 2016-17)

- Cuts have been smaller in other parts of Great Britain
  - 15% in Scotland
  - 11.5% in Wales
- But pattern across services similar
  - Social services down 1%, planning and development down 30-50%
- Reflects smaller cuts in grants by devolved governments
  - In part because less protection for health in these countries (so cuts elsewhere less steep)
- Figures reflect council tax freeze in Scotland (coming to end)
  - Council tax bills up substantially in real-terms in Wales

# Cuts to service spending, 2009-10 to 2016-17, by councils' grant-dependence in England

- Cuts to spending have been much larger in (poorer) areas more reliant on central government grant funding



# Grant allocation in England (I)

- Long-standing idea that grant allocations should take account of grant-dependence of councils
- But this system broke down during this period
- DCLG made a number of tweaks but still underlying problems
  - ‘Banded Caps’ actually redistributed as much to least grant-dependent councils as most grant-dependent councils
  - And undid much of the attempted 2013-14 equalisation ‘reset’
- System abandoned completely in 2014-15 and 2015-16
  - All councils of a given type saw same grant % grant cut
  - Much bigger impact on overall spending power if more grant-reliant



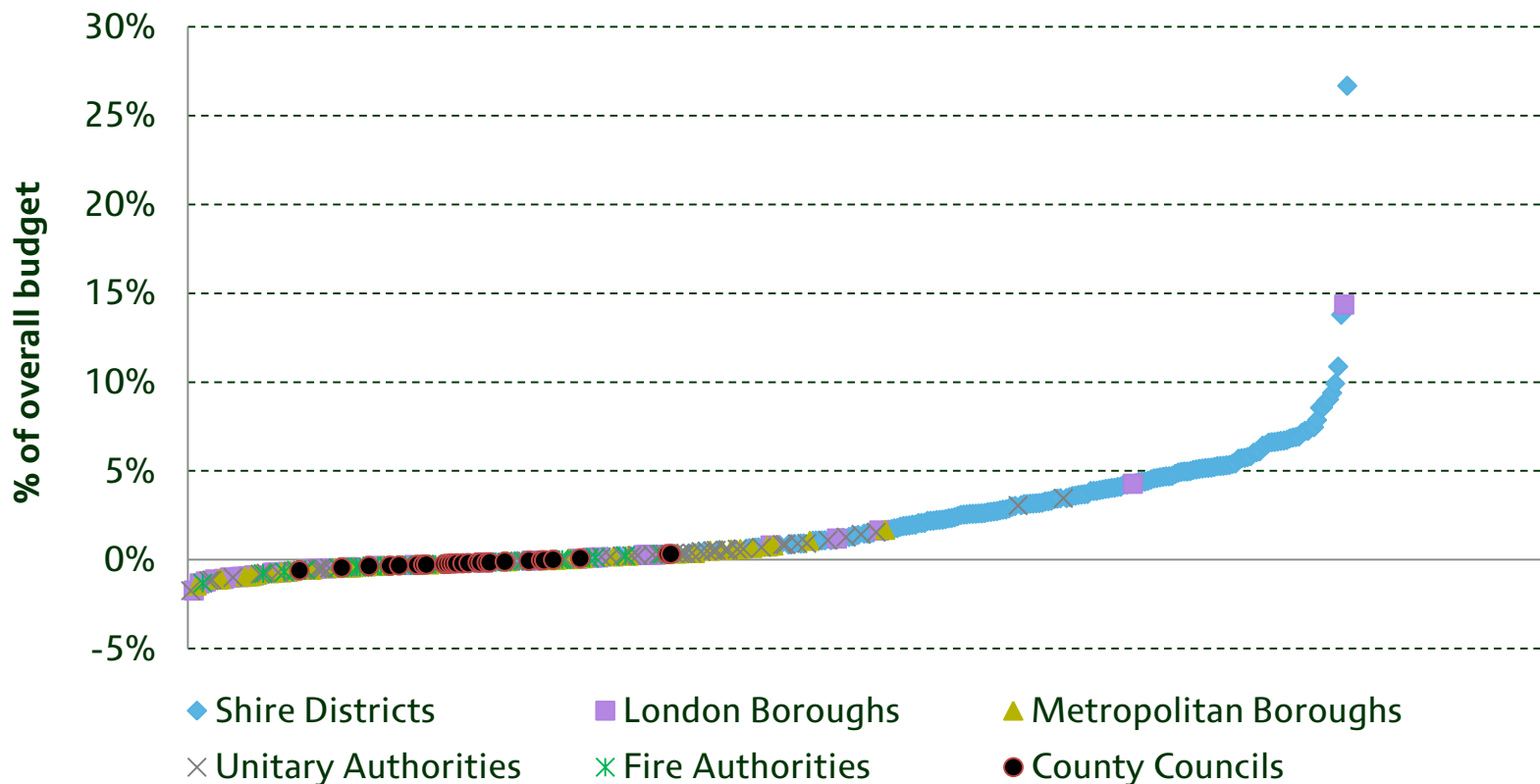
# Grant allocation in England (II)

- From 2016-17 cuts to grants do take into account differences in grant-dependence
  - Much more equal cuts to overall spending power across councils
- But last six years characterised by opaque and unstable grant policies that was often at odds with stated intentions
  - Bigger cuts in areas more reliant on grants was not inevitable

# The business rates retention scheme (BRRS)

- Half of business rates revenues devolved to local government from 2013-14 onwards
- Local areas do not retain 50% of all business rates in their area
  - Initial assessment of how much revenues areas ‘need’
  - ‘Tariffs’ on areas with high revenues / low needs pay for ‘top-ups’ to areas with low revenues / high needs
  - These ‘tariffs’ and ‘top-ups’ then indexed in line with inflation
- Local areas retain up to 50% of the growth in business rates as a result of new developments, refurbishments etc
  - And bear 50% of revenue reductions
- Levies on revenue growth in high revenue areas fund ‘safety nets’ to stop areas where revenues fall seeing very big budget cuts

# Gains and losses (2013-14 to 2016-17) relative to sharing in national growth in business rates



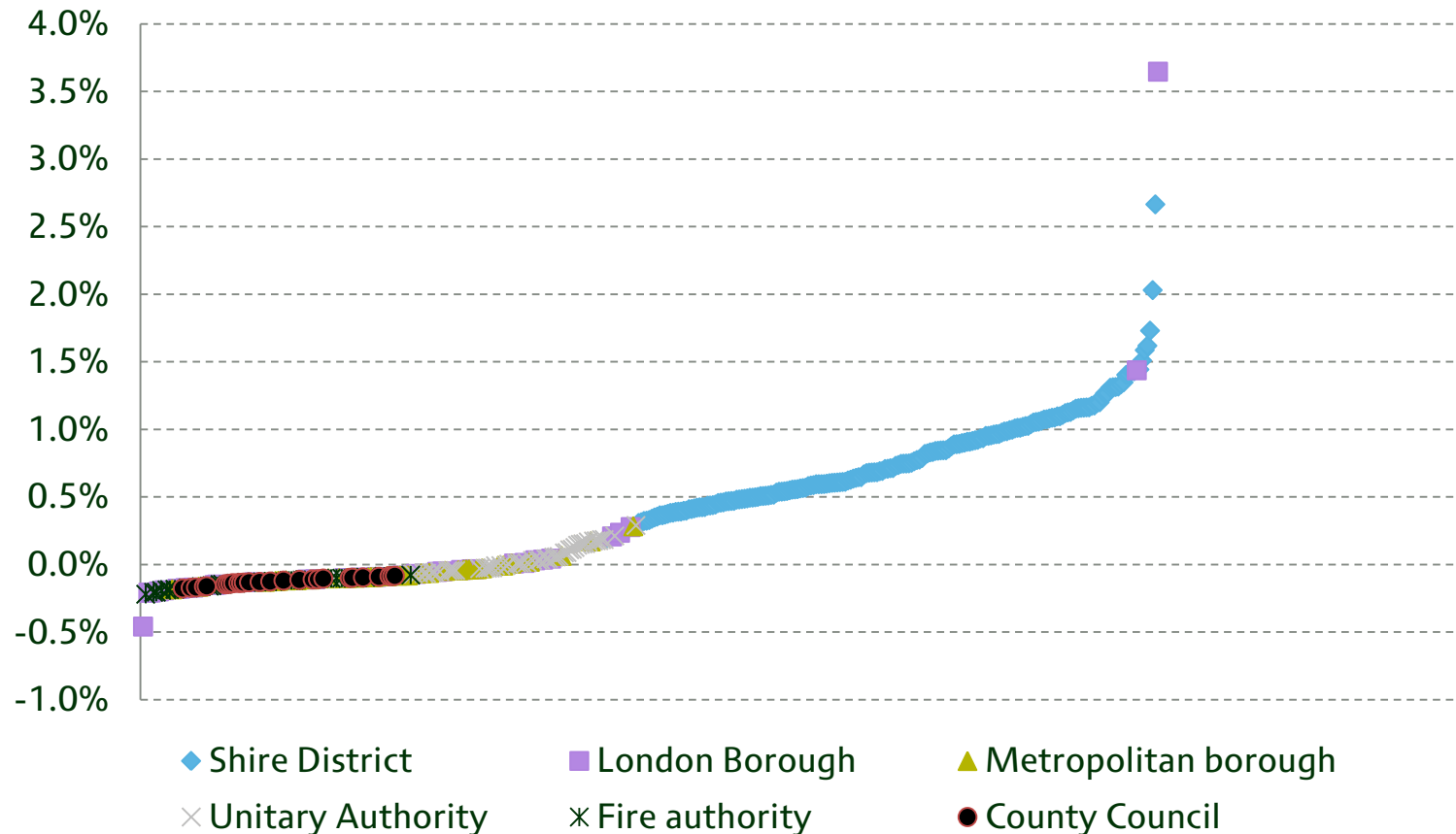
# 100% business rates retention

- Government has announced local areas will keep 100% of the growth in their business rates by 2020
  - Propose to abolish levies on growth in high revenue areas but keep some form of safety net system
- Stronger incentives for revenue growth but also more risk
  - Year-to-year volatility in revenues
  - Long-term divergence in revenues across councils
- Big unknown: are the incentives worth the risk?
  - Can councils do much to boost growth? Do incentives matter?

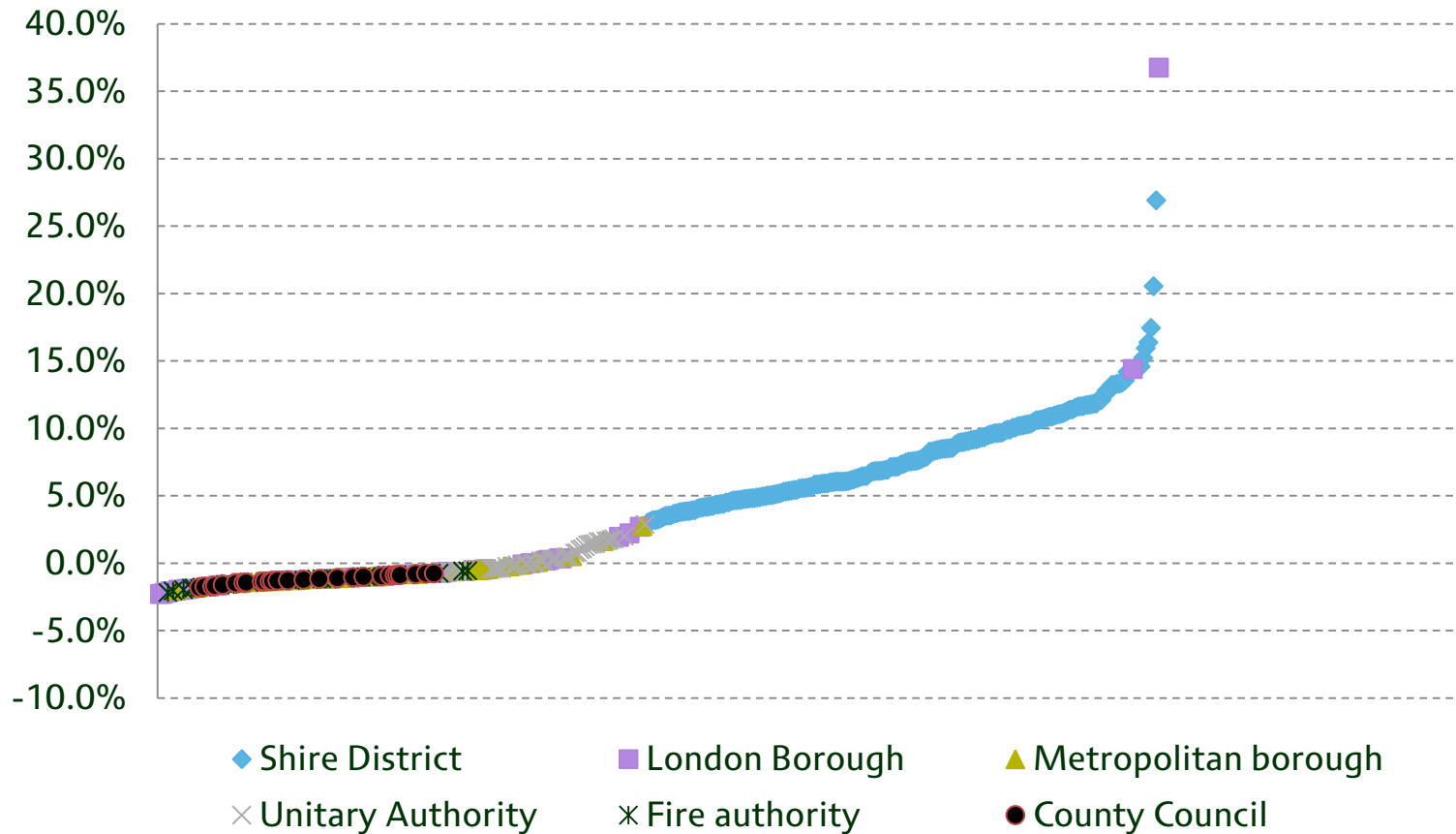
# Dealing with divergence

- Financial incentives require potential for divergence
- But if based on current 50% scheme, divergence will arise even if business rates grow same % in all of England
  - This is because ‘tariffs’ and ‘top-ups’ are indexed to inflation, but business rates can grow faster or slower than inflation
  - So amount of redistribution can fall or rise over time

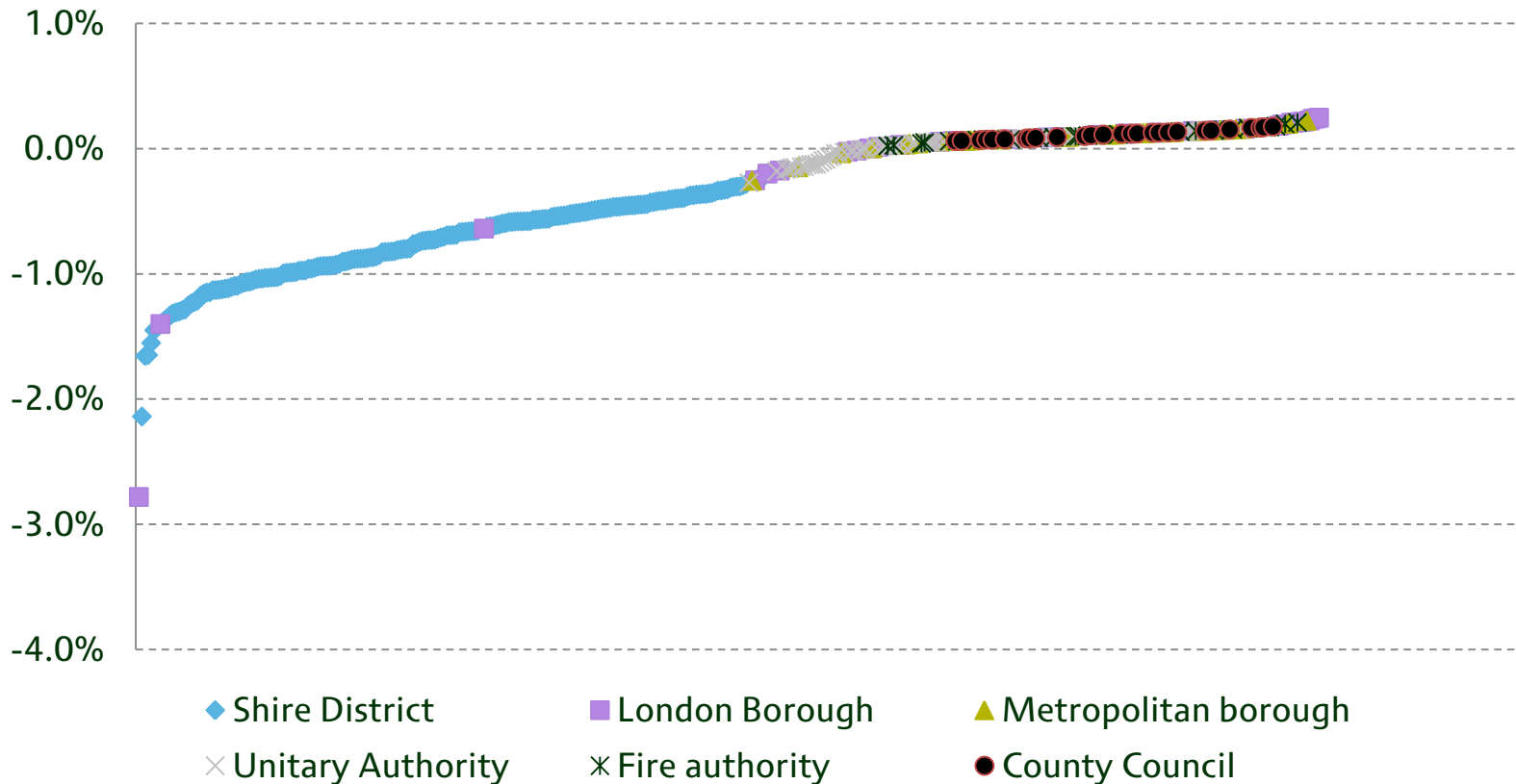
# Revenues grow 0.1% real-terms a year everywhere for 10 years



# Revenues grow 1% real-terms a year everywhere for 10 years



# Revenues *fall* 0.1% real-terms a year everywhere for 10 years





# Dealing with divergence

- Financial incentives require potential for divergence
- But if based on current 50% scheme, divergence will arise even if business rates grow same % in all of England
  - This is because ‘tariffs’ and ‘top-ups’ are indexed to inflation, but business rates can grow faster or slower than inflation
  - So amount of redistribution can fall or rise over time
- Indexing ‘tariffs’ and ‘top-ups’ to average growth addresses this
  - Redistribution keeps pace with average revenue growth

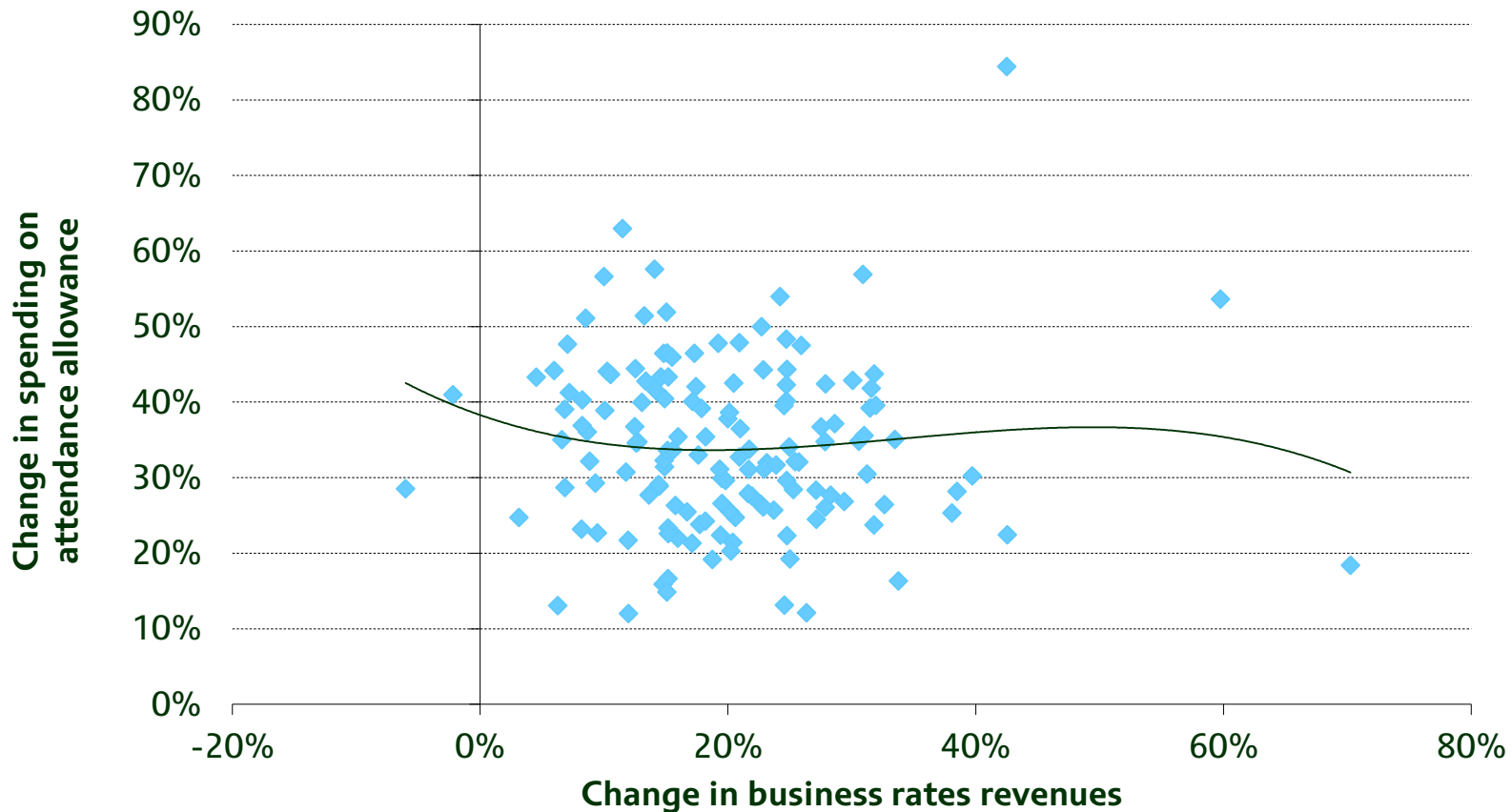
# Resetting the system

- Without a full or partial reset of the system, divergence in funding could continue indefinitely
- How often should the system be ‘reset’? Factors to consider:
  - How fast and large divergence could be
  - Whether such divergence is result of local policy or outside factors
  - Judgement on how much divergence is acceptable
- Fixed resets can provide an incentive to delay development
  - Can a rolling reset be implemented?

# Devolution of additional services to councils

- Business rates revenues to be devolved will be substantially more than general grants that will be abolished:
  - Around £10 billion to find
  - Roll in additional specific grants (e.g. Public Health) and/or additional responsibilities
- A range of criteria against which to judge candidates for devolution
  - Fit with existing services and expertise
  - Ability to tailor to local needs / preferences
  - Fit with economic development
  - Fit with resources available to local government
- Easier to ensure fit with resources in year 1 than subsequent years
  - And even if fits nationally, may not at local level given potential for spending need and revenue divergence

# Change in attendance allowance spending 2005-06 to 2010-11, by council in England



# Scotland and Wales

- Scotland and Wales are moving in somewhat different directions
  - Changes to council tax band relativities
  - Possibly bigger changes to council tax and business rates
  - Possible assignment of part of income tax revenues to councils in Scotland and possibility of new local taxes in Wales?
- On spending side
  - More collaboration across councils in Wales (proposed mergers cancelled)
  - Moves to take education out of the general local government funding system in Scotland?

# Summary

- Big cuts in revenues and spending, especially in England
  - Cuts in England biggest for poorer, more grant-reliant councils
  - Not inevitable
- A major move towards provision of fiscal incentives for growth and development in English council funding system
  - Lots of ‘technical’ but important decisions to take
  - Are these incentives worth the risks?
- Different directions in Wales and Scotland
  - Funding system increasingly differs from England

# Next Steps in Research Programme (I)

- This report is just first stage of our research programme
- In future, will look in more detail at 100% rates retention scheme
  - What factors likely to drive riskiness and divergence in revenues?
  - How much could funding diverge under different policy options?
  - What are the pros/cons of devolving different service areas?
  - What should be done about rates appeals and revaluations?
- To do this will build a council finance model and dataset
- What might the impacts of changes to local taxes in Scotland and Wales be? What if such changes were introduced in England?
- What might impacts of reforms on businesses and households as well as councils be?

# Next Steps in Research Programme (II)

- Most challenging part will be to estimate how councils and local economies have responded and may respond to reforms
  - How have they responded to recent and past reforms that affect incentives for different councils differently?
  - How likely is significant tax competition between councils?
  - What can we learn from other countries?



# Final Thoughts

- Will not be able to say exactly what the impact of the revolution to local government finance will be
  - Even *ex post* impact evaluation will be difficult
- But still important to learn what we can from past reforms and other countries' experiences
- And careful analysis of policy options vital as 'technical' details can have major impacts
- Knowing what is 'unknown' is also important for good policy-making

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