Institute for Fiscal Studies

IFS Briefing

English local government funding: trends and challenges in 2019 and beyond

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The 2010s have been a decade of major financial change for English councils. Not only have funding levels – and hence what councils can spend on local services – fallen significantly; major reforms to the funding system have seen an increasing emphasis on using funding to provide financial incentives for development via initiatives such as the Business Rates Retention Scheme (BRRS) and the New Homes Bonus (NHB).

Looking ahead, increases in council tax and additional grant funding from central government mean a boost to funding next year – but what about the longer term, especially given plans for further changes to the funding system, including an expansion of the BRRS in 2021–22?

Given this context, this note summarises a new IFS report on local government revenues and expenditures which we plan to be the first of an annual series of such reports. It includes a core analysis of what has happened to councils' revenues and spending on different services in different parts of the country and the funding outlook, as well as an in-depth look at the impact of the BRRS and NHB on councils' funding so far.

The report and this note focus on those revenue sources and spending areas over which district, county and single-tier councils exercise real control. We therefore exclude spending on police, fire, national park and education services. When looking at trends over time, we also exclude spending on public health and make some adjustments to social care spending to make figures more comparable across years: public health was only devolved to councils in 2013–14, and the way social care spending is organised and recorded has also changed. Up-to-date analysis of education spending can be found in the IFS's annual education report, available on our website.

Tom Harris, Louis Hodge and David Phillips | 13 November 2019

'English local government funding: trends and issues in 2019 and beyond'

For further details, see the full report at www.ifs.org.uk/publications/14563

Key facts and figures

1. **Cuts to funding from central government have led to a 17% fall in councils' spending on local public services since 2009–10 – equal to 23% or nearly £300 per person.** Almost this entire cut took place in the first half the 2010s. Indeed, spending is budgeted to have risen modestly since its nadir in 2017–18 as business rates revenues, council tax rises and ring-fenced funding for social care have offset continued cuts to general-purpose grants from central government.

2. **Local government has become increasingly reliant on local taxes for revenues.** Council tax paid by local residents makes up almost half of revenues – up from just over a third in 2009–10 – and retained business rates account for 30%, up from nothing. After most councils froze their council tax during the first half of the 2010s, **over the last four years council tax revenues have grown nearly 15% per person in real terms.** This reflects an 8% real-terms increase in tax rates since 2015–16 and at least a 4% real-terms reduction in how much councils spend on helping low-income households pay their council tax bills.

3. **Councils' spending is increasingly focused on social care services – now 57% of all service budgets.** This reflects the fact that councils have cut what they spend themselves on housing, transport, planning, and cultural and leisure services by 40% or more per person in order to limit cuts to social care services – although income from fees and charges means overall spending on these services has not fallen quite so much. As a result, spending per person on acute children's social care services is budgeted to be 2% higher than in 2009–10, and will probably be even higher given councils have overspent relative to budgets by 8% on average over the last four years.

4. **A 4% boost to funding next year would still leave spending per person at least 20% lower than in 2009–10.** And in the longer term, billions of pounds of additional funding from government grants or new devolved taxes will likely be needed to meet the rising costs of service provision – even if council tax increases at double the rate of inflation each year.

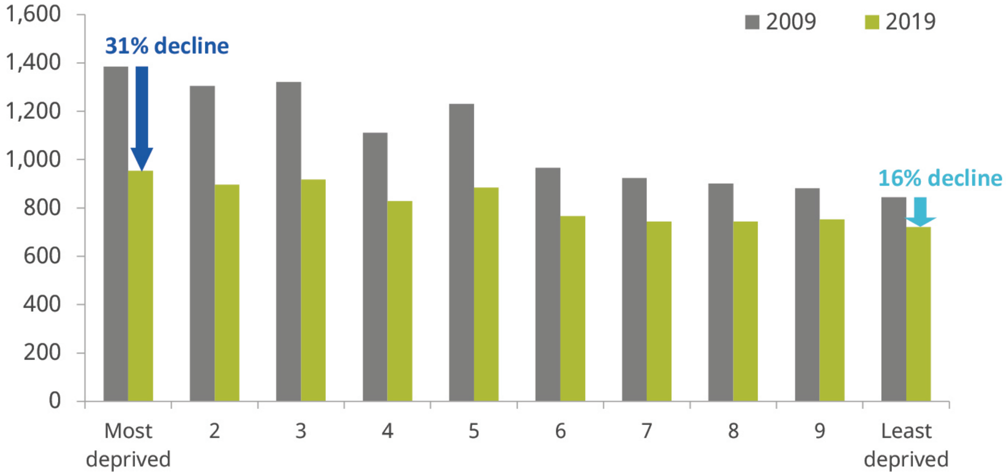
5. **Councils in more deprived areas have done less well from the NHB** than those in more affluent areas, in part because bigger payments are made for new properties in higher council tax bands. In contrast, **they have retained at least as much business rates revenue growth**, on average. In areas with two-tier local government, **districts have retained the bulk of NHB payments and business rates growth and many rely on this for a large share of their overall funding.** In contrast, counties have seen less funding than they would have if equivalent funding had been allocated according to spending needs assessments.

To what extent does the picture differ across different parts of the country?

There is considerable variation in the cuts faced by different councils. This reflects the fact that between 2009–10 and 2015–16, the system for determining how much grant funding councils should get didn't fully take into account how much councils relied on such funding relative to their own council tax revenues. As a result, more deprived, grant-dependent councils have faced larger cuts than more fiscally independent councils. Changes to the way grants were allocated has remedied this issue since then – but not undone the previous regressive pattern.

- **Spending cuts per person in the most deprived tenth of council areas have therefore averaged 31% (£432), compared with 16% (£134) in the least deprived tenth, since 2009–10.**
- **However, despite larger cuts in more deprived areas, revenues and spending are still higher.** For example, spending per person in the most deprived councils is 1.3 times the level in the least deprived – although this is down from 1.6 times in 2009–10. Without defining what we expect from councils in terms of service range and quality, and without a robust way of estimating how much different councils need to meet these expectations, we cannot say whether the new or old funding and spending relativities are more appropriate though.

Net spending in 2009–10 and 2019–20 (2019–20 £ per person), by decile of deprivation



Source: Harris, Hodge and Phillips, 2019.

- **Spending cuts have also varied across regions, again largely driven by differences in reliance on central government funding.** For example, spending per person has fallen by 30% in the North East compared with 15% in the South West. Spending per person has fallen by 32% in London reflecting the fact that the government also significantly reduced funding for the Greater London Authority to subsidise buses and tubes, and councils in London have generally taken less advantage of the scope to increase council tax in recent years.
- **The situation in Scotland, to which council funding is devolved, is somewhat different. On average, spending per person on comparable services has fallen by 15% – 8 percentage points less than in England.** Moreover, because grant funding was cut by substantially less for councils that relied more on it, the regressive pattern of cuts seen in England is not evident in Scotland.

How has local government delivered the cuts?

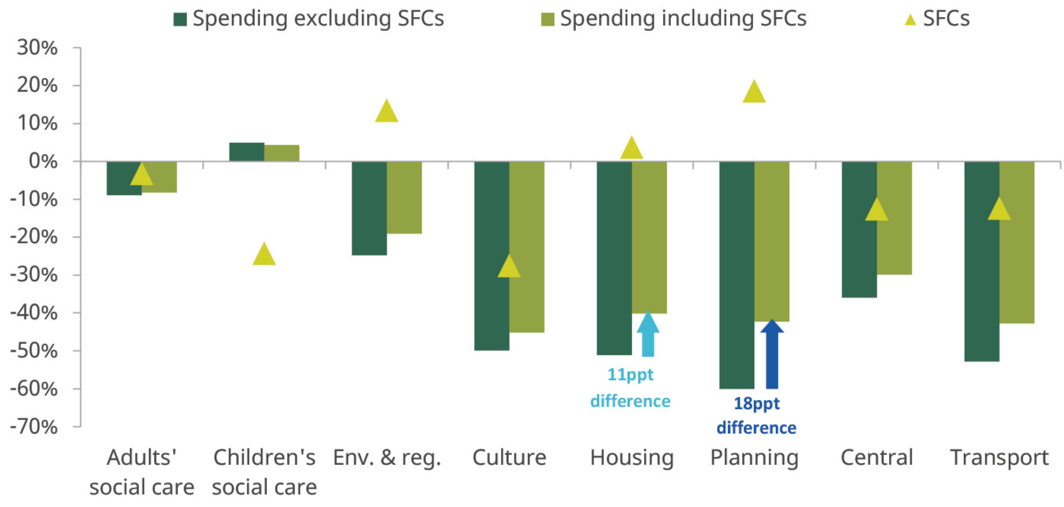
Councils have made large cuts to more discretionary areas of spending and areas where it is relatively easier to raise income from fees and charges. For example, since 2009–10, spending per person on planning and development is down around 60%, on cultural services and on housing services down around 50% and on transport down over 40%.

- **This has allowed councils to relatively protect services for those with acute needs and rising demands.** Spending on adult social care services is down by only 7% per person, and spending on acute children's social care services per person is budgeted to be up 2% – and seems likely to rise by even more given budget overspends have averaged 8% over the last four years. Even for service areas that have seen big cuts overall, there have been increases for some specific areas – such as a dramatic 72% per person for homelessness. And spending on free bus passes is down just 6% per person, and now accounts for 25% of transport spending, up from 15% in 2009–10.

- **Even with this relative protection, tough choices have had to be made – and pressures are evident.** For example, growing demand for services for younger adults means spending on social care for the over-65s is down by an estimated 18% despite a more-than-20% rise in the elderly population. The number of adults receiving care services also fell 27% between 2009–10 and 2013–14 – although it has been broadly flat since 2014–15. For children's social care services, councils have had to cope with a more-than-doubling of safeguarding enquiries, leading to over a third more children being on a protection plan and 17% more being in care.

- **Income from sales, fees and charges (SFCs) has to some extent mitigated cuts to what councils spend themselves; but the extent of this has differed across services.** For example, we find that spending per person on planning and development fell by 18 percentage points less up to 2018–19 once spending covered by SFCs income – which grew – is accounted for. On the other hand, accounting for spending covered by SFCs changes the picture very little for social care services. For adult social care services, for instance, accounting for SFCs reduces the scale of cuts in spending by just 1 percentage point.

Change in net spending per person between 2009–10 and 2018–19 (%), by service area



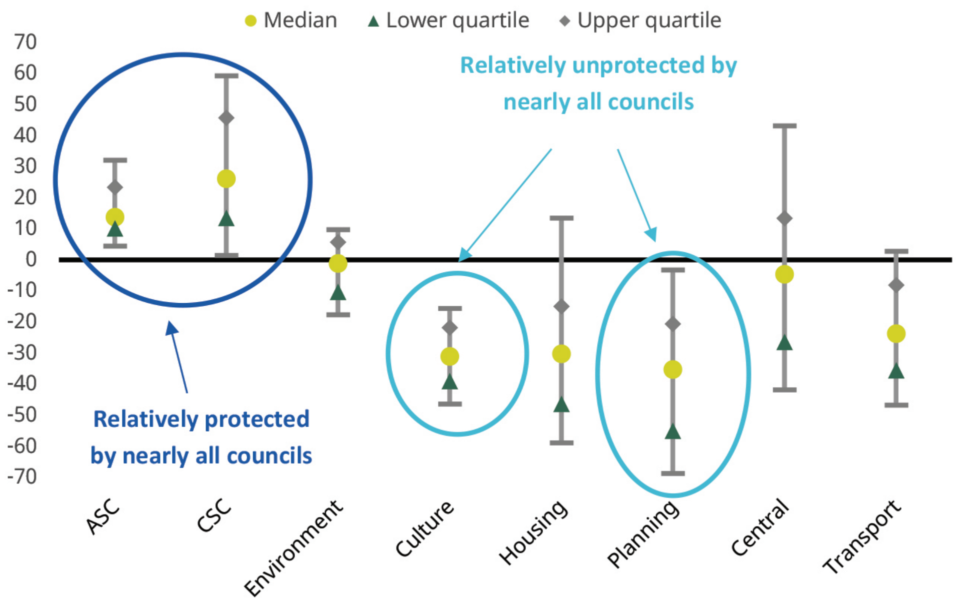
Source: Figure 2.10 in Harris, Hodge and Phillips (2019). Env. & reg. stands for environmental and regulatory services.

How have choices differed between councils and over time?

While nearly all councils have protected social care relative to other services, different councils have allocated the cuts they have faced differently. This is illustrated in the figure below, which shows the distribution of councils' spending cuts for specific service areas relative to the cuts to their total net service spending between 2009–10 and 2019–20.

- **For example, while in one-in-four council areas spending on children's social care has been cut by *at least* 46 percentage points less than their overall cut in spending (often implying sizeable increases in spending), in another one-in-four it has been cut by at most 13 percentage points less.**
- **Relative to the overall size of the cuts they have faced, councils in London have made bigger cuts to adult social care services and smaller cuts to housing and planning and development services.** More deprived councils have also made bigger-than-average cuts to social care services, even controlling for cuts to their overall budgets. These differences will reflect differences in both the pressures being faced at a local level and local preferences.
- **In the last few years, a growing number of councils have started to prioritise spending on housing and planning and development services.** For example, around 36% of councils relatively protected housing spending between 2015–16 and 2019–20, up from 16% between 2009–10 and 2015–16. This likely reflects a growing focus on homelessness and housing as an issue requiring action. However, only 13% of councils have relatively protected cultural services – even fewer than did so between 2009–10 and 2015–16.

The protection of net spending on specific services relative to local authorities' overall spending cuts, 2009–10 to 2019–20



Note: A positive value means that a council cut spending on a particular service by less than the cut it made to overall service spending per person – perhaps even increasing spending on that service. A negative value means a council made above-average cuts to a service. 80% of councils made decisions between the dark grey bars.

Source: Figure 2.14 in Harris, Hodge and Phillips (2019). ASC and CSC are adults' and children's social care respectively

What does the funding outlook look like?

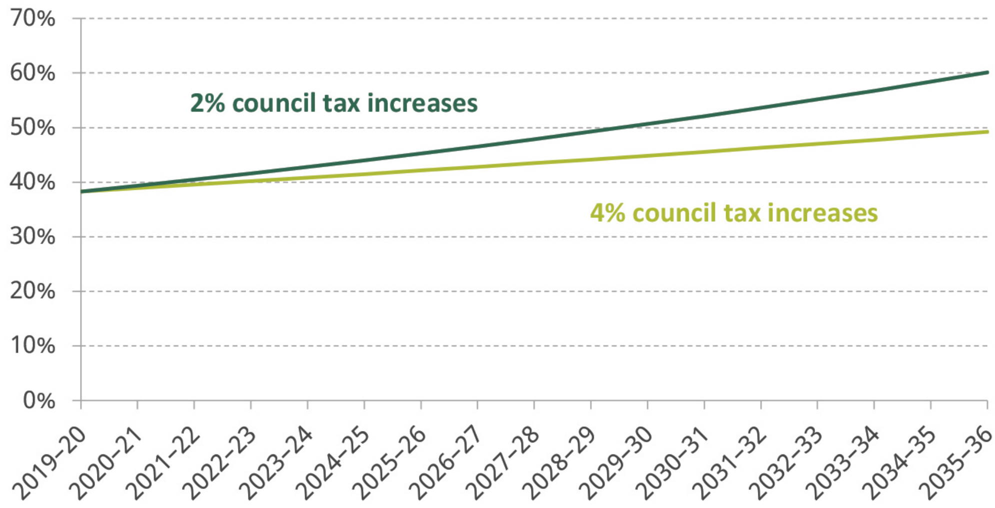
The government has forecast that what it terms councils' core spending power – effectively council tax, business rates and the main grants – could increase by 4.3% in real terms in 2020–21 compared with this year. In part this reflects a £1.1 billion increase in grant funding mostly labelled as being for social care services, but which can in fact be spent as councils wish. It also accounts for increases in business rates revenues in line with inflation, and assumes all councils increase council tax by the maximum allowed without a referendum (2% plus a further 2% for adult social care services).

- **Together with more modest increases in spending over the last two years, if this additional funding is spent in full, around one-fifth of the overall fall in spending per person between 2009–10 and 2017–18 could be undone by the end of next year.** But this would still leave spending per person 20% lower in 2020–21 than it was in 2009–10.
- **Not all councils will benefit equally from the increases in government funding and council tax.** The increases have been targeted at councils with social care responsibilities given these are where spending pressures are most acute – lower-tier district councils will therefore see significantly smaller increases in funding.
- **Some councils may actually see a fall in funding next year, because the government plans not to renew pilots of '75% business rates retention', with pilot councils moving back to the standard 50% retention.** For example, we estimate that councils in Berkshire will gain the equivalent of 5.8% of their non-schools revenues from being a pilot area this year: the loss of this money next year is likely to outweigh increases in council tax and grant funding. But ending the pilots has freed up funding that can benefit councils across the country, not just pilot councils.

Looking further ahead, the vast majority of councils' funding is set to come from council tax and business rates from 2021–22 onwards. This is because councils are set to move from retaining 50% to retaining 75% of business rates revenues, with grant funding cut accordingly to ensure the reform is revenue-neutral at the point of implementation.

- **Revenues from these two taxes will not keep pace with rising demands and costs – unless we see continued large increases in council tax each year *and* sustained improvements in productivity for key services.** With no productivity growth for the adult social care sector (which would be in line with historical trends), for instance, the proportion of local taxes needed for adult social care would grow over time, even with council tax going up 4% a year – double the rate of inflation.
- **With 4% increases in tax bills each year, we estimate an additional £1.6 billion of funding in today's prices would be needed by 2024–25** to both meet projected adult social care costs and stop the revenue available for other services falling further as a share of national income. The amount needed would rise considerably over time, reaching £8.7 billion (in today's prices) by the mid 2030s.
- **With 2% council tax increases, an additional £3.9 billion in funding (in today's prices) would be needed by 2024–25, rising to £18.0 billion (in today's prices) by the mid 2030s.**
- **These figures are based on keeping the current social care system. Increases in generosity would push up costs further, necessitating bigger increases in funding or a bigger squeeze on other services.**

Without productivity growth, the growing demand for and cost of adult social care will take up a much larger share of local tax revenues in future – even with big council tax rises



Source: Figure 3.3 of Harris, Hodge and Phillips (2019).

- **As well as taking decisions about the overall level of funding to provide to councils, the next government will have to take decisions about how that funding should be distributed between them.** Costs are likely to rise at different rates for different councils – because of differences in demographic and socio-economic trends. And the amount councils can raise from council tax and retained business rates varies significantly.

- **Councils could be given additional tax-raising powers, such as via a local income tax, or they could be provided with additional grant funding from Westminster.** The former would give councils and their residents more discretion over how much to tax and spend, and stronger financial incentives to grow the local economy. But the latter would more easily allow money to be targeted at places where spending needs are the highest and/or local revenue-raising capacity is the lowest.

- **As it stands, there is a risk of policies for local government funding and social care coming into conflict.** That is because the recent direction of travel in the funding system has been to increasingly prioritise financial incentives, which means undertaking less redistribution as local needs and revenue-raising capacities change. But at the same time both the Conservatives and Labour have highlighted an aim of ensuring more consistent social care service provision across the country. The next government will have to square this difficult circle.

- **It is also worth noting that the bigger cuts to funding seen by councils in more deprived areas since 2009–10 could get baked into new assessments of councils' spending needs due to come into use in 2021–22.** The next government will need to make an inherently subjective decision about whether current relative funding levels for more deprived and more affluent council areas are fairer than the relative funding levels before the cuts took effect.

What do we know about the impact of the BRRS and NHB so far?

The 2010s have seen two funding schemes aimed at incentivising councils to boost the supply of housing and commercial property in their areas. In particular, the New Homes Bonus pays additional grant funding to councils for several years for each empty property brought back into use and each new home built in their area. The Business Rates Retention Scheme means councils retain a proportion of the real-terms growth or decline in local business rates revenues.

Looking at the direct financial impact on councils' funding:

- **Councils are set to retain £17.5 billion of business rates revenues in 2019–20, of which £1.9 billion is above-inflation growth in revenues.** Altogether since 2013–14, councils have retained £5.9 billion of above-inflation growth in business rates, measured in today's prices.
- **Not all councils have gained equally from the BRRS.** Councils in London have retained the most above-inflation growth – £1.8 billion or £197 per person – over the last seven years. On the other hand, those in the North East have retained the least – £83 million (£31 per person).
- **Perhaps surprisingly, more deprived areas have done at least as well from the BRRS as more affluent areas. But they have done worse from the NHB than less deprived areas, at least outside London.** To some extent, this reflects lower rates of house-building. But it also reflects the fact that higher payments are made for new properties in high council tax bands. Some of the biggest gains have been in quite deprived parts of inner London though – driven by the very rapid rate of housing development.
- **Councils are set to share £0.9 billion of NHB payments in 2019–20, and have received £8.4 billion payments over the last nine years.** London councils have received the most in absolute and per-person terms: £1.8 billion or £207 per person. Councils in the North West have received the least per person: £110.

In areas of the country with two-tier local government, lower-tier district councils receive 80% of NHB payments and, under the standard version of the BRRS, up to 80% of the locally retained share of growth (and falls) in rates revenue.

- **As a result, since 2011–12, lower-tier districts have received NHB payments averaging 9% of their funding.** They have also retained real-terms business rates growth equivalent to 5% of their core spending power since 2013–14. In contrast, counties have received payments and growth equivalent to 0.5% and 0.6% of their core spending power respectively.
- **When designing the new 75% national BRRS, it probably makes sense to allocate a larger share of the growth and falls in revenue to upper-tier counties.** This would channel more of the forecast growth in revenues to counties to help fund social care services, and would reduce the scale of divergences across the country in funding for lower-tier services that could otherwise open up over time if districts continue to retain the bulk of revenue growth and falls.

There is currently very limited evidence on whether the BRRS and NHB are affecting councils' behaviour and boosting property development and growth in the way intended. This is an issue we plan to investigate in the first half of 2020.

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