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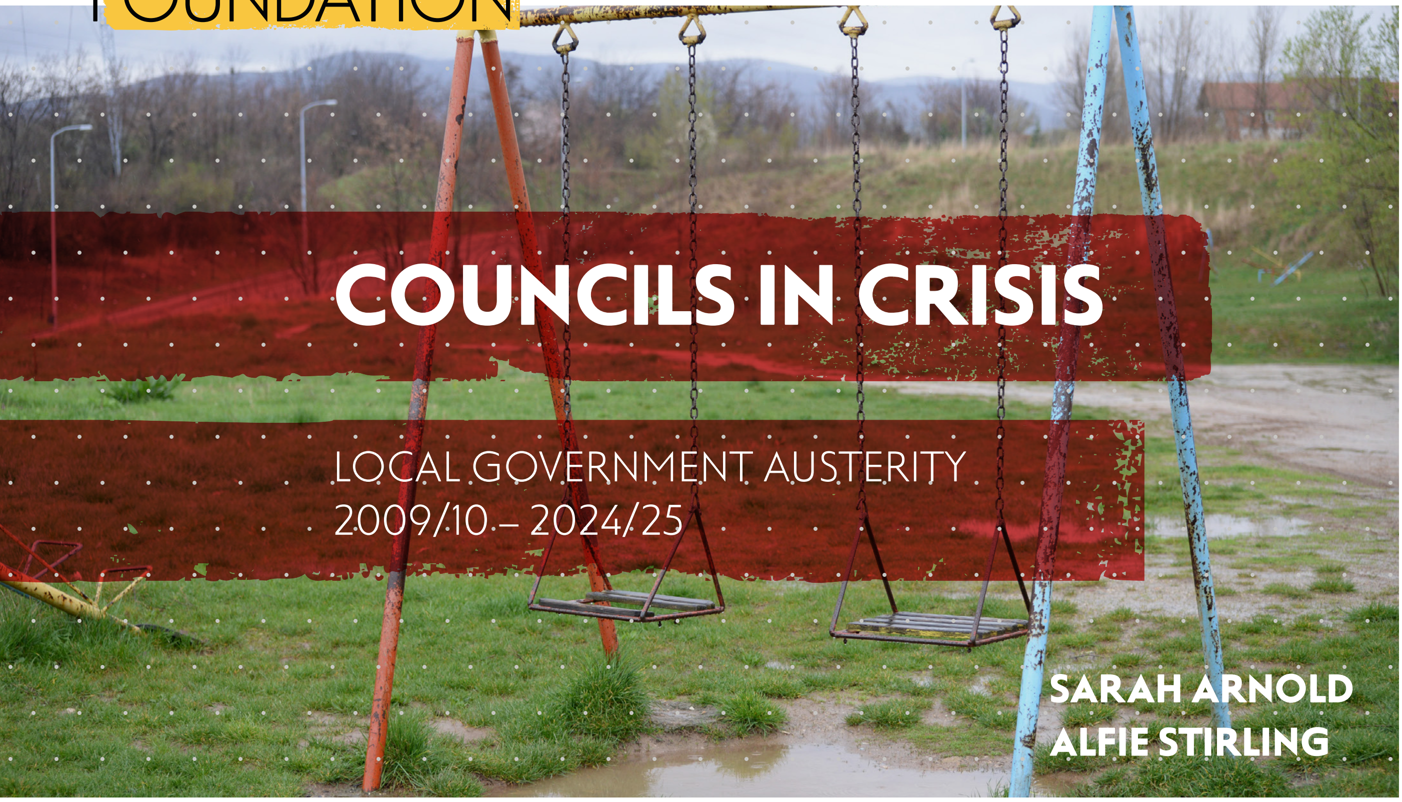

COUNCILS IN CRISIS

LOCAL GOVERNMENT AUSTERITY 2009/10 – 2024/25

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EXECUTIVE SUMMARY

Local government is in crisis. The policy of austerity – discretionary cuts in government spending - enacted by three consecutive governments since 2010 has severely impacted on the day-to-day public services relied upon by millions of families. Local authority leaders across the political spectrum now say they are stretched beyond the point of making savings without impacting front-line services[1]. Many local councils fear they will not even be able to fill their statutory duties going forwards unless cuts are reversed: a view that is now shared by the government's own public audit watchdogs[2]. This means local authorities will be unable to provide essential services which support the most vulnerable in society such as the very young and elderly[3].

Assessing the level of comparable funding for local authorities across time is complicated. On the funding side, following the move to 50% retention of business rates since 2013/14, central government has announced plans to allow local authorities to retain 75% of business rates income by 2020/21. On the spending side, a growing population, changing demographics and greater levels of need mean more resources are required to deliver services at the same level of access and quality. Meanwhile, local authorities have also seen their responsibilities change over time.

Nevertheless, our indicative estimates find that:

- Non ringfenced government grants to local authorities have fallen from £32.2 billion in 2009/10 to £4.5 billion in 2019/20 and are expected to be cut further by 2024/25.
- Despite local authorities retaining a proportion of business rates and growth in business rates revenue, local authorities still have significantly less resources available to them in 2019/20 than in 2009/10. They are only expected to enjoy a small increase in funding between 2019/20 and 2024/25, largely due to increases in council tax that are higher than inflation.
- Over the same time period, demographic and price pressures have driven costs of meeting need up significantly. We compare

how much local authorities have available to them with how much they would need to provide services at the level of access and quality in 2009/10, finding that local authorities will face a funding gap of £25.4 billion by 2024/25.

- There will be a funding gap in all regions of England. The North West will face the biggest per capita gap of £535 per person by 2024/25.

Local authorities have responded to austerity and changes to the funding landscape in a range of ways. However, there are clear signs that they are at breaking point as services are declining to an unacceptable level of quality, and they are becoming unable to meet basic needs.

It is clear that local authorities will be unable to fill that gap without significant reform to the local funding landscape to ensure that vital local services are properly funded. It is likely this will involve significant reform to either business rates, council tax or both. It may also involve the introduction of new local taxes or the further devolution of those that are currently national.

The need for reform represents an opportunity to rethink the relationship between national, local and indeed even (sub)-regional government. What is the appropriate level of granularity for responsibility for revenue generation and service delivery? How can risk be effectively pooled, whilst ensuring local governments have the autonomy to be responsive to local need and priorities?

In addition, any reforms should seek to reduce systematic inequality of funding between different authorities and the potential for postcode lotteries for vulnerable people in need of services. Finally, they should not seek to remove power from local governments, and where possible give local government increased autonomy and control over generating revenue and spending it – as long as finance follows function and local authorities are able to deliver services to an acceptable quality. With these final two goals in mind, it is crucial that we get the mechanisms by which local authorities pool resources and how resources are redistributed between authorities right. Currently that mechanism is the business rates retention system, which will be the subject of our next paper.

1.0 INTRODUCTION

Local government is in crisis. The policy of austerity – discretionary cuts in government spending – enacted by three consecutive governments since 2010 has significantly impacted on the day-to-day public services relied upon by millions of families. Local authority leaders from all political backgrounds now say they are far beyond the point of making savings without impacting front-line services[4]. Many local councils fear they will not even be able to fulfil their statutory duties going forwards unless cuts are reversed, a view that is now shared by the government's own public audit watchdogs[5]. This means local authorities would be unable to provide essential services which support the most vulnerable in society such as the very young and elderly[6].

Beyond austerity, the past decade has seen change and volatility for local government. Devolution and decentralization have also been on the agenda, at least at the level of headline government rhetoric. Beneath this, substantive policy reform has included greater business rates retention by local authorities as well as combined authority devolution deals. Since 2013/14, 50% of the growth in business rates has been retained at the level of local authorities, paid for by reductions in central government grants. Meanwhile, local authorities have been invited to come forward with joint proposals to form combined authorities, which can 'bid' to take over powers currently held by Whitehall. Ten of these devolution deals are active at this date[7].

The stated aims of these reforms were to make local government more independent of central government as well as to incentivise local authorities to foster economic growth within their areas (since they would now retain some portion of the higher tax receipts and, in the case of combined authorities, greater powers over how they are spent). Decentralising power and autonomy from central to local government also has the potential to improve public services as local agents are better placed to determine how to meet local needs[8]. However, the devolution agenda has not been unrelated to austerity. As central government cuts have led to fewer resources for local authorities, retained business rates also became a convenient mechanism for offsetting – or else obscuring – the impact[9].

Nonetheless, with or without austerity, devolution of fiscal policy represents a transfer of risk from national government to regions, towns and cities[10]. The 'principle of equalization' underpinning much of the UK system of local government finance since the 1960s has meant that the difference in needs between authorities has been levelled out through the application of bigger grants for councils with higher needs, affording them the capacity to provide a similar quantity and quality of service as authorities with lower needs. With the virtual abolition of central grants and diminution of the business rates redistribution system, such protective mechanisms against national or local economic decline are significantly weaker if not abandoned. In 2010 the system provided 46% more expenditure per capita for councils in the most deprived quintile – by 2019, the premium had reduced to just 19%. Therefore poorer councils have become relatively less well-funded in relation to their level of need in comparison with better-off councils[11]. This means austerity has been in effect selectively targeted at poorer areas (who were historically more heavily reliant on grant income)[12].
The impact on communities has been severe. One in ten libraries were shut down between 2010-11 and 2016-17, weekly domestic waste collections have reduced by a third, and subsidised public bus transport travel has fallen by almost half[13]. Hundreds of parks and playgrounds[14], libraries[15] and children's centres[16] have also been shut. The British Medical Association reports the alarming impact inadequate public health funding has had on important population health services such as sexual health and smoking cessation[17]. They cite examples of councils with prevalence of smoking significantly higher than average decommissioning or significantly cutting their specialist smoking cessation services, pointing to public sector budget cuts as a key factor in these decisions.

Local authorities have, to a greater or lesser extent, attempted to protect the most vulnerable in their communities from the burden of risk. But by protecting spending on services in relative terms, the overall extent of the cuts has begun to affect service quality and the ability to meet basic needs[18]. To manage, councils are having to shift away from preventative spending towards crisis spending. For example, there has been a 46% reduction in spending on preventing homelessness compared to a 58% increase on homelessness crisis support between 2010/11 and 2016/17[19]. A range of other preventive services have also been cut, such as local welfare assistance funds and family and carer services.

This paper sets out the extent of cuts to local government finance over the last decade, as well as projecting forwards five years to show that they are expected to continue in effect. As revenue is falling, demand for services is rising. We further show the true extent of the local government funding gap once increased need is taken into account. We disaggregate results at a local level. We discuss the impacts of austerity on local governments and their responses to it, to argue that local authorities are at breaking point and reform is needed. Finally, we discuss some key principles behind any reform to local government finance.

This paper represents the first in a series of forthcoming papers from NEF outlining options for reforming local government finance.

2.0 AUSTERITY: THE EXTENT OF THE CUTS

The state of local authority funding is complex, and has changed significantly in the last decade. In particular, as central government grants have been withdrawn, local authorities have been able to keep a higher proportion of business rates. At the same time, local authorities have also seen the remit and responsibilities widened (sometimes corresponding with increased funding) making it challenging to compare the amount of money local governments have on a like for like basis across time. Beneath the headline effects, such changes have also resulted in winners and losers. This chapter provides an update on the changes to date and presents an illustrative attempt to quantify their effects on funding across time.

2.1 WHERE DOES LOCAL GOVERNMENT FUNDING COME FROM?

Local government funding comes from a combination of three main sources:

- Central government grants (accounted for from within departmental expenditure limits, or DEL)
- Council tax (a tax levied on the occupiers of residential properties)
- Business rates (a tax levied on the occupiers of commercial properties)

Overall local authority revenues in England were worth £95.9 billion in 2018-19. Government grants were worth just under half (49%) of this total, while retained business rates accounted for 17% and council tax 32%[20]. The remaining 2% was made up of discretionary charges or requests for contributions to non-statutory services.

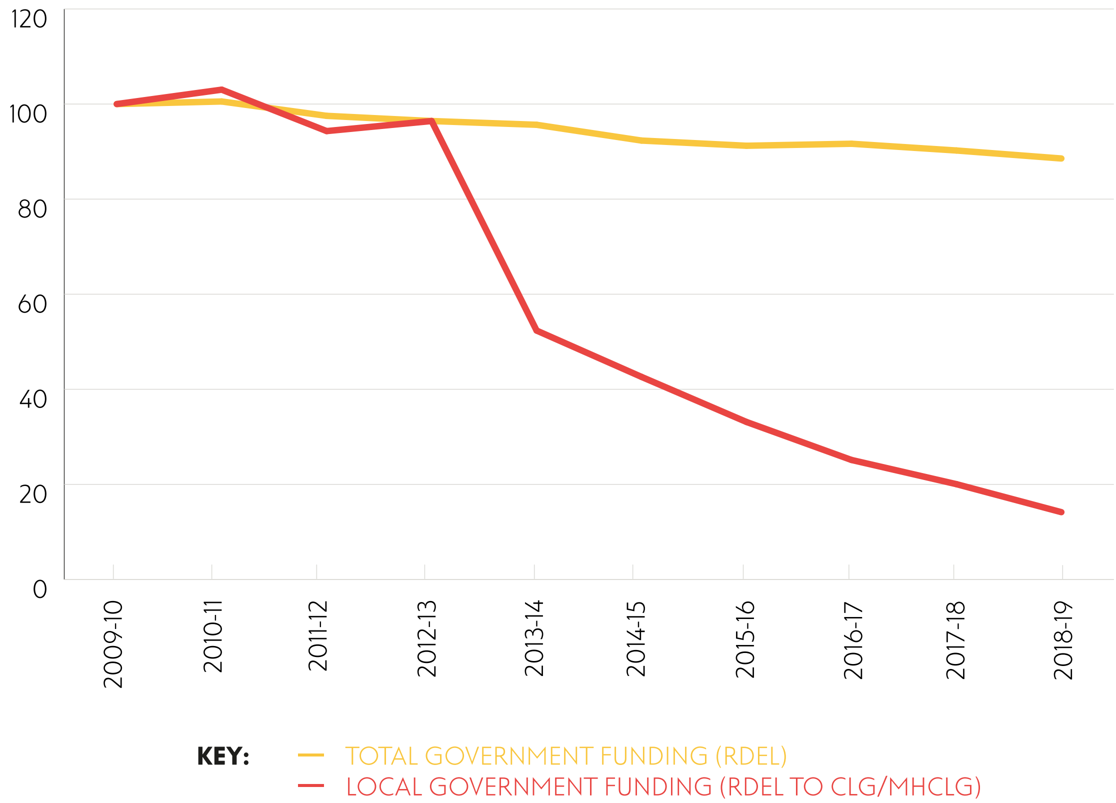
The main non-ring-fenced **central government grant** to local authorities (ie. grant which can be used to finance anything the authority wants) is called the Revenue Support Grant. It is allocated across local authorities on the basis of a formula, partially determined by need and partially by a local authority's ability to raise their own revenue through council tax. This grant has been reduced significantly since 2013/14 and is likely to be abolished in the future, as local authorities are able to retain a higher proportion of business rates growth.

In addition, local authorities receive ring-fenced grants for specific purposes like the Public Health Grant, and other grants to support health and social care, such as the Improved Better Care Grant and the Winter Pressures Grant.

Finally, local authorities also receive grants that are allocated to that authority but passed on to relevant bodies, such as education and policing. By their nature, local authorities have little discretion over how these grants are spent and instead act largely as intermediaries. The size and distribution of grants is determined centrally by national policy makers and this cash is simply passed through local authorities and on to the relevant institutions. Since local authorities have little control over how these grants are spent they are often not regarded as part of local authority funding, and we do not consider these types of grants in any of our analysis going forwards.

Central government grants that contribute to controlled funding have borne the brunt of national austerity. The Ministry of Housing Communities and Local Government (MHCLG, then the Department of Communities and Local Government) experienced the greatest fall in funding of all government departments over the period of the Coalition government and has also faced the largest cuts of any department since 2010/11[21]. Figure 1 below compares the change in total departmental funding to the change in local government departmental funding, which is largely redistributed to local authorities in the form of grants. Between 2009-10 and 2018-19, total government departmental spending was cut by 11% in real terms. Over the same time period, funding to the Ministry of Housing, Communities and Local Government fell by 86% in real terms, although part of this decline was made up for elsewhere through greater business rates retention (see below) and ring-fenced grants.

FIGURE 1
Local government departmental spending has been cut drastically since 2009-10, especially compared to overall government funding
Change in RDEL (Resource Departmental Expenditure Limits, a measure of day to day resource spending) between 2009-10 and 2018-19 (indexed to 2009-10).



Source: PESA statistical outturns (figures for 2018-19 are planned spending). All figures are deflated using OBR's GDP deflator.

Council tax receipts are local authorities largest source of revenue, budgeted at £29.6 billion in receipts in 2018/19[22]. It was first introduced in April 1993, replacing the community charge or 'poll tax', and it is paid on residential properties. Residential properties are placed into one of eight bands, based on property values in April 1991. Since properties have not been revalued since 1991, council taxes have failed to capture changes to property value over time, and there have been frequent calls for them to be revised[23].

Council tax has also been criticised as being particularly regressive as it is only weakly linked to property values, with council tax differences between bands much smaller than corresponding differences in property values. Someone living in a £100,000 property faces a significantly higher effective tax rate (council tax relative to property value) than someone living in a much higher value property. Furthermore, different property values in different areas of the country mean that higher-value areas can set council tax lower in order to fund a given level of services, driving much lower effective council tax rates in London and the South of England than the North[24].

Local authorities are able to increase the rates of council tax up to a centrally determined threshold each year, although if they want to raise it further, they have the powers to hold a local referendum to determine if they have a local mandate to do so. In 2018/19 this threshold was 3% without social care responsibilities, or 6% for councils with social care responsibilities. The difference between the two thresholds is known as the 'social care precept' and was introduced in 2016/17 to alleviate some of the pressure on councils with responsibilities for social care.

Business rates revenues also fall mainly under controlled funding and in 2018-19, local authorities were expected to retain £17.1 billion in income under the business rates retention system[25].

Prior to 2013/14, local authorities passed all business rates receipts back to central government. These were then redistributed back to local authorities in the form of grants, based on an assessment of local need and taking into account local authorities' council tax receipts. However, from 2013/14, in aggregate local governments were allowed to retain 50% of locally collected rates and up to 50% of associated growth of income at the local authority level. The remainder of receipts are returned to central government. Although not yet confirmed, from 2020/21, the government has announced its intention for this retention figure to be 75%. The move is intended to be fiscally neutral (ie. reforms will not raise or lower the amount available to local government) with a corresponding withdrawal of government grants.

As the capacity of an area to generate business rates does not necessarily match local need, revenue is redistributed between authorities by a complex system of tariffs and top-ups. The system is intended to reset every few years, to ensure that some local authorities do not benefit from runaway growth whilst others languish. At the reset, the amount each local authority needs (called the business rates baseline) is compared to the amount it can generate through business rates. If the authority is expected to generate more than it needs, it must pay a tariff; if the authority is expected to generate less than it needs, it will receive a top-up.

Over the following years, if the local authority increases the amount it generates in business rates revenue, it keeps a proportion of that growth. If the local authority raises less revenue, there is a safety net (currently kicking in at 92.5% of estimated need) in place to ensure that funds available to local authorities do not fall below that floor. This is partly paid for by a levy on the additional growth retained by authorities. Consider a local authority that is expected to raise £100 million in business rates revenue in year one. Its local share of revenue amounts to £50 million under the current retention system. If its baseline need is calculated as £40 million, it must pay a £10 million tariff to central government. Alternatively if its baseline need is £60 million, it receives a £10 million top up from central government in addition to business rates retained. Suppose that in the following year, the authority raises £55 million in business rates. It must still pay the top-up (or will receive the tariff) as it did in the previous year, albeit adjusted for inflation. But it will also be able to keep up to 50% of the £5 million growth in business rates (subject to the levy).

2.2 COMPARING LOCAL GOVERNMENT SPENDING POWER ACROSS TIME

Assessing the level of comparable funding for local authorities across time is complicated. On the funding side, and following the move to 50% retention of business rates since 2013/14, central government has announced plans to allow local authorities to retain 75% of business rates income by 2020/21. By this date, the Revenue Support Grant will also be completely abolished, as well as most ring-fenced grants under local authority control, including the Public Health Grant and Rural Services Delivery Grant. On the spending side, a rising population, changing demographics and increasing levels of need mean more resources are required to deliver services at the same level of access and quality, while local authorities have also seen their responsibilities change across time (see text box for an overview of three of the most significant changes in responsibility).

MAJOR CHANGES TO LOCAL AUTHORITY DUTIES SINCE 2009-10

Public health

The Health and Social Care Act 2012 abolished primary care trusts (NHS bodies responsible for most health commissioning and public health) and gave most of their responsibilities for public health to local authorities, accompanied by a new ringfenced grant – the Public Health Grant. The move transferred new duties to local authorities to improve the health of the people who live in their areas, including responsibility for a range of public health services previously provided by the NHS like most sexual health services and services to address drug or alcohol abuse. Public health responsibilities for adults and children over 5 were transferred in April 2013; in 2015, responsibilities for children 0 – 5 were transferred as well.

Social care

The Care Act 2014, while setting out a common approach to assessing care needs and entitlement, also placed new statutory duties on councils to provide specific services. These services included an information and advice service available to all, support to carers looking after people on an informal basis, responsibilities to arrange independent advocates for those unable to engage with the care process themselves, and operation of a deferred payment scheme so that people do not have to give up their homes to pay for care needs until after death.

Homelessness

The Homelessness Reduction Act 2017 extended entitlements for those at risk of homelessness and created additional legal duties for councils to prevent and reduce homelessness. Limited additional funding was promised to local authorities to fulfil these duties, but councils were also expected to realise savings in the medium term by reducing the cost of homelessness. However, this has been criticised as being insufficient: 67% of senior council figures say they did not have sufficient resources to fulfil their new duties; while London Councils estimated that the additional funding only met 39% of additional costs[26].

Nevertheless, figure 2 below presents an illustrative analysis for how local authority funding might be considered on a like-for-like basis across time. The analysis pertains to 'core spending power'–defined as the level of resources local authorities have at their discretion to meet their duties and support residents[i]. Further to this, the analysis adjusts core spending power to take account of the increased and differing duties of local government over time – in particular with respect to public health. For further detail of the analysis, see Appendix One.

i Core spending power is a government measure used to define how much local authorities have to spend on core services. Currently (for 2019/20) it includes the settlement funding assessment (made up of retained business rates and revenue support grant), council tax, and additional grants, namely: Improved Better Care Fund, New Homes Bonus, Rural Services Delivery Grant, Social care support grant and Winter pressures grant. For further detail on the measure, see: https://www.gov.uk/government/publications/core-spending-power-final-local-government-finance-settlement-2019-to-2020

It does not usually include the public health grant, but in order to track comparably across time we are including this in our analysis (and estimate an equivalent value for 2009/10 by scaling down 2013/14 taking into account population changes.).

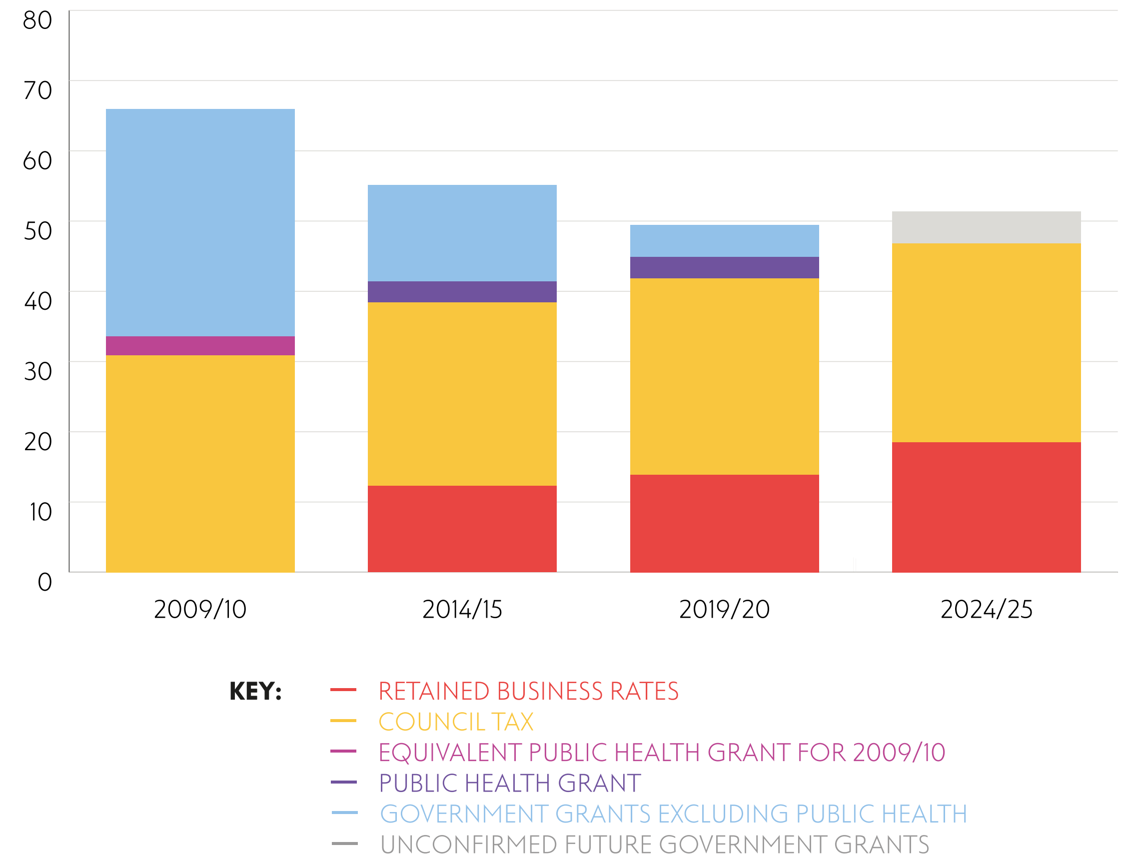
Therefore, for the purpose of this analysis, we have operationalised core spending power as the settlement funding assessment, plus council tax, the Improved Better Care Fund, New Homes Bonus, and Public Health Grant.

Our analysis makes clear that overall levels of funding under local authority control have steadily fallen over the last decade. Increased revenues from both business rates and council tax receipts have not made up for the withdrawal of government grants.

Over the next five years, the picture is less certain as the government has still not confirmed its plans for 2020/21 onwards. However, using assumptions about the most likely future pathway based on documents out for consultation, local governments are still facing a minor loss, unless a few government grants are continued (these are as yet unconfirmed and the government has announced its intentions that the move to a higher proportion of business rates retention would be fiscally neutral – suggesting these grants are likely to be abolished). If those grants are discontinued, funding available to local authorities will decrease slightly – although as we discuss in the next chapter, demand is rising and therefore the gap between what is needed and what is available is rising.

Between 2009-10 and 2019-20, non-ring-fenced grants to local authorities have fallen by £27.6 billion in real terms (86%), excluding public health.

FIGURE 2
Local authority spending power has been falling since 2009/10 to present and is not projected to rise significantly in the next decade
Change in local authority core spending power and public health grants between 2009/10 and 2024/25 (£ billion, 2019-20 prices)



Sources: Authors' calculations using MHCLG local authority revenue expenditure and financing statistics. Figures are deflated using OBR's GDP deflator. See Appendix One for further details of sources. Our figures are consistent as far as possible with the most recent government announcements, including the September 2019 Spending Round.

2.3 Distribution of changes to core spending power across different local authorities

Aggregate figures for core spending power conceal a high degree of variation across regions and at the level of individual local authorities. There is a distinctive geography of austerity, in which different localities are affected to a greater or lesser extent, depending on factors such as their level of cuts to date, ability to raise additional income and access to sources of resilience, such as local assets and reserves[27].

A key driver of regional variation is the size of business rates tax base by local authority, since the new business rates retention system allows councils to retain a share of the growth in tax receipts from year to year (see section 2.1 above). Furthermore, cuts to grant funding have occurred according to a 'flat rate' percentage cuts across all local authorities. Therefore, in absolute terms, those authorities who receive a higher proportion of their funding through central grants have been most affected. The same areas have been also been least likely to gain from additional policy change for local government such as the business rates retention uplift and the New Homes Bonus.

3.0 ESTIMATING THE FUNDING GAP

Just as the levels of local government funding have been cut, demand for services has been rising for a multitude of reasons: primarily demographic pressures combined with the impact of policy decisions. Since 2009/10, the population of England has increased by 7%[28]. Furthermore, the population is ageing – putting more pressure on social care services. As life expectancy is increasing, healthy life expectancy is not increasing at the same rate, so people are living for longer in ill health[29.]

In addition, the impact of austerity itself has likely ultimately increased need in the long run: a lack of resources has forced local authorities to shift spending towards those with only the very highest level of need. This represents a shift away from prevention towards those in crisis, and ultimately leaves those with lower levels of need to only receive support once they hit crisis point – at which point their support is likely to be more costly. For example, some local councils have felt forced to take the decision to restrict developmental early years' services, leaving children in disadvantaged areas and children in danger of being taken into care without access to crucial services[30]. But early intervention has been evidenced time and again to lead to savings in the long run[31.]

So what do past and future local government funding cuts mean for local authorities in terms of meeting need? To come to an answer we follow a similar methodology to that used by the LGA[32.] Our analysis differs in that we use 2009/10 levels of access and eligibility for services rather than current crisis levels, in order to reflect the decline in service quality and access due to a lack of funding per capita in the last 10 years[33]. This may slightly over-estimate the gap as it ignores efficiency savings over the last decade, but analysis of efficiency savings finds that much have been realised through the closing of services and thus reversing these are desirable. We estimate the funding gap as the difference between local government core spending power and the cost of providing services at a comparable level of access and quality across two given time periods. The chart below presents two key funding gaps of interest:

1. The gap between projected 2019/20 funding and the estimated cost of services assuming 2009/10 levels of eligibility
2. The gap between projected funding in 2024/25 and the same 2009/10 baseline for service costs

To project changing demand for services across time we consider the largest service areas (in terms of budget) funded out of core spending power, and identify the key drivers of changes in cost (both in terms of demand and inflation). We then model the effects of changes in cost pressure as a result of these drivers since our baseline year of 2009/10. Table 2 in the appendix provides further details on our methodology for projecting service costs across time.

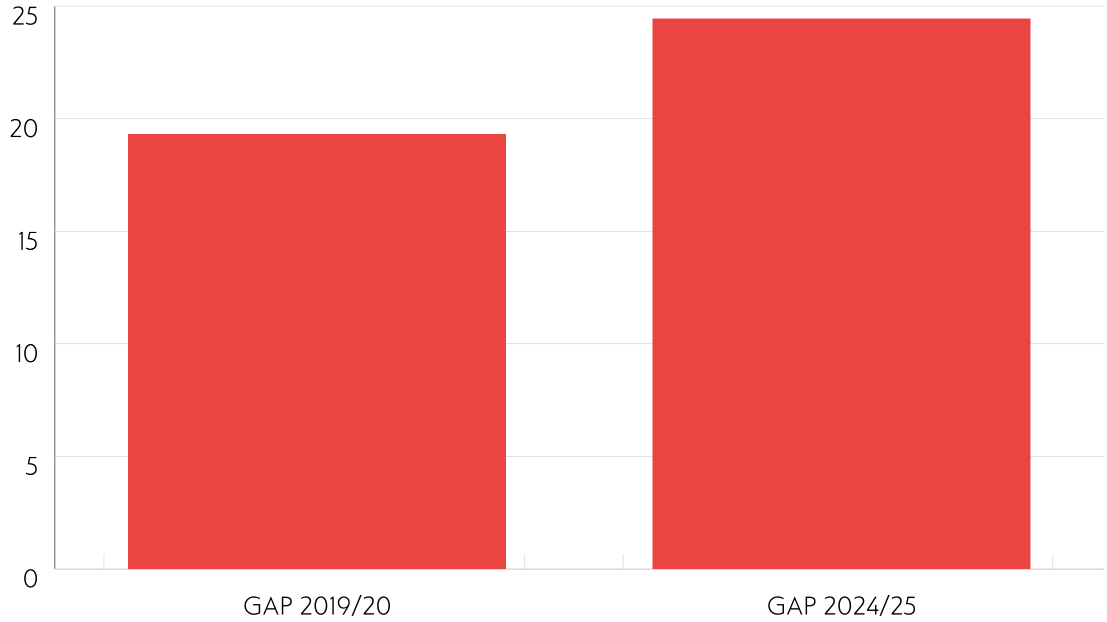
In 2024/25, we estimate a funding gap of £25.4 billion (2019/20 prices) compared with the resources required to deliver services on a comparable level of quality and access as seen in 2009/10 (see Figure 3 below). This would imply local authorities will need an additional 54% funding on top of current projections.

It should be noted, that these estimates assume that local authorities make the maximum annual increases to council tax and that funding streams such as the Improved Better Care Fund are continued from 2020/21. To the extent that these assumptions do not hold, the funding gap could be at least £4.5 billion larger in 2024/25.

FIGURE 3

Local authorities will face a significant funding gap of £25.4 billion by 2024/25

Estimates of the funding gap between expected revenue and need, in terms of 2009/10 level service access and quality, in 2019/20 and 2024/24 (£ billion, 2019-20 prices)



Source: own calculations, see appendix Two for details.

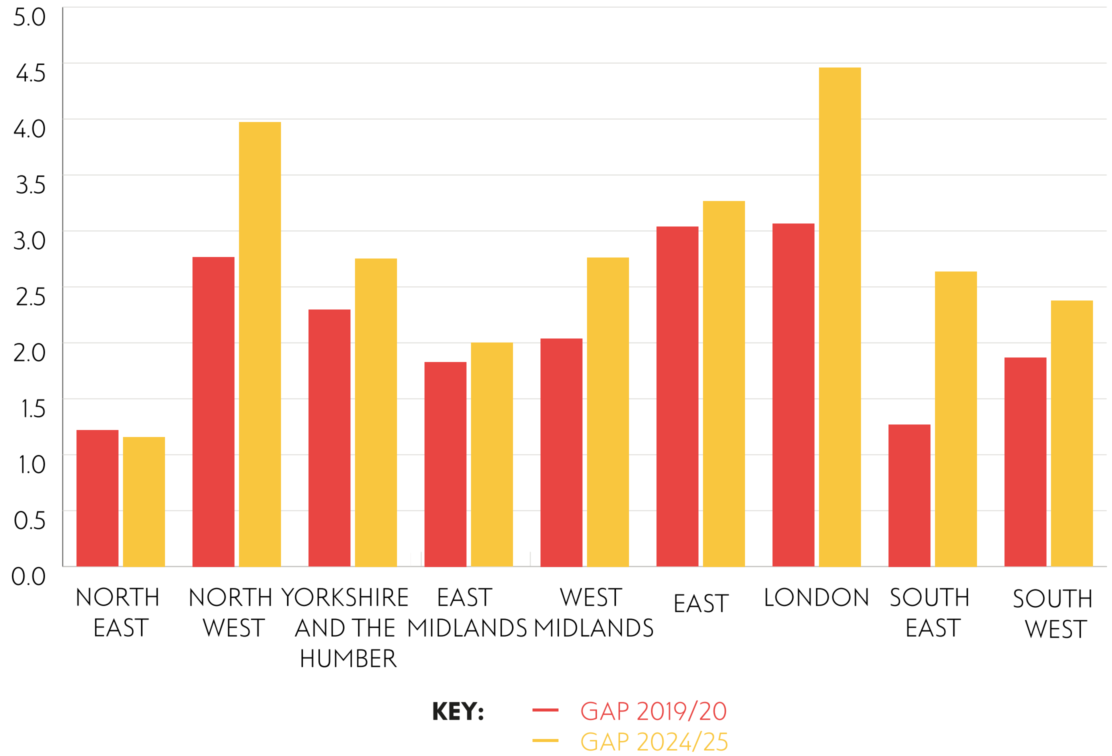
3.1 The funding gap by region

We further break down the funding gap estimations by region in figure 4 below. We find that every single region faces a funding gap on average. London is facing the largest overall funding gap. However, on a per person basis, the North West is facing the largest funding gap, followed by East of England and then Yorkshire and the Humber. Of course, this is a regional average and hides much variation. Some local authorities are set to gain significantly from higher business rates retention and the reform of the retention system (particularly in London), in places with a greater ability to grow their business rates base.

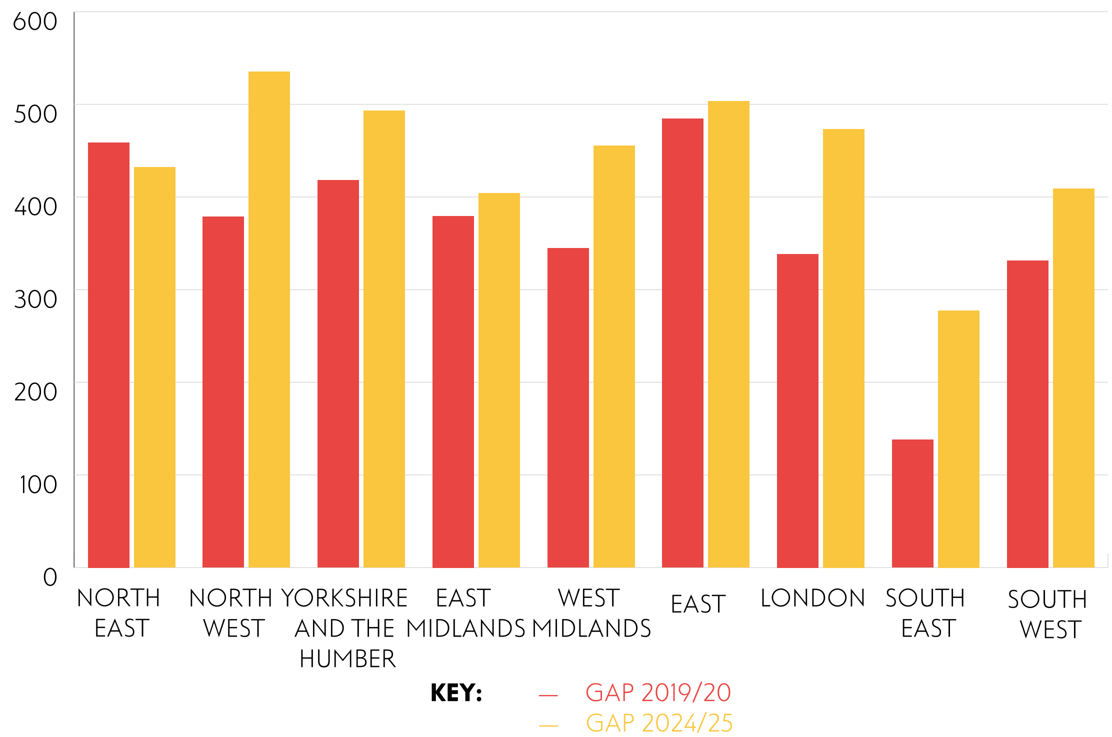
FIGURE 4

All regions are currently experiencing a sizeable funding gap which will increase by 2024/25 in nearly all regions

Estimates of the funding gap between expected revenue and need, in terms of 2009/10 level service access and quality, in 2019/20 and 2024/24, by region (£ billion, 2019-20 prices)



Estimates of the per capita funding gap between expected revenue and need, in terms of 2009/10 level service access and quality, in 2019/20 and 2024/24, by region (£ billion, 2019-20 prices)



Source: own calculations, see appendix Two for details.

4.0 TIME FOR REFORM

Local authorities have responded to austerity and changes to the funding landscape in a range of ways. However, there are clear signs that they are at breaking point as services are declining to an unacceptable level of quality, and they are becoming unable to meet basic needs.

4.1 Cutting spending to services and rationing

The key source of savings for councils in the face of austerity has been to cut spending to areas where they have fewer or no legal responsibilities, in order to protect those for which they do (most notably social care). This means that spending on discretionary service areas have fallen markedly: spending on planning and development has fallen 52.8% since 2010-11, spending on highways and transport has fallen by 37.1% and cultural and related services fell by 34.9%[34].

Even in social care, although levels of spending have been protected as far as possible, councils have also increasingly made difficult decisions to make savings by rationing access to services even where they have a legal duty to provide support in order to keep up with rising demand. For example, in one council, explicit decisions have been made to target support only for those with the highest level of need, despite acknowledgement that this would "leave people with substantial needs without necessary support".[35] Across the country, there has been a 1.8 million increase in requests for adult social care since 2015/16, up 2%, but the number of service users has been falling[36]. The Care Quality Commission report that unmet need for those over aged over 64 has increased markedly since 2010[37].

4.2 Efficiency savings

A key principle underlying austerity policies is the idea of doing more with less through the realization of efficiency savings. Local authorities have managed to improve efficiencies, through consolidating organizational structures, sharing services, and integrating information technology. Nationally, councils have reduced total spending on management and support by 25.7% in real terms since 2010/11[38]. However, authorities cannot continue to make efficiency savings forever. They have moved away from 'easy wins' such as closing programmes or restructuring teams. Given the length of time they have been delivering savings, authorities are now reporting they are near the end of their ability to make further savings[39].

4.3 Additional responses

In addition to making savings, local authorities have options to increase the amount of revenue available to them through investments, as well as increasing fees and charges. They can also draw down on reserves (but this is obviously not a long term solution).

In the past few years, local authorities are increasingly reliant on unplanned drawdowns of reserves to cover funding shortfalls – particularly those with responsibilities for social care. The NAO estimates that one in ten would have dangerously low levels of reserves by the end of the decade if they continued to use them at the rate they did in 2016-17[40].

There are also signs that a greater share of the cost of service provision now falls on the service user, through increased fees and charges. Local authorities are allowed to charge for services they have a power (but not a duty) to provide. The income earned from these charges must not exceed the cost of providing the service, there is no restriction on how the costs are calculated. Across all non-social-care service areas as a whole, income from sales, fees and charges increased from 16.1% to 21.9% as a share of total spend, 2010-11 to 2016-17[41].

5.0 WHERE NEXT?

The Government plans to change the way local authorities are funded from 2020/21, but the full details of how it will work are unclear. What is likely is that given current known announcements – existing plans will not close that funding gap. Taking into account what is known about current plans, local authorities are facing a funding gap of £25.4 billion by 2024/25.

It is clear that local authorities will be unable to fill that gap without significant reform to the local funding landscape to ensure that vital local services are properly funded. It is likely this will involve significant reform to either business rates, council tax or both. It may also involve the introduction of new local taxes or the further devolution of those that are currently national.

Therefore the need for reform represents an opportunity to rethink the relationship between national, local and indeed even (sub)-regional government. What is the appropriate level of granularity for responsibility for revenue generation and service delivery? How can risk be effectively pooled, whilst ensuring local governments have the autonomy to be responsive to local need and priorities?

Any reform should follow the following principles of good tax design:

- Improve the long-term financial sustainability of local government
- Increase progressivity of locally administered taxation
- Increase accountability and transparency
- Improve on economic efficiency, for example in the housing market
- Be politically and technically feasible

In addition, any reforms should seek to reduce systematic inequality of funding between different authorities - reducing the potential for postcode lotteries for vulnerable people in need of services. Finally, they should not seek to remove power from local governments, and where possible give local government increased autonomy and control over generating revenue and spending it – as long as finance follows function and local authorities are able to deliver services to an acceptable quality. With these final two goals in mind, it is crucial that we get the mechanisms by which local authorities pool resources and how resources are redistributed between authorities right. Currently that mechanism is the business rates retention system, which will be the subject of our next paper.

One key proposal first suggested by IPPR that would likely fulfil all our criteria for reform, is to allow local authorities to retain growth in business rates in proportion to their need[42]. Currently, local authorities retain a proportion of their growth in business rates, but this means local authorities with a larger business rates base gain significantly more from a modest growth in business rates than those with a smaller base – effectively disadvantaging poorer local authorities with a smaller base. If instead local authorities were awarded for growing their base in proportion to need, local authorities would be more equitably rewarded for growth. This will be described further and discussed in the context of other reforms to the business rates retention system in our next paper.

APPENDIX 1

Assumptions for modelling local authority core spending power

Figure 2 shows the fall in local authority spending power since 2009/10 to the present, as well as forecasting expected spending power in 2024/25. We do not take into account ring-fenced and uncontrolled grants (ie. those grants that are simply passed on) for police or education. We also do not consider any money local authorities hold in reserves.

As far as possible, our estimates are consistent with the most up to date government announcements, including the September 2019 Spending Round for departmental spending allocations 2020/21. Therefore we protect all grants in real terms from their 2020/21 allocations, except those that have been explicitly announced as being abolished in the move to 75% business rates retention, namely the Public Health Grant, Rural Services Delivery Grant, and the Revenue Support Grant. Although it has not yet been reconfirmed, we assume 75% business rates retention is implemented from 2020/21 onwards.

Although the public health grant is not usually included in estimates of local authority spending power, they must be included in order for figures to be comparable over time.

We do not have public health grant figures for local authorities in 2009/10 (as this duty was carried out by PCTs prior to 2013/14), and therefore have used equivalent deflated figures from 2013/14. Further detail of sources and assumptions are included in the following table. All figures were deflated using OBR's latest GDP deflator figures.

Funding stream	**2009/10**	**2014/15**	**2019/20**	**2024/25**
Retained business rates (including section 31 grants for under-indexing the business rates multiplier)	N/A	As per the settlement	As per the settlement (assuming authorities protected from negative revenue support grant)	We construct a model of retained business rates, assuming local retention share rises to 75%, but keeping the levy and safety net the same as they are currently. We assume the system will not be reset in the period 2020/21 to 2024/25.
Council tax	As per the settlement	As per the settlement	As per the settlement	Uprated from 2019/20 baseline, assuming all authorities raise taxes by the maximum allowable without a referendum (annually 2% plus 2% if they provide social care)
Government grants including:				
Revenue support grant	As per the settlement	As per the settlement	As per the settlement	N/A – rolled into business rates
Improved better care fund	N/A	N/A	As per the settlement	Assume kept constant in real terms from allocations announced for 2020/21 in the 2019 spending round
Rural services delivery grant	As per the settlement	As per the settlement	As per the settlement	N/A – rolled into business rates
New homes bonus	N/A	N/A	As per the settlement	Assume protected in real terms
Stronger towns fund	N/A	N/A	N/A	Allocated as announced 4th March 2019[43], assuming allocated equally across six years
Public health and children's 0-5 services grants	Assume the same in real terms as the grant provided in first year of existence (2013/14)	As per the settlement	As per the settlement	N/A – rolled into business rates

APPENDIX 2

Assumptions for estimating local authority cost pressures

Figures 3 and 4 shows the local authority funding gap. We build on the LGA's methodology for estimating the funding gap from 2018, updated to use the most recent government data and funding announcements[44]. We consider the largest areas of service funded out of core spending power, and identify the key drivers of changes in cost (both in terms of demand and inflation). We then model changes in cost pressure as a result of these drivers compared to the base year (2009/10). Assumptions used to model changes in cost pressure are provided below. To put figures into real terms, all figures were deflated using the OBR's most up to date GDP deflator.

Service area	Areas of spending	Demand assumption	Inflation assumption
Adult social care – working age	18+ adults with learning disabilities Rest of working age adult social care	Population projections, 18–64	55% CPI inflation, 45% expected increase in national living wage (weighted as 60% of adult social care costs are labour related and 75% of all staff are direct care workers)[45]
Adult social care – older adults	Population 65+ in poor health	Population projections, 85+	55% CPI inflation, 45% expected increase in national living wage
Children's social care	Looked after children Children in need Rest of children's social care	Population projections, 19 and under	CPI inflation
Public health	Public health	Total population projections	CPI inflation
Other services funded from core spending	For example, homelessness; maintenance highways and transport; environment and regulatory services	Total population projections	CPI inflation

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