3. The outlook for councils' funding: is austerity over?

Key findings

The government has forecast that what it terms councils' core spending power 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 their 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 such as adult social care. For example, with increases in council tax of 4% a year (double the rate of inflation) and no growth in productivity in the adult social care sector (in line with historical trends), the fraction of these taxes needed for adult**

social care could grow from 38% to 41.5% by 2024–25 and nearly 50% by the mid 2030s. Capping increases in council tax at 2% a year (the rate of inflation) would see adult social care needing 44% of local tax revenues by 2024–25 and 60% by the mid 2030s. In this case, the amount left over for other services would fall significantly over time, implying ongoing austerity for services that have often seen cuts of 40% already over the last decade, unless additional funding is found for councils.

- **Even with council tax bills increasing at 4% a 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. For example, estimates from the Health Foundation and King's Fund suggest free personal care for the elderly – a recent Labour pledge – would cost £6 billion initially, but rise to over £8 billion in today's prices by 2030.**

- **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.**

The previous chapter showed that the last decade has been one of austerity for local government, with revenues and spending per person down by almost a quarter between 2009–10 and 2019–20. It also showed that the bulk of the cuts – although not necessarily the bulk of the pain associated with them – occurred in the first half of that decade. Indeed, budgets for 2019–20 imply a modest increase in spending relative to 2018–19, reflecting increasing council tax revenues and bills.

But will these increases continue in the years ahead, ending austerity for local government? Or will councils again face tough choices over which services to prioritise and which to cut back? That is the question we explore in this chapter. In particular, Section 3.1 looks at recently announced plans for the next financial year, 2020–21. Section 3.2 then looks further ahead, discussing the outlook out to the mid 2020s and beyond.

3.1 The government's plans for 2020–21

In his 2019 Spending Round, Chancellor Sajid Javid announced additional funding for local government as part of wider increases in government spending. In particular, he announced:

- An increase in funding via the general-purpose Revenue Support Grant and redistributed business rates ('baseline funding levels') in line with inflation. In cash terms, this amounts to around £0.3 billion, and it is the first time that this general-purpose funding has increased in a decade. This year, for instance, it fell £0.9 billion in cash terms.

- An increase in grant funding for adults' and children's social care of £1 billion. This continues a trend of increases in grant funding targeted at social care services – with other significant increases announced in Autumn 2015, Spring 2017 and Autumn 2018. One notable difference from past announcements though is that this funding is labelled for social care services but not actually ring-fenced: it can therefore be spent as councils see fit. The grant funding that is currently ring-fenced for adult social care (the Improved Better Care Fund and Winter Pressures Grant) will remain ring-fenced but be frozen in cash terms.[1]

- Keeping funding for the NHB and the Rural Services Delivery Grant fixed in cash terms.[2]

- And, subject to consultation, allowing councils to increase their council tax by up to 2% for general expenditure and up to an additional 2% for adult social care (the ring-fenced 'social care precept'), without requiring a referendum. The former would raise around £0.6 billion if taken up in full and is lower than the 3% increases allowed for general expenditure this year. The latter would raise around £0.5 billion if taken up in full and means powers to levy additional increases specifically for social care will not now end in 2019–20 as initially planned.

Furthermore, the chancellor assumed that growth in the council tax base (i.e. the amount that would be raised even if there were no increases in tax rates) will generate

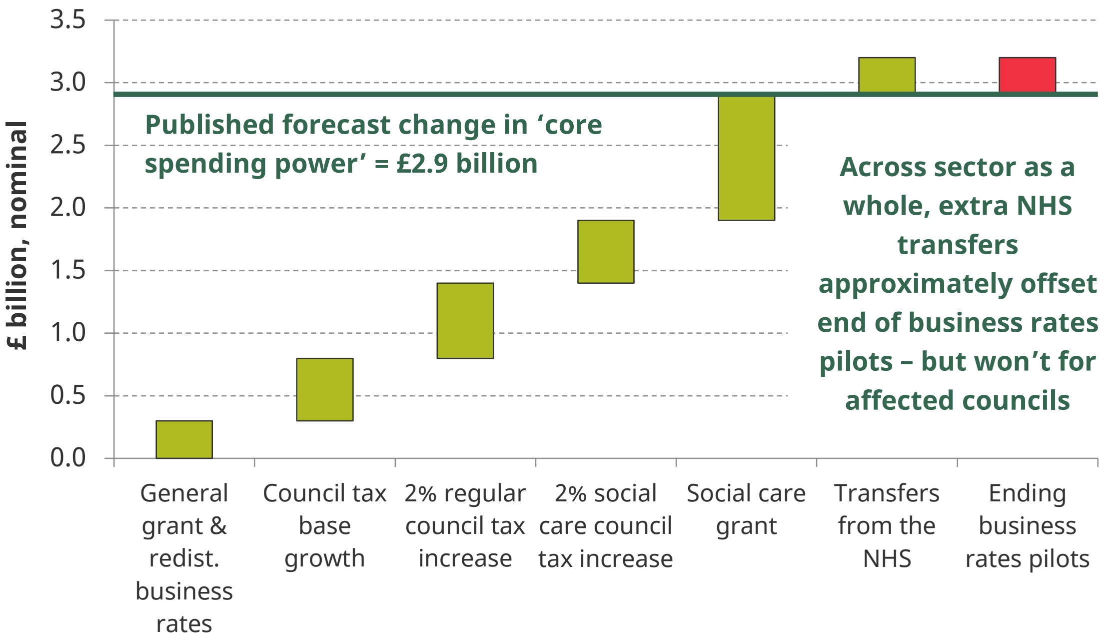
1 At £1.8 billion and £240 million, respectively.

2 At £0.9 billion and £81 million, respectively.

approximately £0.5 billion. This is significantly higher than would be generated from expected house-building alone and reflects the fact that in its projections, the government is effectively relying on councils continuing to cut back the generosity of their council tax support schemes for low-income households,[3] or cut (increase) other discretionary discounts (premiums). If this were not the case, increases in the council tax base would be expected to raise slightly more than half the £0.5 billion implied by the chancellor's figures.

All told, this amounts to a £2.9 billion increase in what government terms 'core spending power' – a cash-terms increase of around 6.3% and a real-terms increase of 4.3% – if councils increase their council tax by the full amount allowed and continue cutting back the generosity of their council tax support schemes. He also announced two other increases in council funding outside the core local government settlement: an increase in the Public Health Grant and of transfers from the NHS to help pay for social care of 3.4% above inflation, in line with the average annual increase agreed for the NHS as part of its long-term funding deal (and, indeed, slightly higher than the 3.1% increase the NHS will receive in 2020–21). These will provide an additional £170 million and around £100 million ring-fenced for public health and adult social care spending, respectively. For public health this represents the first increase since 2015–16 (this year it was cut by £85 million, for example).

Figure 3.1. Contributions to forecast changes in councils' funding in 2020–21 if underlying business rates remain unchanged in real terms



Note: Figure for ending business rates pilots is based on the estimated gain from pilots in 2019–20 and could be higher or lower than this depending on whether underlying business rates revenue grows or shrinks in real terms in 2020–21.

Source: Authors' calculations using HM Treasury (2019) and IFS's local government finance model.

[3] Adam, Joyce and Pope (2019) highlight how councils have cut back levels of support by, among other things, increasing minimum payments, capping support amounts for those in high-band properties, and cutting capital limits.

A quiet cut to retained business rates revenues?

However, in its consultation on its detailed plans, the government has also confirmed a funding *cut* that will affect a significant number of councils: the end of business rates retention pilots outside of Bristol, Cornwall, Greater London, Greater Manchester, Merseyside and the West Midlands.[4] This means the 117 councils that are currently pilots as part of 15 pools will move from retaining 75% of the growth in business rates to 50%,[5] as well as having that growth subject to the levies that operate in the standard version of the BRRS. Greater London will also see its retention rate switch from 75% to 67%, reducing retention rates for 32 London boroughs back down to 30% (with the Greater London Authority receiving the other 37%).

The size of this cut will depend on the real-terms growth in business rates revenues in 2020–21 relative to 2013, when the BRRS was first introduced and from which growth is measured from. We do not yet know this of course. But in the next chapter, we estimate how much pilots are gaining as a result of the pilots in the current financial year, 2019–20, based on published forecasts for business rates revenues. This suggests the 15 pools that will move back to 50% retention are gaining £193 million as a result of their pilot status, and London councils are gaining £65 million as a result of having 75% as opposed to 67% retention. Thus even if there is no real-terms growth in underlying business rates revenues in 2020–21, changes to business rates pilots will reduce funding for local government by around £258 million.

If there is real-terms growth in underlying business rates revenues in 2020–21, overall funding for local government will, of course, be higher than if there is no growth (even 50% of the growth is better than nothing!). However, to offset the abolition of the pilots, we estimate that, on average, those councils moving back to 50% retention will need business rates revenues to have grown around 1.33 times more over 2013 levels than they had grown by 2019–20, requiring growth of around 3.1% above inflation in just one year. Across England as a whole, we estimate that underlying business rates revenue growth of around 2.2% above inflation would be needed to offset the effect of ending the pilots on overall funding for local government.

Changes to a wider measure of local government funding

Taking into account these additional funding increases and cuts suggests a broader measure of council funding (the government's 'core spending power' plus funding from the NHS for public health and social care plus retained business rates growth) will increase by around £2.9 billion or around 3.5% in real terms if there were no above-inflation growth in underlying business rates revenues. Each additional 1 percentage point by which underlying business rates revenues grow would generate around £119 million for local government, equivalent to an additional 0.25 percentage point increase in real-terms funding.

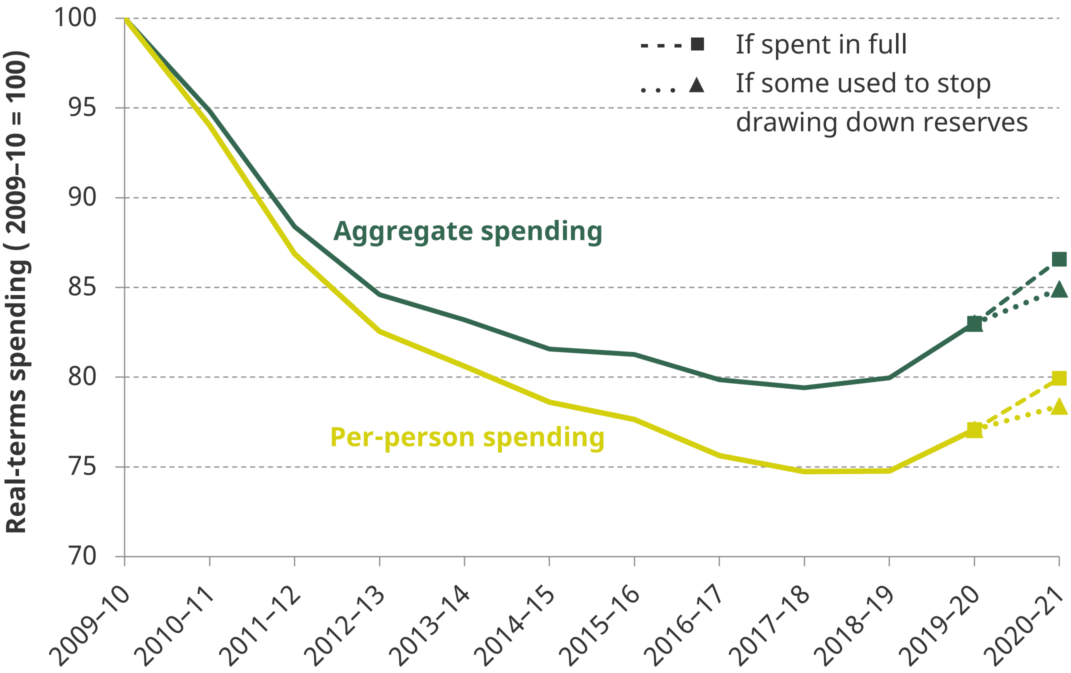
To what extent do these funding increases offset previous cuts?

As covered in depth in Chapter 2, these planned funding increases follow a decade, the first eight years of which (to 2017–18) saw local government spending on services fall by

4 Ministry of Housing, Communities and Local Government, 2019a.

5 The pools are Berkshire, Buckinghamshire, East Sussex, Hertfordshire, Lancashire, Leicester and Leicestershire, Norfolk, Northamptonshire, North and West Yorkshire, North of Tyne, Solent, Somerset, Staffordshire and Stoke-on-Trent, West Sussex and Worcestershire.

Figure 3.2. Increase in funding planned for 2020–21 in the context of the cuts to council spending in the 2010s



Note: The dashed lines with squares show the potential path for spending and per-person spending if the additional funding for 2020–21 is spent in full. The dashed lines with triangles show the potential path if councils use part of the additional funding to stop drawing down reserves in 2020–21.

Source: Authors' calculations using Ministry of Housing, Communities and Local Government (2019a) and Ministry of Housing, Communities and Local Government (2019b and previous years' data).

21% and spending per person fall by closer to 25%, driven by falls in funding from central government. Even taken alongside the modest spending increases planned for the current year, the additional funding increases planned next year, if spent in full, would mean only a small part of the earlier real-terms cuts to council spending across England as a whole would be reversed:

- around a third of the cut to overall service spending;
- around a fifth of the cut to spending per person.

However, as discussed in Chapter 2, councils' budgets imply a drawdown of reserves of approximately £0.95 billion in 2019–20.[6] If councils decide to use part of the funding announced for next year to stop drawing down reserves, then the amount available for spending on services may increase by more like 2.3% in real terms (not 4.3%) next year. In this case, an even smaller share of earlier real-terms cuts to spending would be reversed on average by next year:

- just over a quarter of the cut to overall service spending;
- around a seventh of the cut to spending per person.

[6] Ministry of Housing, Communities and Local Government, 2019b. Almost 60% of this relates to planned use of reserves by the Greater London Authority in large part to fund an increase in spending by Transport for London.

Moreover, the funding boost (and the previous cuts) takes place in the context of rising costs and demands for certain key services such as social care services, so at least part of the increases will be absorbed by these pressures. For example, Local Government Association (2018) and PwC (2019) estimate that the spending needs of councils are growing by around 1.5% in real terms a year, driven by rising demands and costs for both adults' and children's social care services – and, as discussed in the next section, these forecasts seem somewhat conservative.

However, even so, a real-terms increase in spending of around 4.3% would almost certainly exceed the in-year spending pressures facing councils. This would enable councils to make some inroads into any backlogs of maintenance that may have built up, and/or make some modest increases in the range and quality of services provided, if they choose to spend the additional funding for next year in full. There will be less scope for such action if a significant part of the additional funding is used to bolster reserves positions.

It is also worth noting that the proportion of past spending cuts that could be offset by the extra funding this year and next differs significantly across the country, reflecting differences in the scale of those past cuts. In particular, less of the past cuts will be offset in more deprived parts of the country where cuts have been larger (e.g. averaging 31% for those councils with the highest levels of deprivation, as shown in Figure 2.9) than in less deprived parts where cuts have been smaller (e.g. averaging 16% in the least deprived council areas).

Will all councils see funding increase to the same extent?

In addition, councils will not all see their funding increase next year in line with the national average.

In part, this will reflect the fact that some may choose to increase their council tax by less than the full extent allowed (and assumed by the government in its figures). For example, in 2019–20, a number of councils froze or even cut their council tax, despite all being able to increase their council tax by at least 3%. Some will reflect differences in underlying council tax and business rates tax base growth across the country. But differences will also reflect decisions by central government on how to allocate funding:

- First, and most obviously, shire district councils will see a smaller increase in funding than councils with social care responsibilities. This reflects the facts that, subject to consultation, increases in council tax will be capped at 2% (rather than the 4% allowed for those with social care responsibilities) and that unsurprisingly they will not receive any of the additional grant funding for social care services. With general grant funding and funding from redistributed business rates frozen in real terms, this means shire districts will rely on growth in their council tax bases (whether as a result of house-building or changes to the cost of exemptions, discounts, premiums or council tax support schemes) and retained business rates revenues for any real-terms increase in funding. Nevertheless, this is a marked improvement on the past decade when shire districts have seen real-terms cuts in general grant and hence overall funding. And as discussed in Chapter 2, lower-tier district councils appear to be coping better financially despite facing significantly larger cuts, on average, than councils with social care responsibilities.

- Second, the amount of funding for social care different councils with social care responsibilities will receive will differ. In its consultation on detailed plans for next year's funding allocations,[7] the government proposes to allocate the additional grant funding for social care services so that overall increases in funding for social care (including the ring-fenced 2% council tax social care precept) are broadly in line with historical assessments of adult social care spending needs.[8] In cash terms, this means much more funding for some councils than others: assessed spending needs per person under the current formula are more than twice as high in places such as Knowsley and Blackpool as they are in places such as Wokingham and Bracknell Forest.

  Of course, allocation on the basis of needs is a perfectly sensible way to allocate spending. However, given that the grant is notionally for adults' *and* children's social care services, it is unclear why it is assessed need for the former only that is being used to allocate funding, especially given recent focus on children's social care as the most pressing financial pressure. Allocating funding in this way will mean more goes to rural and more affluent areas where the assessed spending need for adult social care services is relatively higher than that for children's social care services, and less for urban and more deprived areas. And it is worth noting that current assessments of spending needs were last updated in 2013–14, since when the populations and socio-economic characteristics of different areas are likely to have changed, sometimes significantly. The update to spending needs assessments being undertaken by the government in its Fair Funding Review is clearly sensible – albeit too late to be used for next year's allocations.[9]

- Third, those councils that are currently piloting 75% retention of business rates growth but that will move back to 50% retention next year will very likely see smaller increases in funding, and in some cases potentially even reductions in funding. For example, we estimate that councils in the Berkshire and Northamptonshire pilot pools are gaining, on average, an amount equivalent to 5.8% and 4.8% of their core spending power in 2019–20, which they will lose when pilots end.

  However, while the loss of these additional retained business rates revenues will clearly be unwelcome to these councils, it is worth noting that abolition of their pilots does return them to the standard BRRS scheme that non-pilot councils are subject to. Indeed, it is unclear what the justification is for allowing remaining pilots to enjoy more of the growth in business rates revenues since 2013 than other councils, other than the fact that 100% retention (or 67% retention in the case of London) was agreed as part of broader 'devolution deals' with councils in these regions.

- Fourth, the government proposes to increase the funding every council gets from general grant funding and redistributed business rates in line with inflation, i.e. freezing them in real terms. This may sound like it treats all councils equally, but it does not account for the fact that different councils rely on these revenues to very differing extents to bolster the revenues they receive from council tax and retained business rates revenue growth.

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7 Ministry of Housing, Communities and Local Government, 2019a.

8 £150 million of the grant allocation will be given to those councils that can raise less via the council tax social care precept.

9 See Amin-Smith and Phillips (2019b) and Amin-Smith, Harris and Phillips (2019a) for further discussion of the Fair Funding Review.

If grant and redistributed business rates revenues were changing very differently from council tax revenues, this could lead to very different spending cuts across councils. Indeed, this is exactly what happened in 2014–15 and 2015–16, when grant allocation decisions last took no account of the degree to which councils rely on grants. In the coming year, though, increases in council tax bills (other than for adult social care via the social care precept) are likely to be fairly close to inflation given the 2% cap, just like the change in grant and retained business rate revenues allocations. Therefore the government's proposals should not lead to very large differences in funding changes between councils this time round. However, the fact that it could shows the need to put in place a proper system for determining redistributive grants and transfers – which, as with updated spending needs assessments, is something the government plans to do in the year after next, 2021–22.[10]

3.2 The longer-term outlook

Detailed plans for 2021–22 have not yet been published. But, as already mentioned, we do know the broad detail of a number of reforms planned by the government and have a number of projections for demand and cost pressures for key service areas. Analysis of these plans and projections highlights that there is a strong likelihood that the government will need to continue with increasing grant funding or devolve additional revenue streams if we wish to avoid a return to austerity for local government. This could prove difficult if the economy takes another downturn and another round of fiscal tightening (i.e. tax rises and/or spending cuts) is required.

Potential future cost and demand pressures

Projecting the future spending needs of councils is difficult and subject to significant uncertainties – including changes in underlying demand-drivers (such as the number of old and sick people requiring social care, and the number of children in need). However, based on assumptions about how these factors will evolve over time, a number of studies examine the future spending needs of councils, focusing in particular on adult social care services. Table 3.1 summarises their projections for the annual above-inflation increases in spending required for different service areas over the first half of the 2020s. Differences between the studies are driven by differences in the factors taken into account and the assumptions made about them.

Adult social care services

The resulting differences in spending needs projections can be significant. For example, based on a model developed by the Personal Social Services Research Unit (PSSRU) at the London School of Economics, Johnson et al. (2018), Wittenberg, Hu and Hancock (2018) and the Office for Budget Responsibility (2018) project that the cost of adult social care services will rise by around 3.5% a year above inflation during the first half of the 2020s. In contrast, projections by the Local Government Association (2018), PwC (2019) and the Institute for Government (2019) are for costs to rise by closer to 2% a year.

[10] Again, see Amin-Smith and Phillips (2019b) and Amin-Smith, Harris and Phillips (2019a) for further discussion.

Table 3.1. Summary of projections of above-inflation increases in spending needs during the early 2020s

Study	Adults' social care	Children's services	Other services	Overall
Johnson et al. (2018)	3.7%	N/A	N/A	N/A
Wittenberg et al. (2018)	3.4%	N/A	N/A	N/A
OBR (2018) – central	3.4%	N/A	N/A	N/A
OBR (2018) – lower productivity scenario	3.9%	N/A	N/A	N/A
OBR (2018) – higher productivity scenario	2.9%	N/A	N/A	N/A
LGA (2018)	1.7%	3.1%	0.4%	1.6%
PwC (2019)	2.3%	1.5%	0.5%	1.4%
IfG (2019)	2.2%	1.5%*	0.6%**	N/A

Note: Johnson et al. (2018), Wittenberg et al. (2018), OBR (2018) and IfG (2019) are all based on a model by PSSRU at the London School of Economics. Differences between them relate to different assumptions about changes in unit costs (i.e. the real-terms cost of inputs to produce a unit of output), which ultimately reflect different assumptions about productivity growth in the wider economy.

* This includes core children's social care services only, unlike for LGA and PwC which include expenditure on Sure Start, services for young people, and education services funded by councils' general revenues (as opposed to ring-fenced education grants).

** This includes a subset of other services only: waste collection, road maintenance, libraries, trading standards, food safety, health and safety, and planning. It excludes other areas of environmental and regulatory services (such as waste disposal and flood and coastal protection), other areas of culture and leisure services (such as parks, leisure centres and visitor services), public transport, housing and central administrative services.

Source: Authors' calculations using information in studies cited.

A number of factors underlie these differences. For example, the PSSRU's model incorporates assumptions that the proportion of the population with learning disabilities that necessitate care will grow over time, whereas the LGA's and PwC's are based on existing prevalence. Second, the PSSRU's model incorporates more disaggregated population projections (by five-year age band), which allows it to take account of the fact that among the over-65s, for instance, it is the population aged over 80 (who are most likely to require care) that is growing fastest.

Third and most important are differences in assumptions about what will happen to the cost of providing care of a given type to a given person – so-called 'unit costs' – which ultimately depends on what happens to productivity. Johnson et al., Wittenberg et al. and the Office for Budget Responsibility (OBR) in effect assume no productivity growth in the social care sector, justified on the grounds that between 1997 and 2016, the Office for National Statistics estimates that productivity in the adult social care sector actually fell by 0.7% a year. This means that increasing pay for social care workers in line with wages in the broader economy translates into above-inflation increases in unit costs (because the wage increases are not offset by rising productivity).

In contrast, the projections made by the Local Government Association (LGA), the Institute for Government (IfG) and, as far as we can tell, PwC assume either that productivity in the adult social care sector will grow at least somewhat, or that real wages in that sector will decline relative to those in the wider economy. For instance, the IfG assumes that unit costs rise in line with inflation, and the LGA assumes this for the majority of adult social care spending.[11] If wages in the social care sector are to increase in line with the wider economy though (which would likely be needed for recruitment and retention), this would require productivity in the sector to increase in line with the wider economy too – a significant change from recent experience.

Sensitivity analysis by the OBR in which the annual change in unit costs is 0.5 percentage points higher (low productivity) or lower (high productivity) than in its central projection also illustrates the importance of assumptions about productivity to overall cost pressures.

Children's and other services

Projections for other services, including children's services, are only available in the LGA, PwC and IfG analyses.[12] All show very modest above-inflation increases in spending needs for 'other services' of around 0.5% a year. This is broadly in line with population growth, and reflects the fact that unit costs are generally assumed to rise in line with inflation. As discussed above, this requires some combination of productivity improvement and/or falls in relative wages.

Turning to children's services, it is notable that there are significant differences between the projections of the LGA (3.1% above inflation) and PwC and the IfG (1.5%). Most of this difference seems to be explained by differences in assumptions about service demand. The LGA assumes that underlying demand for spending on looked-after children and safeguarding will increase in line with trends in the number of children in foster placements or residential care and the number subject to child protection plans between 2013 and 2017, a period seeing significant growth in both. The IfG also looks at changes in the number of children in foster placements or residential care but does so over a longer period (2007 to 2017), which results in slower growth *per year*, as well as changes in the number defined as being 'in need' (which is a broader group than those on a protection plan), which has also grown less quickly. PwC, on the other hand, uses projections of the total size of the under-18 population to predict future costs.[13]

Summary

Overall, while each study considered in Table 3.1 projects that councils will need above-inflation increases in funding in the five years after 2020–21, the precise projections vary significantly, driven by different assumptions about demands (especially for children's services) and productivity and unit costs (especially for adult social care services).

[11] The LGA does also allow part of the costs of adult social care services to increase in line with the National Living Wage – although the projections were made prior to the recent announcement of a further substantial increase in this mandated minimum during the early 2020s to 67% of median hourly pay (up from 60%).

[12] The IfG's analysis includes only a subset of children's and other services, as discussed in the note to Table 3.1.

[13] This is initially done at the council level, and then summed to the national level. Starting at the local level in this way means that if more (less) of the growth in the under-18 population takes place in areas where demand is currently highest, overall demand across the country as a whole will grow by more (less) than the under-18 population across the country as a whole.

Will councils receive enough funding under current plans?

Whether councils will have enough funding post–2020 to maintain the quality and range of services provided will depend on what will happen to both their spending needs and their revenues. The previous discussion has already highlighted uncertainty about the former – driven by uncertainty about what will happen to the demand for and unit costs of different services. Revenues are also uncertain and will depend on what happens to local tax bases and rates, and what additional revenue streams councils are provided with.

To explore this issue, we therefore take two scenarios for both spending needs and local tax revenue, looking not just at the period up to 2024–25, but out to the mid 2030s.

For spending needs, we focus on the projected need for adult social care spending:

- In spending needs scenario 1 (S1), we assume that spending on adult social care services would have to rise by 3.4% above inflation to keep pace with demand and cost pressures, in line with the projections in Office for Budget Responsibility (2018). As already highlighted, this effectively assumes no productivity growth in the adult social care sector – which is actually a slightly better performance than over the last 20 years. But it represents our baseline scenario for cost pressures.

- In spending needs scenario 2 (S2), we assume that spending on adult social care services would have to rise by 2% above inflation to keep pace with demand and cost pressures, broadly in line with the studies by the LGA, PwC and IfG. As already highlighted, these studies effectively assume improvements in productivity in the adult social care sector – which would be a significant improvement on performance over the last 20 years – or falls in the wages of social care workers relative to other workers. This can be considered a conservative scenario for cost pressures (i.e. the expectation is that they would probably rise by more).

For revenues, we focus on the amount raised from council tax and 75% of business rates. This is because the government plans to increase the proportion of business rates retained by local government to 75% from 2021–22, and at the same time abolish the Revenue Support Grant, Public Health Grant and a number of smaller grants in order to ensure that the reform is revenue-neutral at the point of implementation.[14] This means that councils will rely on council tax and business rates for the overwhelming majority of their funding – unless plans are made to top them up.

We do not know how revenues from these taxes will evolve over time, so we look at two scenarios for council tax increases:

- 2% per year, which is what the government proposes as the maximum increase in council tax in 2020–21 without a referendum, excluding the extra increases allowed for adult social care services (which may not be extended indefinitely);

[14] See the next chapter and Amin-Smith and Phillips (2019a and 2019b) for further detail on these plans.

- 4% per year, which is what the government proposes as the maximum increase in council tax in 2020–21 without a referendum, including the extra increases allowed for adult social care services.[15]

In both scenarios, the council tax base is projected to increase in line with growth in the number of households (an average of 0.66% per year), and retained business rates revenues are projected to increase by 0.3% a year above inflation, in line with medium-term forecasts by the OBR. In reality of course, there is uncertainty about growth in the tax base too, but we abstract from that here to keep our analysis tractable.

Figures 3.3 and 3.4 show the fraction of revenues from council tax and (75% of) business rates that would be needed to increase adult social care spending in line with the cost pressures under S1 (high cost pressures) and S2 (low cost pressures), respectively.

Looking first at Figure 3.3, we can see that if adult social care costs were to rise 3.4% a year above inflation, even if council tax were increased 4% a year every year, the share of local tax revenues needed for this service area would rise from 39% in 2020–21, to 41.5% by 2024–25, and to almost 50% by the mid 2030s.

Meeting the increasing cost of adult social care services in full would utilise more than three-quarters of the overall growth in local tax revenues over the period, limiting increases in the local tax revenues available for other service areas (including children's services) to an average of just 0.7% above inflation per year between 2020–21 and 2024–25, and around 0.5% a year thereafter. Without funding top-ups, this would see spending on these other services fall as a percentage of national income, and could see cuts to some services if demands and costs are rising significantly in certain areas (e.g. if the LGA's assumptions about continued increasing demand for children's social services prove correct).

If, instead, council tax were to be increased by 2% a year every year, meeting the demand for adult social care services would see the fraction of local tax revenues required increase to 44% by 2024–25 and around 60% by the mid 2030s. Meeting this would use all of the growth in local tax revenues – and more. The amount available for other services (including children's services) would *fall* by 1.4% a year in real terms between 2020–21 and 2024–25 and by 2.5% a year in real terms over the following decade. Without additional revenues, this would mean the reimposition of very significant austerity for a range of local government services on an ongoing basis.

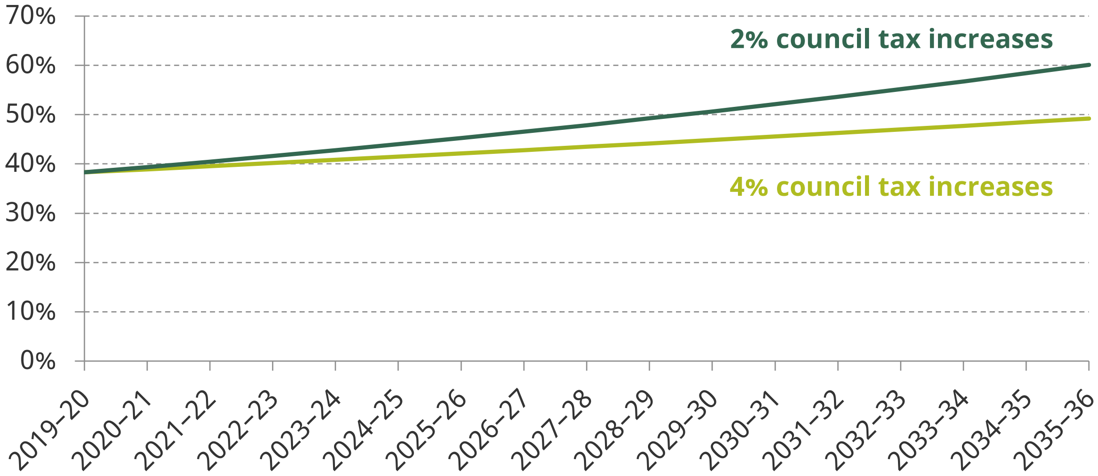
Turning to Figure 3.4, we can see that if the cost of adult social care services were to increase more in line with estimates from the LGA and PwC – 2% per year above inflation – the picture looks rather different, at least if council tax is increased significantly.

For instance, with 4% a year increases in council tax, the share of local tax revenues accounted for by adult social care would only increase very slightly over time. The amount left over for other services would grow by 1.7% per year above inflation, almost enough to maintain spending as a percentage of national income and almost certainly enough to increase spending in real terms modestly for all service areas.

[15] Note that because only councils with social care responsibilities can increase their council tax by 4%, the average increase allowed across all councils is around 3.9%.

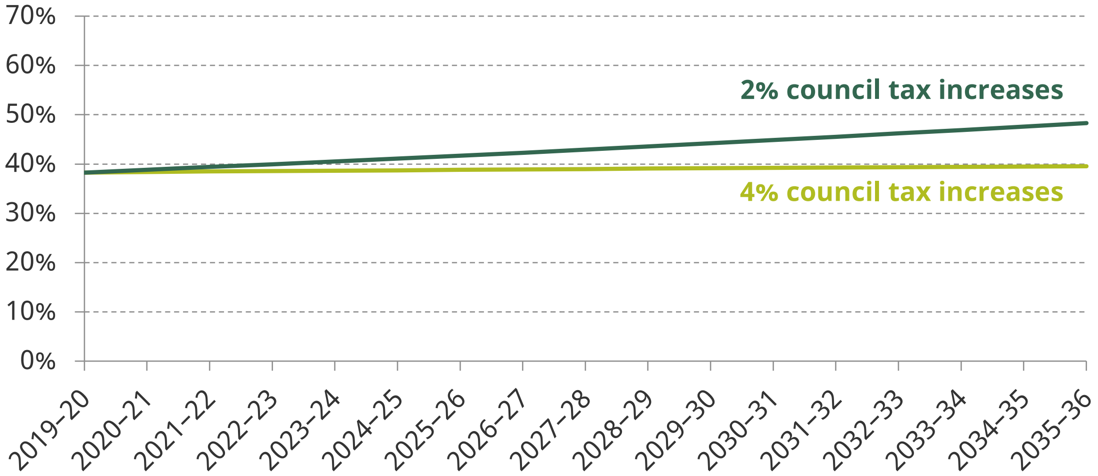
Things would still be tough with council tax increases of just 2% a year – the share of local tax revenues required for adult social care would still rise and the amount available for other services would still be falling in real terms, by around 0.4% per year during the early 2020s and by 0.7% a year thereafter. This is clearly less drastic than if adult care costs were rising more significantly, but would still require severe cuts to certain services, on top of the cuts they faced during the 2010s.

Figure 3.3. The share of council tax and retained business rates needed to meet adult social care spending pressures if costs rise 3.4% above inflation annually (S1)



Source: Authors' projections using budgeted council tax receipts from Ministry of Housing, Communities and Local Government (2019b), an estimate of how much councils would receive from 75% business rates retention in 2019–20 given forecast business rates receipts in NNDR1 forecasts for 2019–20, and projections for social care spending pressures reported in Office for Budget Responsibility (2018).

Figure 3.4. The share of council tax and retained business rates needed to meet adult social care spending pressures if costs rise 2% above inflation annually (S2)



Source: Authors' projections using budgeted council tax receipts from Ministry of Housing, Communities and Local Government (2019b), an estimate of how much councils would receive from 75% business rates retention in 2019–20 given forecast business rates receipts in NNDR1 forecasts for 2019–20, and the average of spending pressures for adult social care in Local Government Association (2018) and PwC (2019).

Table 3.2. Additional revenue required on top of local tax revenues under different scenarios for costs and council tax increases

Adult social care costs scenario	Council tax increase	Additional revenue required so that revenues for services other than adult social care:			
		(a) keep pace with growth in national income		(b) keep pace with average of LGA's and PwC's projections of needs	
		2024–25	2034–35	2024–25	2034–35
Adult social care spending needs increase 3.4% above inflation (S1)	2%	£3.9bn	£18.0bn	£3.3bn	£13.6bn
	4%	£1.6bn	£8.7bn	£1.0bn	£4.2bn
Adult social care spending needs increase 2% above inflation (S2)	2%	£2.8bn	£13.2bn	£2.2bn	£8.8bn
	4%	£0.5bn	£3.9bn	–£0.0bn	–£0.6bn

Note: All figures in 2019–20 prices.

Source: Authors' calculations using estimated council tax and retained business rates revenues from Ministry of Housing, Communities and Local Government (2019b).

Table 3.2 shows how much additional funding would be needed in each of the scenarios for adult social care costs and council tax increases to ensure that after 2020–21, the revenues available for other services either:

(a) grow in line with current OBR forecasts and long-term projections for growth in national income of 1.6% above inflation out to 2023–24 and 2.1% thereafter – stopping the fall in such spending as a proportion of national income that has been seen over the last decade; or

(b) grow in line with the average of the LGA's and PwC's (probably conservative) projections for spending needs for services other than adult social care, which equates to 1.2% above inflation.

In doing this, in addition to taking account of revenue from local taxes, we also take account of potential revenues from government grants for non-education spending that the government is likely to retain after the roll-out of 75% retention.[16] This allows us to

[16] This includes a number of social care grants – such as the Improved Better Care Fund, the Winter Pressures Grant and the Social Care Support Grant. The first two are assumed to be frozen in cash terms at their level in 2019–20 and 2020–21. We take account of the increase in the Social Care Support Grant in 2020–21 but assume it is frozen in cash terms thereafter. We also include the New Homes Bonus, which is assumed to be frozen in cash terms in 2020–21 and then increasing in line with tax bills thereafter (given payments depend on the average Band D tax rate), and the Former Independent Living Fund Recipient Grant, Flexible Homelessness Support Grant and Localised Council Tax Support Administration Subsidy Grant – each of which is assumed to be frozen in cash terms.

look at how much additional funding would be required *on top of* the grants councils will likely continue to receive post 2020–21.

The table shows that if council tax increases were kept to 2%, significant additional funding would be needed even if the costs of adult social care services increased at a relatively conservative 2% above inflation each year (S2): for example, £2.8 billion in today's prices by the mid 2020s and £13.2 billion in today's prices by the mid 2030s for revenues for other services to keep pace with growth in national income. If adult social care costs were to grow in line with our baseline scenario (S1), the figures would be larger still: £3.9 billion and £18.0 billion respectively. And in that case, even 4% increases in council tax would mean an additional £1.6 billion would be needed by the mid 2020s and £8.7 billion by the mid 2030s, to maintain spending on other services as a share of national income. Only in the scenario with 4% council tax increases and small increases in the cost of adult social care would little or no additional revenue need to be provided to local government to meet spending pressures.

Our scenarios therefore illustrate a key point: that in order for growth in council tax and business rates revenues to keep pace with local government's spending needs after 2020–21, we would require both relatively large rises in council tax each year, and relatively subdued cost pressures for major service areas such as adult social care services – e.g. due to improved productivity performance. Without such increases in council tax and productivity, it seems highly unlikely that revenues from council tax and business rates will keep pace with the rising demands for and costs of local government services (especially adult social care services).

Two further points are worth noting before moving on to a discussion of how any funding gap could be filled:

- First, these projections are based on current levels of spending and service provision. They do not account for any efforts to undo previous cuts, nor the cost of any increase in the range, quality or coverage of services: such policies would mean further additional funding would be required. For example, the Labour party (2019) has announced that it would roll out free personal care for the elderly (currently, such support is means-tested), which the Health Foundation and King's Fund have estimated would cost £6 billion in today's prices in 2020–21 and £8 billion in today's prices in 2030–31, even if based on current stringent assessments of who needs care.[17]

  Labour has said that these services will be funded by general taxation – although it has not defined whether that will be from national or local sources. However, even if additional funding were provided to local government at the time these reforms were introduced, unless that additional funding were increased over time, meeting the rising costs of free personal care would further squeeze the resources required for other local services.

- Second, as with the outlook for the coming year, the longer-term outlook will differ across councils. This means even in the (improbable) case where funding from council tax and business rates were sufficient at a national level, it would not be in all local areas. And in the (more probable) case where funding from council tax and business

[17] Bottery et al., 2018.

rates is insufficient at a national level, the funding gaps could be significantly bigger in some areas than others.

Perhaps most obviously, this is because spending needs are likely to grow at different rates in different areas – e.g. because the population is ageing more rapidly or is becoming relatively more deprived. Just as important, though, is that revenues are likely to grow at different rates in different areas. In part, this is because, as highlighted above, the government plans to update its assessment of how much councils need to spend in 2021–22 and redistribute revenues accordingly during the subsequent few years in its Fair Funding Review. Even after that, those areas with smaller council tax bases (i.e. with more of their households in low tax bands and/or in receipt of discounts or exemptions) will benefit relatively less from increases in council tax bills than areas with bigger council tax bases. Some areas will benefit more than others from growth in the business rates tax base – both because of differences in underlying growth rates and because of the design of the BRRS.

As discussed in the next chapter, the current government plans to periodically redistribute revenues – at least partially – to prevent such divergences between spending needs and revenues from growing too large. But it is unclear just how frequent and how partial those resets will be. And the potential for divergence is an inherent feature of any system using revenue retention to provide financial incentives to boost tax base growth and tackle spending needs. This is an important point to bear in mind when considering the options available to the government to address the likely council funding gap.

Options for providing additional funding to councils

Broadly speaking, if councils do not have sufficient revenues to meet growing demands and costs, at least one of four things will have to happen:

1. councils will have to start cutting the range or quality of the services they provide again;

2. councils will have to be relieved of some of the services for which they are currently responsible;

3. central government grant funding for councils will have to be increased over time; or

4. councils will have to be given access to additional sources of revenue themselves, including via tax devolution.

The most appropriate option will depend on the financial circumstances central government finds itself in, and its objectives.

For example, the wider economic situation will have a bearing on the amount of money available to central government for topping up local budgets. If further austerity is required at a national level, it seems unlikely that local government could escape this.

Taking certain responsibilities off local government would seem to go against the recent trend to devolve additional areas of responsibility to local government – especially in areas with devolution deals. However, alongside its plans for free personal care for the elderly, the Labour party discussed a National Care Service to sit alongside the National Health Service, which could involve a very significant centralisation of responsibilities for adult social care. Amin-Smith, Phillips and Simpson (2018) discussed how such an approach could address inconsistencies between social care policy – where the aim seems to be greater consistency in quality across the country – and local government finance policy – which, since 2010 at least, has placed growing emphasis on financial incentives for growth, increasing the scope for funding divergences. However, such a centralisation would involve several tricky issues, not least the need to find a mechanism to top-slice councils' local tax revenues to help pay for the newly centralised social care service.

Turning to the provision of additional funding, the choice of whether to do so via grants funded by taxes raised at a national level, or through devolution of additional revenue-raising powers to councils, depends on both principles and practical issues. Raising funding via national taxes and then allocating it via grants according to need would likely result in service provision being more comparable across councils. And it would be administratively simpler than devolving further tax revenues and powers. But raising revenues locally and letting councils bear more of the change in local revenues would allow different councils to make different decisions on tax and spending levels, and give them stronger incentives to grow local tax bases – by allowing differences in revenue performance to result in divergences in funding.

Determining which option to choose therefore means addressing whether to prioritise national consistency and solidarity, or local discretion and incentives. This is not a question with only two polar answers, and neither is the choice over whether to provide additional funding via grants funded by national taxation or via additional revenue-raising powers: some element of both could be used to supplement the revenues from council tax and the 75% BRRS.

Which taxes could be devolved?

If the decision is taken to rely at least in part on the devolution of additional tax revenues, what options are there? Amin-Smith, Harris and Phillips (2019b) assessed the suitability of different taxes for full or partial devolution to local government. They concluded that:

- Devolution of the additional remaining 25% of business rates revenues, which would provide a little over £6 billion, would be administratively straightforward. However, it would leave councils with a relatively narrow and unbuoyant tax base (especially given that increases in average business rates bills are capped at inflation).

- Councils could be given more discretion over currently mandatory discounts and exemptions from council tax, and the referendum requirement for increasing council tax seems hard to justify (we do not have such a requirement for any other tax). However, giving councils more significant powers – such as the ability to revalue properties in their own areas – could pose significant problems for the redistribution of funding between councils. It would be better to revalue and reform council tax at a national level, and such action is overdue.

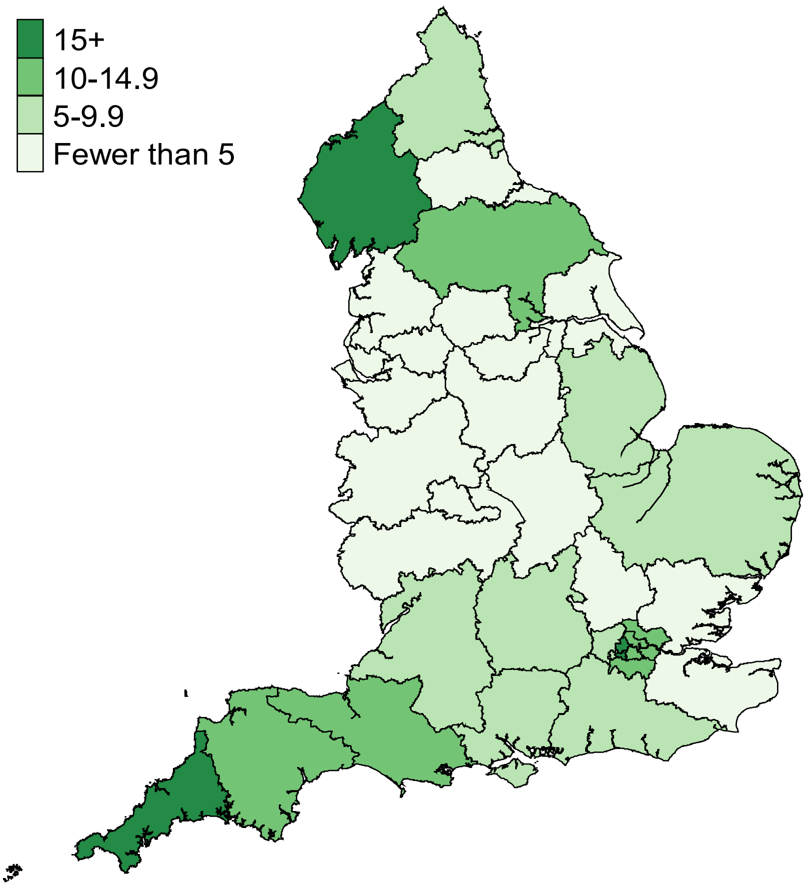
- While tourist accommodation taxes would be administratively feasible and would raise useful amounts in a few well-visited areas, a £1 per night charge (the level often discussed) would raise little more than £0.4 billion across England. Some areas would gain relatively little because, as illustrated in Figure 3.5, the number of overnight stays in tourist accommodation per usual resident is low for large swathes of the Midlands and North (estimates for individual local authority areas are not available, but would show even starker differences).

- Corporation tax and VAT are unlikely to be good candidates for devolution because of the complexity of apportioning corporate profits and value-added. Stamp duty land tax revenues can be apportioned between areas but are very unequal and highly volatile, and this is a particularly damaging tax which should be abolished – not entrenched via devolution.

- A local income tax would be the most sensible option for devolution of a significant new revenue stream and local tax-raising powers. Concerns about tax competition between councils, and inequality in the revenues that different councils could raise, could be mitigated by restricting powers to a flat-rate local income tax. Each 1% on all tax bands would raise around £6 billion per year across England.

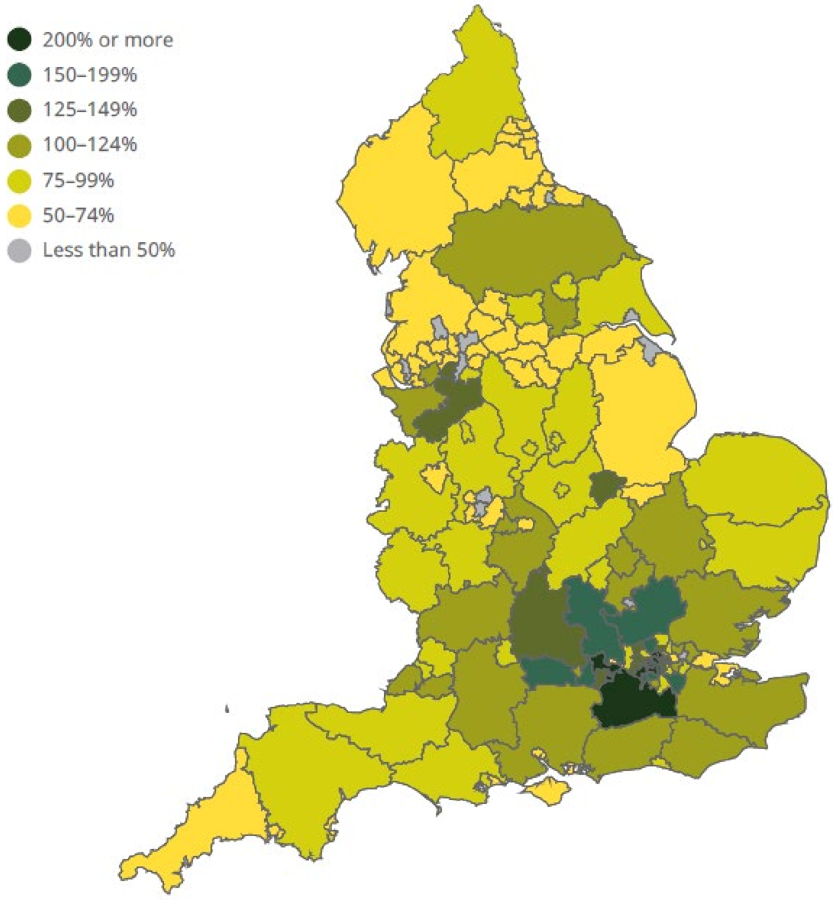
Devolving local income tax powers would not be without its challenges though. For instance, because there is currently no statutory duty for people to tell HM Revenue and Customs (HMRC) where they live, HMRC does not have up-to-date address details for all taxpayers. This (and people with multiple homes) has caused difficulties with devolution of income tax to Scotland and Wales and may need reform if a local income tax were to be introduced in England.

Figure 3.5. Overnight stays per resident in 2016, by region of England



Source: Figure A.1 of Amin-Smith, Harris and Phillips (2019b).

Figure 3.6. Revenues per person from a flat-rate local income tax, by upper-tier council area: share of national average



Source: Based on figure 8.4 of Amin-Smith, Harris and Phillips (2019b).

It is also the case that even if powers were restricted to a flat rate, revenues would still vary quite substantially between areas, as shown in Figure 3.6. Our estimates suggest that revenues per person in richer parts of West London and Surrey, for instance, would be more than twice the national average, while in places such as Blackpool, Blackburn, Hull and Sandwell, they would likely be less than half the average.

A system to redistribute revenues between richer and poorer council areas would therefore be needed – akin to what already exists for council tax and business rates. There would be a decision about how extensive this redistribution should be, and how frequently it should be updated – questions that the government is currently grappling with for council tax and business rates as well.

3.3 Summary

This chapter has considered the outlook for local government funding, asking ‘Is austerity over for councils?’.

In the coming year, the answer looks to be ‘yes’. While the increase in funding announced by the government offsets only a small part of the cuts councils have faced over the last decade (and the headline figures gloss over plans to reduce the share of business rates growth many councils benefit from), if spent in full it is likely to exceed the in-year cost and demand pressures facing councils, allowing them to tackle maintenance backlogs or make some modest improvements to services.

Beyond this year, the answer is that we do not know, as detailed plans for future funding arrangements have yet to be set. What we do know is that in the absence of improved productivity, the funding available from council tax and business rates is unlikely to keep pace with the rising costs of and demands for local public services, most notably adult social care services. That means big choices loom as to whether to accept the resumption of austerity for at least some local government services, or to find additional funding for them. The latter could be via providing increased levels of grant funding funded through national taxation, the devolution of additional revenue streams and revenue-raising powers to councils, or some combination of the two, with the most appropriate option depending on the priority placed on national consistency and solidarity versus local discretion and incentives.

The choices taken will affect not only the amount and type of funding available to local government, but also its distribution between different councils, and hence the extent to which service quality and council tax rates vary across councils. Decisions taken over the next year – about the future operation of the BRRS, for instance – will affect the extent to which the revenues of different councils diverge from their relative spending needs over time. We will consider the effect of different options in detail in future work, but it is also worth looking at the experience of different councils under the BRRS so far. Analysing its impacts as well as the impact of the New Homes Bonus across councils is the focus of the next chapter.

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