

Ministry for Housing Communities and Local Government

Fair Funding review: a review of relative needs and resources

A Submission by:

**The Chartered Institute of Public
Finance and Accountancy**

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CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. CIPFA shows the way in public finance globally, standing up for sound public financial management and good governance around the world as the leading commentator on managing and accounting for public money.

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1. Executive Summary

- 1.1 The current Fairer Funding Review is timely given the changes in funding around business rates retention and the spending review due in Spring 2019. There is increasing concern around the financial sustainability of local government and this has been highlighted in the recently published NAO report¹
- 1.2 CIPFA continues to call for the establishment of an independent body to advise Government on the funding needs of local government and on the allocation of funding to local authorities. CIPFA research has identified international models where this is successful.
- 1.3 CIPFA would like government to define fairness more clearly in order to ensure that any measure of success can be easily identified. While the principles within the consultation are understandable there is an issue that without clarifying exactly what "fair" means it may be difficult to measure the success of this review. CIPFA's response to the review suggests three concepts of fairness as a starting point for the discussion.
- 1.4 The reduction of funding and the increase in demand has created a sustainability challenge that has to be addressed. There is an increasing disconnect between the funding envelope available to local authorities and the services they are required to deliver. Part of this discussion must be a review of statutory services. In 2011 government reviewed the statutory duties placed upon local authorities and identified 1294² duties that were required. A review of services may be able to identify those that no longer add value to delivering local authority primary objectives. An open and honest conversation about what can be delivered within the funding envelope is needed particularly in light of the additional responsibility accompanying 75% business rates retention.
- 1.5 Additional risks are always experienced during a period of transition. It is necessary to develop early exemplar and modelling to support

¹ National Audit Office March 2018 Financial sustainability of Local Authorities

² MHDCLG June 2011 Review of Local Statutory Local Government duties

financial planning. CIPFA would recommend that this includes independent expertise and learning from previous funding changes.

- 1.6 With any public funding model it is necessary to ensure that there is a balance between equalisation and incentive. The fact that income will grow faster in parts of the country and this does not correlate with a growth in need. The fair funding review must address how this imbalance will be addressed in the longer term to ensure that the funding model is transparent.

2. Background and context

- 2.1 The current fair funding methodology was introduced ten years ago and since that time there has been a continuing reduction in government funding for local authorities. Funding has fallen substantially between 2010-11 and 2017 – 18 during which time local authorities experienced a real term decline in Government funding of 49.2%³
- 2.2 Figures from the Local Authority Revenues expenditure and Finance 2017-18⁴ showed that total revenue expenditure by all authorities in England is budgeted to be £94.5 billion in 2017 – 18. The majority of this is made up of council tax, grants and business rates with greater increased reliance on locally retained income as funding patterns continue.
- 2.3 Against this backdrop of reduced income there has been an increase in demand for services. Pressures on adult social care are well documented but looked after children demand grew by 10.9% between 2010/11 and 2016/17 while homelessness demand increased 23.7% during the same period.⁵ Local authorities must provide these services as part of the range of statutory duties which they are required to deliver by the Ministry of Housing Communities and Local Government and other Government departments.
- 2.4 Government has chosen this year to reconsider how the relative needs and resources of local authorities should be reassessed in light of business rate retention increasing from 50% to 75% by 2019/20. Local authorities will have a greater control over the income that they raise and there is a need to ensure that nationally resources are distributed fairly.
- 2.5 The Fair Funding Review builds on the call for evidence on needs and redistribution in 2017 which CIPFA responded⁶. It recognises the

³ National Audit Office March 2018 Financial sustainability of Local Authorities

⁴ DCLG JUNE 2017 Local Authority Revenues expenditure and Finance 2017-18

⁵ National Audit Office March 2018 Financial sustainability of Local Authorities

⁶ CIPFA September 2016 consultation Self Sufficient Business Rates

demographic pressures affecting service provision and seeks to address the concerns about the fairness of the current funding distribution by looking at the technical way the formula is calculated and the selection of cost drivers.

3. CIPFA's Comments

3.1 CIPFA's comments and observations are split into three sections. The first reflects CIPFA's concerns that while this review is important and influential it does not address the wider issues such as the long term financial stability of the local government sector. In light of the current financial crisis with Northamptonshire⁷ it is important that the sector looks to address the functions and sustainability of local government. A sound allocation formula is important but the question that is not asked in the consultation is whether the quantum being allocated means local authorities are appropriately funded to meet their statutory duties.

"Looking further across the country, children's and adult social care remains the main focus of resources for many town halls, set this against the phasing out of government grants and widespread use of reserves, it is clearly time for an honest conversation about what services councils should realistically be expected to deliver."⁸

3.2 The second responds to the specific technical questions that have been asked within the consultation paper. We have not responded to all of these as practitioners are best place to make specific comment. We have selected the questions where there is a broader perspective and a national context.

3.3 Our final section reviews available evidence on international funding models and considers any concepts and principles that are relevant to the issues of establishing methods of fair funding.

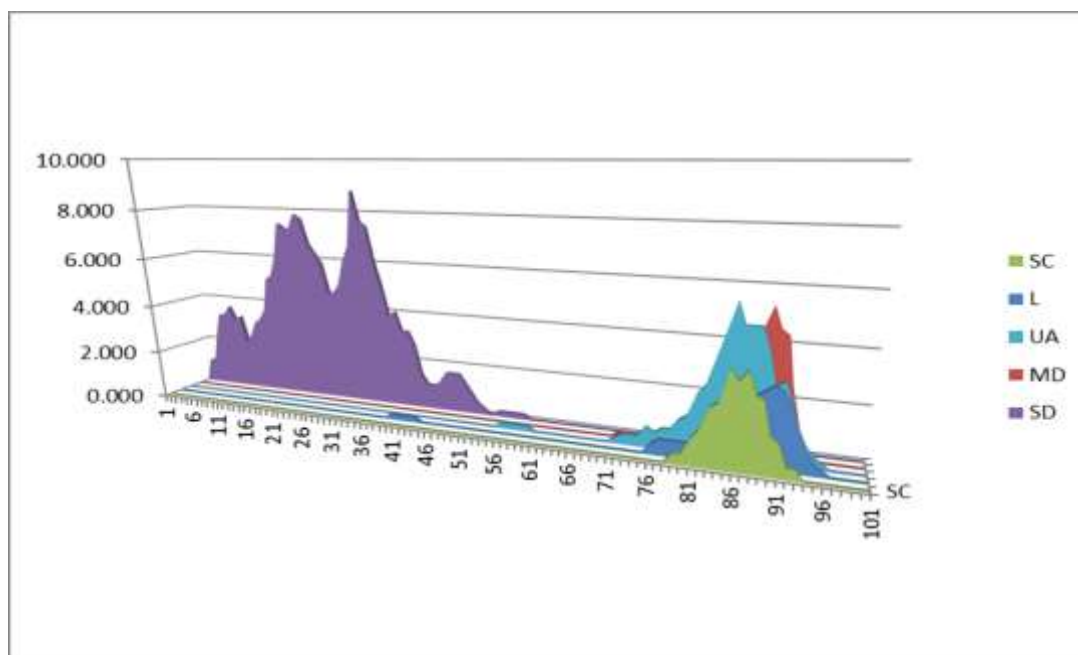
⁷ House of Commons Hansard 6 February 2018 vol 635

⁸ Rob Whiteman March 2018 Public Finance

4. Long term wider financial stability response

4.1 Although this fairer funding review is vital, it must also be supported by adequate funding in totality. For many years the funding of local government has been falling with demands rising. This is not sustainable and any funding review must be supported by realistic discussions about the quantum.

4.2 Below is a graph from CIPFA Finance Advisory Service showing how the spending pressures are impacting on different local authority types and how close they are to being unable to pay for their services. Taking into account business rates, council tax and grants this illustrates at a high level the financial challenges faced by unitary, metropolitan, London and county councils. Comparisons are made with district councils who do not have responsibility for social care or looked after children.



4.3 The fair funding consultation deals with how resources should be allocated and looks into the technical detail of this formula. CIPFA would argue that any change to the formula must not allow for any increase in Whitehall influence over decision making. While Whitehall decide the quantum, it would be beneficial for the allocation of the funds to be depoliticised. CIPFA continues to call for the establishment of an independent body to advise government on the funding needs

of local government and on the allocation of funding to local authorities. Even with the introduction of a new funding system and a more transparent formula the independent body would ensure that the financing system was objectively applied.

4.4 We reiterate the call of the Independent Commission on Local Government Finance when it said:

“The role of an independent funding body, appointed by the sector and government together, would be to advise government as it carries out this task and to report to Parliament on the reasonableness of the government’s decisions.”⁹

There is a spending review in the spring of 2019 and this would be an opportunity for the independent funding body to advise the government on the distribution of funding.

4.5 CIPFA would also like the review to reflect on the concept of fairness, a term used throughout the consultation. While the principles within the consultation are understandable there is an issue that without clarifying exactly what “fair” means it may be difficult to measure the success of this review.

4.6 The three concepts of fairness¹⁰ that we consider may help to shape this conversation would be:

- Needs driven - Fairness as a means of social justice
- Deservedness - Fairness as individual freedom
- Sameness - Fairness as equality of outcome

It would be useful to have a clear understanding of which concept underpinned the decision making of this review and ensure that this was clearly communicated.

4.7 CIPFA considers that in light of current austerity there should be an independent review of the functions of local government. There is an increasing disconnect between the funding available and the demand for services with funding projections suggesting this will get worse¹¹ In 2011 Government reviewed the statutory duties placed upon local authorities and identified 1294¹² duties at that time that were required. A review of services may be able to identify those that no

⁹ Independent Commission on Local Government Finance 2014 Financing English Devolution

¹⁰ Arthur Dobrin Psychology Today May 2012 It’s not fair but what is fair

¹¹ NAO Financial Sustainability in Local Authorities March 2018

¹² MHDCLG June 2011 Review of Local Statutory Local Government duties

longer add value to delivering local authority primary objectives. For example it may be possible to argue that the Provision of Services Regulations 2009, reg 41 the function of which is to enable the supervision of temporary service providers across the European Economic Area (EEA) should not be a statutory duty.¹³

4.8 Statutory services must be delivered, but costs reductions can be made in the way those services are provided such as a reduction in staff time or numbers or a reduction in opening hours. Non statutory services may be stopped altogether to save costs if other sources of income are not identified. Parks for example are a discretionary service where local authority budgets have been cut but funding sourced through other routes.

“Currently, just under a quarter, 22.5%, of funding for parks comes from external sources and this is expected to increase to almost a third, 29%, in the next three years.¹⁴

4.9 Ensuring local authorities are adequately funded for their statutory responsibilities is essential. The consultation on the fair funding element is relatively silent on the reality that with 100% retention there will be a basket of ‘new’ services or responsibilities devolved to local government.

4.10 CIPFA suggests that the scope of a new relative needs formula includes these new relative demand drivers in some way rather than as an addition at a later stage. We recognise the Government’s position on the need to take additional responsibilities and have been involved in those ongoing discussions¹⁵ but will continue to argue that local authorities must be appropriately funding for the services they deliver.

4.11 Recent evidence from the Kings Fund serves to illustrate the link between underfunded service and dissatisfaction.

Below is a graph illustrating the impact of local authority funding reductions on services.

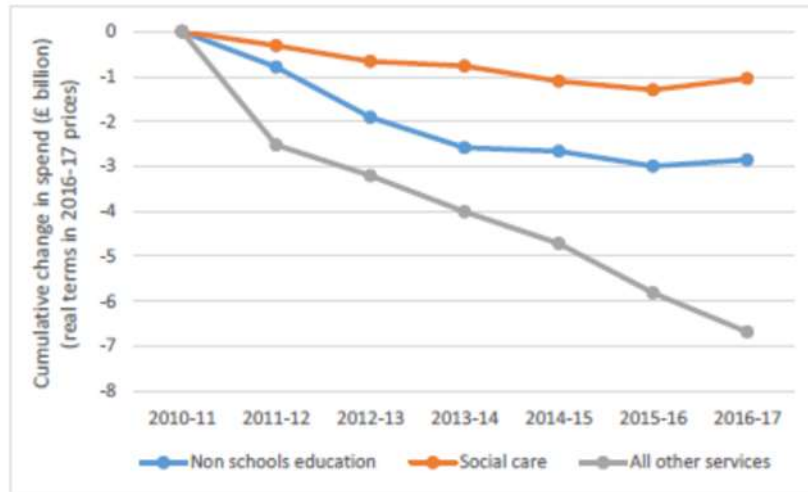
¹³ MHDCLG June 2011 Review of Local statutory Local Government duties

¹⁴ Heritage Lottery fund 2016 State of UK public parks

¹⁵ Business rates retention Steering group

The study by the Kings Fund and Nuffield Trust identified that “satisfaction with social care services was 23% in 2017 and dissatisfaction had increased by 6 percentage points to 41%”¹⁶

Cumulative change in spend by service: all local authorities



Source: NAO analysis of departmental data. See standalone methodology.

In 2018 the National Audit Office report on Financial Sustainability in Local Authorities made the observations that local authorities now spend less on services and that spend is concentrated in social care. Since 2010-11 there has been a 4.4% fall in social care spend and a 33% fall in other service spend. Saving pressures are falling disproportionately on other services.

- 4.12 The review does not address the issue of transitional protection for those that will have less income after the introduction of this system. Due to the nature of long term outsourcing contracts and other financial obligation it will be necessary to ensure that on day one no local authority would be disadvantaged.
- 4.13 CIPFA recommends that the department develop exemplars and models that identified possible outcomes and provides these to the sector as early as possible. The review should also learn from other Whitehall funding changes to identify possible unintended consequences. Research on a recent review of school funding identified

“Even though a greater share of funding is proposed to be allocated to disadvantaged pupils, EPI research finds that the overall impact

¹⁶ Kings Fund and Nuffield Trust February 2018 Public satisfaction with the NHS and social care in 2017

of redistributing the schools budget results in shifting funding away from the most disadvantaged pupils towards what is considered the 'just about managing' group."¹⁷

¹⁷ Education Policy Institute March 2017 The implications of the National Funding Formula for schools

5. Short term technical response

5.1. Question 1

What are your views on the Government's proposals to simplify the relative needs assessment by focusing on the most important cost drivers and reducing the number of formulas involved?

As a result of the reduction in funding and growing demand there is need for a more open means of distributing limited resources across local authorities based on key cost drivers that underpin their purpose. It should be one that allows them to continue to deliver services within a sustainable financial framework. Any new system must encourage good behaviours across local government and incentivise performance improvement.

In terms of the characteristic of a good system we support the principles within the consultation. However many of the principles identified do not sit naturally alongside each other. For example, stability is normally at odds with fairness in that you do not update data regularly as stability of funding is deemed better overall. Fairness a term used consistently within the document is normally associated with the more complex and simple with the more crude.

Given the factors, we acknowledge that it is impossible for all these aims to be simultaneously met to the full in any final design

There is a considerable body of evidence going back to Layfield¹⁸ and as recently as Reforming Local Authorities Needs¹⁹ that provide detail on the local government finance system. This evidence along with other relevant published work should be included within this debate.

5.2 Question 2–19

Data sets and key cost drivers

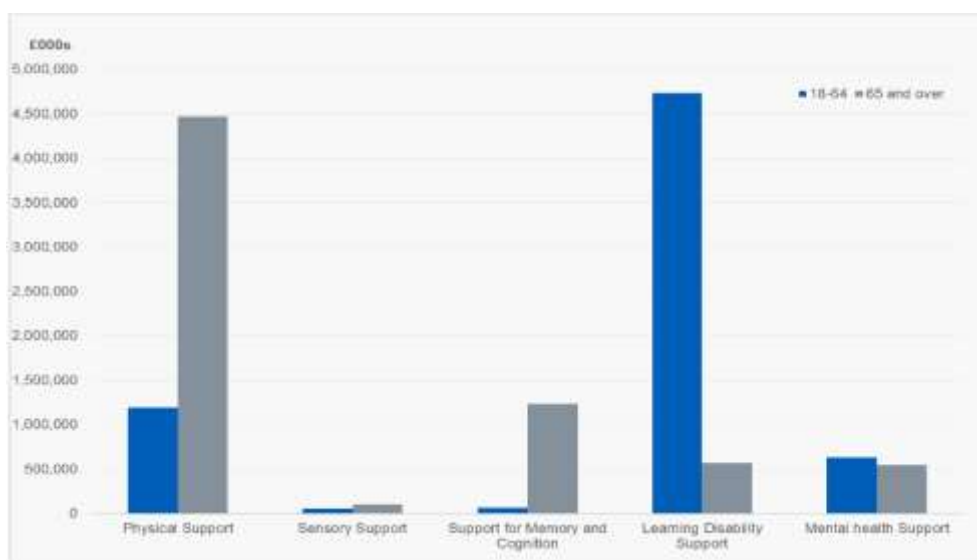
As stated in our earlier response it is difficult not to anticipate that general population including age characteristics; aspects of geography and aspects of demography including certain deprivation indicators, will be included in the final formula. In our view the key will be transparency and early engagement with the sector on both

¹⁸ Layfield Commission 1976

¹⁹ LG futures October 2017 Reforming Local Authority Needs

the choice of statistical technique but also early and regular exemplifications of the impact to the technical groups.

Below is a chart from CIPFA's Finance advisory service on Long Term Support Expenditure by prime support need 2016/17 highlighting the importance of understanding the age profile within an area when considering resource allocation.



5.3 Question 20

Do you have views about which statistical techniques the Government should consider when deciding how to weight individual cost drivers?

CIPFA would advocate that the process is informed by the use of independent technical statistical expertise that can provide robust challenge as the detailed work progresses. This last point also reflects learning from recent formula review work elsewhere in Whitehall.²⁰

²⁰ House of Commons June 2017 School funding in England. Current system and proposals for 'fairer school funding'

6. International Models of Funding

- 6.1 CIPFA has completed a review of previous research into models of financing local government and transfers from central government. What our review shows is that there are a range of difficulties in making comparisons, however some general concepts and principles are clear and should be considered in relation to establishing fair funding.
- 6.2 When comparing international models²¹ differences emerge in the levels of local tax autonomy as well as whether the local government structure is organised on a single or multi-tier basis. This can also be further complicated by the different scale of local government bodies in different countries regarding local powers and the level of spending in relation to overall public spending or GDP. Studies²² show that in Denmark for example, not only has significant local control over taxation, but that local government spending is relatively significant as a proportion of GDP compared to the UK.
- 6.3 Observations from previous research also note that the overall trend in the western democracies over the last twenty years has been towards increased decentralisation of spending.²³ Linked to this is the need to consider the concept of equalising funding for services between local authorities with differing abilities to raise their own resources.

7. Equalisation and its impact on Fair Funding

- 7.1 In many countries, where there is local Government funding through a combination of locally raised resources and taxes and shared resources provided by Central Government, there is a system of equalisation. This enables Central Governments to ensure that the levels of services provided will be in broad terms consistent from one authority to the next. An equalisation system takes account of the resources available to a local area and measures that indicate need, population size and other measures.

²¹ International Comparison of Global City Financing: A Report to the London Finance Commission, prepared by the Institute on Municipal Finance and Governance, October 2016

²² 'International Comparisons of Local Government Finance: Propositions and Analysis' Tony Travers, (2005),

²³ A background study for the Lyons Inquiry by Cardiff University, March 2007

- 7.2 The more tax autonomous²⁴ a region or area is, the greater there is a need to consider the impact of equalisation on that authority. Equalisation may act as a disincentive for an authority under certain conditions.
- 7.3 If an Authority were to consider raising local taxes as a method of raising funding to balance budgets this is likely to impact on equalisation measures in place that take account of the level of local tax base. It may also prove unpopular with electorates and is not necessarily fair or progressive in that the structure of council tax currently could lead to the increase forming a larger proportion of household spending for less wealthy households.
- 7.4 Conversely, research²⁵ also notes that there can be issues related to Councils that move towards raising other sources of revenues locally. Other sources of revenue might be from a wider range of local taxes, such as a tourist tax and fees and charges. While this can be a good idea to improve a council's financial position, equalisation may also act as a barrier to improving the councils overall position if these sources form part of the equalisation calculations. This would simply shift the burden of funding away from Central Government to local government.
- 7.5 To achieve fair funding the concept of equalisation remains important. However it needs to be clear and transparent what the measurement basis will be and what sources of funding are considered. The system of equalisation needs to be regularly reviewed and updated. There is also a case to make for not dis-incentivising local government from growing their local economies and retaining additional incomes raised through value added activities.

²⁴ 'Tax Autonomy' – relates to the level of taxation raised and retained by the local government/authority for the area/region

²⁵ House of Commons Library: English local government finance: issues and options: Research paper 14/43, September 2014

8. The role of Independent Funding Bodies

- 8.1 International models of funding also highlight the role of Independent funding bodies. Such a body would be separate from Government but would have responsibilities for making recommendation as to how centrally raised revenues are shared across local government and how the system of equalisation is determined and applied.
- 8.2 In the case of the Australian model,²⁶ the Commonwealth Grants Commission (CGC) identifies drivers (called disabilities) that cause a state's service delivery costs, or revenue raising capacities to vary from the average. The process is both regular and comprehensive and is being further reviewed in 2020.²⁷
- 8.3 The CGC has also responded to claims that its processes may discourage tax reforms or reduce economic growth by completing an independent review of its methods and impact. This review concluded *"that the current system can and does create perverse incentives in theory, but that there is little evidence of those incentives having any effect in the real world. In particular, there is no evidence that HFE acts as a material disincentive to State tax reform."*
- 8.4 CIPFA supports the view that the assessment of shared funding allocations and methods of equalisation should be completed independently of Government.²⁸

²⁶ The Australian Government, Commonwealth Grants Commission <https://cgc.gov.au/>

²⁷ [Australian Government: Commonwealth Funding Commission 2020 review inquiry page, Nov 2016](#)

²⁸ Public Finance - Councils need independent commission, Steve Freer CIPFA, Nov 2012 : <http://www.publicfinance.co.uk/2012/11/councils-need-independent-commission>