

# Local Government Finance Settlement 2008/09 to 2010/11

4<sup>th</sup> February 2008

The 2008/09 to 2010/11 Local Government Finance Settlement was announced on 6<sup>th</sup> December 2007. This is the first ever three year settlement for local government. After a period of consultation, it will be debated by the House of Commons on 4<sup>th</sup> February 2008.

## Key LGA messages

- **We welcome the fact that for the first time local government have formula grant figures for three years**
- **The settlement does not take full account of the pressures facing local government. To do so would need an increase of around £1.3bn on grant for local authority services excluding schools.**
- **Pressures Councils face include:**
  - **ones that arise from changing demographics, such as adult social care and the impact of migration**
  - **ones that arise from central Government asking local government to do more, such as concessionary fares and implementing reforms to the care system**
  - **ones that arise from central Government taking more money back from local government, for example through increased landfill tax (£144m in 2008-09) and increased charges by the Courts (£40m)**
- **Councils are managing these pressures well and making massive efficiency savings, but still face hard choices between service reductions and council tax increases. Cashable efficiency savings of 3% p.a. have been assumed in the Government's settlement, so the money saved from efficiency is not available to improve services or reduce Council tax.**
- **The distribution of the settlement will make these pressures particularly difficult to manage for some authorities.**
- **The LGA is opposed to any use of the government's capping powers.**
- **The settlement is funded to a greater extent than ever before by Business Rates. The amount of Revenue Support Grant coming from general taxation has fallen by 29% to less than £3bn. The Government should be maintaining its support for local authorities, not cutting it.**
- **The LGA looks to the government to move forward to reform the local government finance system to give Councils more freedom and flexibility to determine their own funding. Reform of the Local Authority Business Growth Incentive (LABGI) and Business Rate Supplements are a good start, but the Government's proposals are too limited.**

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**briefing**

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## The overall settlement

- We welcome the fact that a three year settlement has been announced, but it does not take account of the pressures facing authorities. If the LGA's CSR bid had been funded in full it would have been a 7% cash increase; in fact the cash increase is, on average, about 4%.

## Increase in total grant for local government

- The **total Aggregate External Finance (AEF)** increase for the three years is 4.0/4.3/4.3% in cash terms, or 1.2/1.5/1.5% in real terms. This is **below the overall 2.1% real increase** for public expenditure as a whole and below the departmental settlements for education (3% real), transport (3% real) and health (3.7% real).
- However the picture facing **local authority services excluding schools** is bleaker. If the ring-fenced grants for schools are taken out, the increase is **3.5/4.0/3.1% cash** or **0.7/1.3/0.4% real**, as the chart below shows:

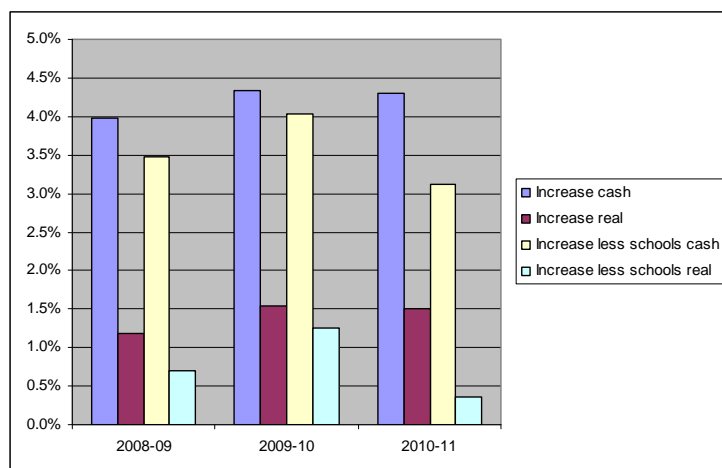


Chart 1: Increases in cash and real terms in AEF including and excluding schools' grants<sup>1</sup>

## Increases in formula grant

- Formula grant consists of revenue support grant and redistributed business rates. Here the settlement confirms what was announced in the Comprehensive Spending Review. The increases in revenue support grant and redistributed business rates are, including PFI special grant 4.2/3.5/3.4% cash but excluding PFI special grant **3.7/2.8/2.6% cash (1.0/ 0.1/-0.1% real)**, as the chart below shows:

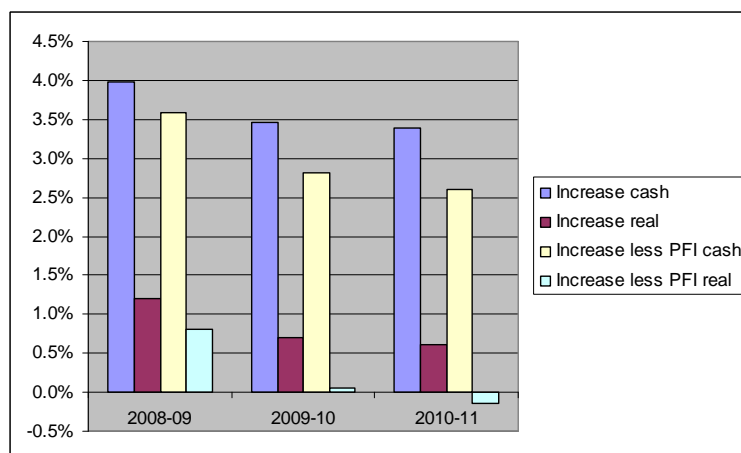


Chart 2: Increases in net AEF with and without PFI grant in cash and real terms

## Pressures from changing demographics

### Adult Social Care

- In our work for the Spending Review, we estimated **total pressure of £2.6bn** over the Spending Review period arising from the increased demands due to demographic challenges and independent sector costs. **The total formula grant increase to local government over the three years, for all services, is just over £2.6bn.**
- Local authorities face an increasing **complexity** of cases. Older people with mental health needs are increasing. 25% of over 85's develop dementia and one third of these need constant care or supervision. Local authorities have also seen an average annual increase of 9% in care weeks provided in the period for 2000/01 to 2003/04 for people with disabilities.
- Between 2001 and 2004 there was a 15 per cent increase in the number of people with learning disabilities using social services. In this period the number of people with learning disabilities aged over 65 and using services rose by 31 per cent.
- This has led to authorities tightening criteria, as the Commission for Social Care Inspection has recently pointed out.
- We welcome the government's decision to pay a **Social Care reform grant** amounting to over £500m over the CSR period as a whole and the debate on how to fund the costs of social care. However the grant is 'back-loaded' (£82m in 2008/09 rising to £274m in 2010/11) and local authorities are facing real pressures now, forcing them to review criteria. One borough council in the south east informed us that, as a result of demographic and other pressures, expenditure on social care in 2008-09 will need to rise by 4.6 per cent in real terms. Similarly, a council in the north west has identified that expenditure will need to increase by 2.2 per cent in real terms. Both of these authorities are on the floor, and therefore will receive real terms reductions in funding.
- The LGA and the Association of Directors of Adult Social Services are carrying out a survey of current pressures which will be reported in the next few months.

### Population projections and migration

- The settlement uses 2004-based population projections for 2008, 2009 and 2010. These do allow for more predictability in that they allow multi-year settlements to be announced. However many authorities have expressed concern that the 2004-based projections are in essence based on the last five years mid-year estimates projected forward and as such they **do not allow the most recent population trends to be accurately reflected** so they would prefer the most recent figures to be used. The LGA welcomes the joint review that has been announced.
- Many councils have expressed their concern at the way that migration is dealt with in population statistics. This includes the new methodology for the international migration component in the mid-year estimates, which feeds into the population projections.
- We note that short term migrants (that is those resident for under 12 months) are not included in the population statistics for either mid-year estimates or projections). We called in our settlement response for **CLG to commission research into the precise way in which short term migrants impact on the demand for local authority services, in time for consideration for incorporation into the next three year settlement.**
- We continue to believe that **the government should create a fund of £250m to alleviate particular pressures of migration in local council areas, and the**

**undercounting in the official statistics, as a pragmatic and proportionate response.**

## **Pressures from increased burdens on local government**

### **Concessionary Fares**

- Since the 2006 extension to the concessionary fares, councils report rises of over 150% in payments to operators compared with the position in 2005/06. **We believe that the government, in conjunction with the LGA should, examine whether the £350m for implementing the 2006 extension of concessionary fares was sufficient and fund any shortfall;**
- The LGA welcomes the decision to pay the extra costs for the 2008 scheme in the form of a specific grant. However **the government should keep under review whether the amount (£212m in 2008/09) is sufficient and whether the increases in 2009/10 and 2010/11 reflect the pressures.** Ultimately the grant should reflect actual costs to councils.
- Councils are reporting difficulties in estimating the precise cost in the run-up to April 1<sup>st</sup>. One shire district has told the LGA that it estimates costs in 2008/09 of between £2.3 million and £2.7 million, which compares with the government's specific grant of £463,000 and RSG of £1.1 million. A particular pressure is appeals from operators.

### **Children's Services and schools funding**

- The same pattern noted in adult social care can be seen in the pressures on children's services. This includes rises in the number of children in care (up 17% between 00/01 and 04/05), partly due to improved and more joined up services identifying more children in need. This has made an important contribution to the government's 'every child matters' agenda; Councils have a vital part to play in implementing reforms to the care system as outlined in the Care Matters white paper.
- So too has the number of children with severe and complex needs. Medical advances mean these children are surviving and living longer. Between 1999 and 2004 the prevalence of conduct disorders among children rose from 5.3% to 5.9%.
- With the transfer of schools funding in 2006/07, over half of all local authority external income comes in the form of ring-fenced grants. Ring-fencing places constraints on authorities, as recognised by Sir Michael Lyons in his report. And, in a tighter financial climate, these constraints lead to poorer value from spending. **We therefore believe that the government should commit to removing the ring-fence from Dedicated Schools Grant from April 2011.**
- The increases in Dedicated Schools Grant, whilst still higher than those in formula grant, are lower than those of recent years. This places pressure on authorities to find savings. One reaction, particularly in rural areas, is to reorganise small primary schools. The LGA considers that councils cannot be expected to pay out of council tax for keeping small schools open, particularly when the government has made it clear they will cap increases above 5%.

### **Equal Pay claims**

- As detailed in a report by Local Government Employers, many authorities are facing pressures from equal pay claims. The total burden, including back pay, is estimated to be around £2.8bn. We welcome the government's decision to allow this to spread across years. But, to allow for the most effective management of this pressure, **the government should allow Councils complete freedom on whether, when and to what extent they capitalise settlements for equal pay claims.** We believe that

this flexibility would present a negligible risk to the government's overall fiscal framework

## **Pressures from central government taking more out of local government**

### **Waste and landfill tax**

- The **cost of waste to English councils** is some £3bn per annum. Increases in costs relate to preparation for meeting the EU Landfill Directive. The actual tonnage of municipal waste disposed of in landfill has decreased from 20.9 million tonnes in 2003/04 to 17.9 million tonnes in 2005/06. However this has meant cost increases which average 10% annually since 2001/02.
- **Landfill tax** is rising annually at £8/tonne, from the current rate of £24/tonne to £32/tonne from April 2008. This increase in the escalator is increasing costs for disposal authorities by a minimum of several hundred thousand pounds, and by well over a million pounds each for many authorities, even though councils are successfully diverting waste away from landfill. This was supposed to have been channelled into local authority grant, but we have been unable to ascertain from the Government how much of landfill tax has been recycled, and how it has been returned to local government. Our estimate is that, assuming that landfill tax increases over 2003-08 were already fully returned, that the additional amounts to be returned over the CSR period attributable to the further £5 per tonne increase in the escalator would be at least £78m/£150m/£215m..
- In its settlement response the LGA asked the government to clarify exactly how it has ensured the landfill tax escalator is revenue neutral to Councils. The government have now replied that the resources will no longer be hypothecated to local government. **This represents a backtracking from its previous pledge.**

### **Increase in public law family fees**

- A consultation document published by the Ministry of Justice on 19<sup>th</sup> December 2007 estimates that the overall effect will be £40m per annum. It says that this has been allowed for in the overall CSR increases. However, the manner in which this has been done has never been transparently explained. If that is the case it means that there is less available for other pressures. In the final settlement there has been an adjustment to the baseline used for working out the damping. **This has the effect of redistributing resources from authorities above the floor to authorities on the floor; no new money has been provided.**

### **Efficiencies**

- Local government continues to be ahead of the public sector as a whole in its **pursuit of efficiencies**. The target of 2.5% pa efficiency savings over the 2004 spending review period was met one year ahead of schedule. Against a target of £3bn, councils will have achieved savings of over £4bn by the end of 2007-08; reinvesting these into 'front-line' services.
- In the three year CSR period, local government has been asked to make **efficiency savings** amounting to 3% of their budget requirement. The government claim to have taken these into account in assessing pressures. Therefore these are not available to be put into improvements in services or reductions in council tax.

### **Distributional impact on different authorities**

- For a sizable minority of authorities, the picture is bleaker as they receive the minimum or 'floor' level of increase. Around a third of all **authorities with responsibility for children's services and social care** will receive a minimum increase of 2%, 1.75% and 1.5% in the CSR years. And around a third of all **shire districts** will have minimum grant increases of 1%, 0.5% and 0.5% in the three years. This is at the time when they are facing pressures of concessionary fares and environmental services.
- Floors are funded by reducing the grant to authorities above the floor through scaling back. Over the whole three year period authorities with children's services and social care responsibilities will have £1,850m redirected away from them to pay for the floors for other authorities. **The LGA considers that floor to be funded in full without the need for scaling back or ceilings.**

### Supported Borrowing and the effect of damping

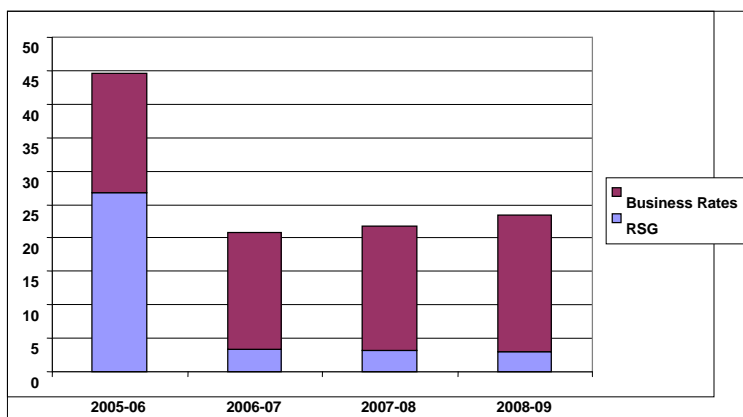
- Part of formula grant is to pay for borrowing for authorities' capital programmes. This is allowed for in authorities' relative needs formulae, but this is largely counteracted by the effect of the damping mechanism which means that authorities on the grant floor receive no more money than the minimum increase for their class for supported borrowing and that authorities above the grant floor have their increase above the floor scaled back to pay for the floor.
- The LGA has called for a full review of supported borrowing and its relationship to the damping mechanism.

### Council tax and capping

- Councils are facing hard choices between service reductions and council tax increases. Early indications are that the **average council tax increase will be around 4%.**
- The LGA believes, as does Sir Michael Lyons in his report, that there is no justification for capping. Councils have proved themselves adept in managing financial pressures and delivering significant efficiencies for their residents. **The LGA is strongly against the use of the government's capping powers.**

### Government contribution and income from business rates

- The overwhelming majority of formula grant to non-police authorities is now accounted for by business rates, as the chart overleaf shows. In 2008/09 the **NNDR distributable amount will rise by 10.8%, from £18.5bn to £20.5bn.** This is explained by the rise in the retail price index, in the rise in the business rates taxbase and in the reforms of business rates to include incorporation of empty properties, which will come into effect from 2008/09. Therefore **Revenue Support Grant will fall by 29%** from 2007/08 to 2008/09. Over the CSR period, it is likely that the Government's contribution to Revenue Support Grant from general taxation will continue to decline.



### Reforms to the local government finance system

- **The LGA believes that the Government should now implement a review of the whole system for determining Formula Grant, with the aim of delivering improved transparency and the greater flexibility for Councils promised in the Central-Local Concordat.** Reforms might, for example, include joint Central-Local consultation on and determination of the NNDR distributable amount, progressive return to local control of the NNDR taxbase and independent evaluation of factors included in the grant formula
- Local authorities do not keep the proceeds of increased business rates directly. Over the last three years the **local authority business growth incentive scheme (LABGI)** has recycled back to local authorities some of the proceeds of taxbase growth. However there is no LABGI scheme in 2008/09 and only £150m in 2009/10 and 2010/11. The LGA has recently replied to the LABGI consultation. **The Government's reform of LABGI would be made most effective by providing Councils with a clear and direct incentive to grow the Business Rates base. The financial rewards available should be directly proportional to growth and uncapped, thus allowing Councils a predictable return on their investment in developing the local economy.**
- Following Sir Michael Lyons report, it is vital that the government addresses his recommendations in order to reform the local government finance system. This includes the **implementation of the business rate supplement**, more flexibly than currently envisaged in the Government's White Paper; and **substantive reforms to council tax benefit** to improve take-up.
- We also call on the government to look again at the **proposals the LGA submitted to the Lyons Inquiry** in December 2006. This set out a framework for new financial arrangements, including a Single Conversation on services at a national level and an Independent Public Finance Commission. It also included a more transparent joint assessment of new burdens, on the lines of that in Denmark.

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