

# Provisional Local Government Finance Settlement for 2008-09 to 2010-11



8th January 2008

## Response by the Local Government Association

### Summary

- We welcome the fact that for the first time ever a three year settlement has been announced. This will give local authorities more ability to plan ahead.
- The settlement does not take full account of the pressures facing local government, including adult social care and the rising costs of landfill and authorities will be faced with hard choices between service reductions and council tax increases.
- We believe that the provisional settlement needs change and clarification on a number of specific issues. More fundamentally, we believe that the processes by which the settlement is constructed need radical reform.

### Immediate issues

- The proposed floor levels are for many authorities below likely inflation over the period of the settlement. The Government should re-examine carefully whether the level of floors for all authorities is likely to be sufficient, in the light of evidence received from individual Councils and authorities.
- In a number of areas the Government has by its own actions generated significant cost increases for local authorities. Transfers of funding to reflect movement of cost from central to local government should be clearly identifiable in the settlement, but are not. We recommend that the Government sets out transparently how these matters have been dealt with in the settlement. Where appropriate, the Government should confirm additional funding. The principal issues involve:
  - The £40m p.a. increase in public law family fees on which the Ministry of Justice is currently consulting
  - Increased costs attributable to the landfill tax escalator, which the LGA estimates will add £78m/£150m/£215m to authorities' costs over the three year period even if local authorities continue to divert waste away from landfill at a rate of 4% per year.
  - Additional costs for proposed enhanced reporting of financial statistics and changes to audit arrangements
  - An additional burden of £4.5m in 2008-09 from new limits for means tested student support
- The top-slice amounts proposed in the settlement should be revised to match the recommendations of the local government sector, or the Government should otherwise make good the shortfalls in funding
- In the light of evidence that some departments have not fully understood the unringfenced status of the new area-based grant, the Government should confirm that Councils have the exclusive responsibility to determine the way in which this grant is spent.

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# submission

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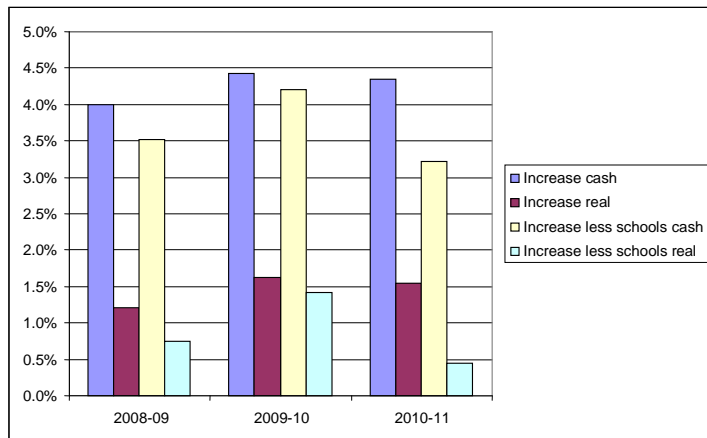
- Many Councils face substantial cost pressures attributable to migration. Until a robust method for establishing these currently unrecognised costs can be established, the LGA continues to believe that the Government should create a fund of £250m to alleviate particular pressures in local council areas as a pragmatic and proportionate response.
- Councils have proved themselves adept in managing financial pressures and delivering significant efficiencies for their residents. But in the tighter future financial climate, it is increasingly uncertain where significant cost pressures that are not fully met by grant will fall. There is therefore no case for any continuation of Council tax capping.

### **Longer term issues**

- The Government's (non-police) contribution to formula grant has fallen from just over £4bn in 2007-08 to £2.9bn in 2008-09. The overwhelming proportion of the settlement is funded by Business Rates raised by local authorities. The methodology of the four-block model obscures rather than clarifies the key decisions taken about grant changes. We therefore believe that the time is now right for a review of the whole system for determining Formula Grant after 2010-11, with the aim of delivering improved transparency and the greater flexibility for Councils promised in the Central-Local Concordat
- Given the importance of Business Rates within the settlement, the Government's reform of LABGI should provide 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.
- In order to make real terms changes in funding more transparent, the Government should commit to the development of a National Statistics index of local government pay and prices that would provide a fair measure of inflation relevant to locally delivered services.
- There are two specific areas where a severe lack of knowledge about service costs means that detailed review and, if appropriate, additional funding is needed:
  - Concessionary fares, where we propose a joint review with Government about whether the £350m for implementing the 2006 extension was sufficient. In relation to the further extension of the scheme that is being introduced from April 2008, 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.
  - Migration, where research should be commissioned 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.
- As the Government has acknowledged, growth in public spending is being reined back from levels seen in the last few years. It is therefore all the more important that efficiency of spend is maximised. This cannot be achieved if key local spending decisions are subject to excessive central control. We believe that it would deliver better value for the public for:
  - Councils to have complete freedom on whether, when and to what extent they capitalise settlements for equal pay claims
  - The Government to commit to remove the ring-fence on Dedicated Schools Grant from April 2011.

## The overall settlement: increases in total AEF

- We welcome the fact that for the first time ever a three year settlement has been announced. This will give local authorities more ability to plan ahead.
- The LGA, in its submission for the Comprehensive Spending Review, calculated that a 4.2% real terms increase was necessary to enable authorities to manage and deliver new burdens such as new policies in children’s services, additional services in recognition of the growing number of elderly people and the rapidly increasing costs of waste management. That would equate to an average 7% per annum in cash terms.
- In fact the total Aggregate External Finance (AEF) increase for the three years is 4.0/4.4/4.3% in cash terms, or 1.2/1.6/1.6% 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 3.5/4.2/3.2% cash or 0.8/1.4/0.4% real, as Chart 1 below shows.

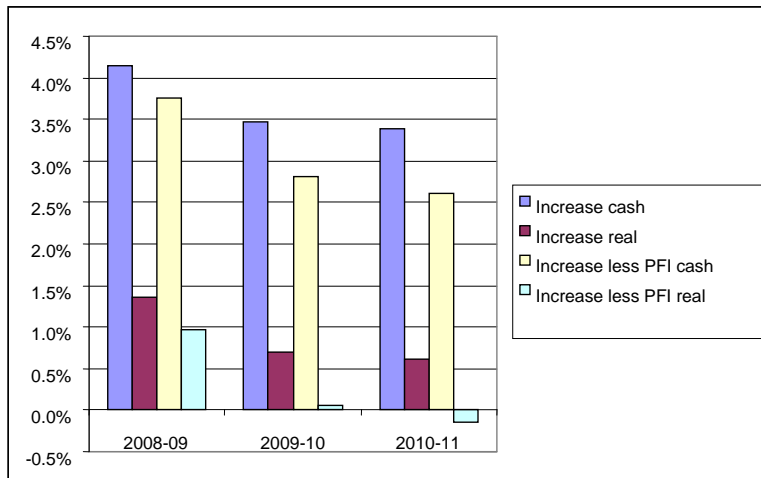


**Chart 1: Increases in cash and real terms in AEF including and excluding schools’ grants<sup>1</sup>**

## Increases in Net AEF

- The proposed settlement confirms what was announced in the Comprehensive Spending Review. The increases in net AEF are shown in Chart 2. They 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)

<sup>1</sup> The chart shows increases of total AEF including and excluding the following grants which go straight to schools: Dedicated Schools Grant, Ethnic Minority Achievement Grant, School Lunch Grant, Targeted Support for Primary and Secondary Strategy, Music Grant, City Challenge, School Development Grant (schools element), Making Good Progress, School Standards Grant, Early years; increasing flexibility grant, extended schools grants, targeting mental health in schools grant



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

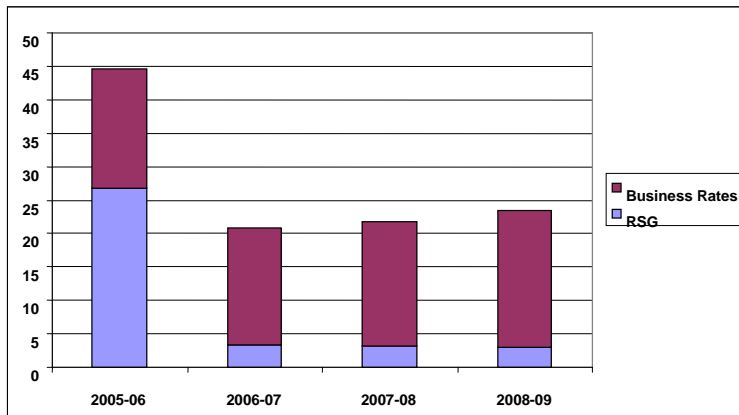
- The LGA considers that in evaluating the resources which go into formula grant it is more relevant to use the increases net of PFI special grant, as this is not available for distribution to authorities in formula grant.
- These comparisons use the GDP deflator to express inflation. As the LGA said in its submissions on the CSR, this does not reflect the true level of cost increases facing local government. We acknowledge that there has been joint work on measuring pay pressures, but believe that it would be more transparent for there to be an index of local government pay and prices which could be jointly owned by central and local government. **We recommend that the government should now commit to the development of a National Statistics index of local government pay and prices that would provide a fair measure of inflation relevant to locally delivered services.**
- 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.

### **Government contribution and income from business rates**

- The overwhelming majority of formula grant to non-police authorities is accounted for by business rates, as Chart 3 below 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 28.4% 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. **We believe 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.

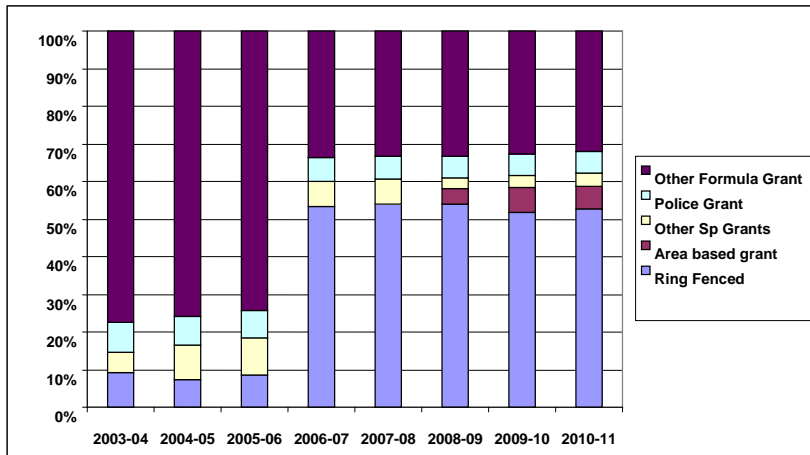
**The Government's reform of LABGI would be made most effective by providing Councils with a clear and direct incentive to grow the Business Rates base. The financial rewards available should be directly proportional to growth and uncapped, thus allowing Councils a predictable return on their investment in developing the local economy.**



**Chart 3: contribution of RSG and business rates towards formula grant (£bn)**

### Ringfenced and non-ringfenced grant

- 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, as shown in Chart 4 below. The LGA recognises the joint work on grants that was done, which has resulted in the transfer of many specific grants to the non-ring fenced area-based grant (ABG). We welcome this. However, some Councils have reported to us that departments have advised them that they 'expect' parts of the ABG allocation to be spent in particular ways. This is not in line with the removal of ring-fencing. **The Government should therefore take further steps to ensure that departments recognise that Councils have the exclusive responsibility to determine the way in which area-based grant is spent.**
- 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.**



**Chart 4: Ring-fencing within Total AEF from 2003-04 to 2010-11**

### New burdens

- There has been joint work on understanding and managing spending pressures, but there is still no commitment to fully assess and fund new burdens, including looking at costs retrospectively. The spending pressures identified by the LGA as part of the joint exercise on pressures in the period leading up to the settlement have not gone away. In addition, a large number of authorities (for example 58 of the 150 authorities responsible for education and social services in 2008/09) are on the grant floor so will be under particular pressure.
- In addition the following new burdens have come to light since the settlement announcement. Whilst not large individually they will have a larger effect cumulatively.
  - Increase in public law family fees. A consultation document published by the Ministry of Justice on 19<sup>th</sup> December 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 it the case it means that there is less available for other pressures;
  - Student support – adjustments have been made to the settlement of £5.4 / £21.7 / £27.9m to take account of the transfer of student support from local authorities to the government which is happening progressively over the CSR period. However the announcement of the increase of limits for means testing has meant that authorities face a new burden, which we estimate amounts to £4.5m in 2008/09. It is suggested that the start of the transfer be delayed to 2009/10;
  - Requirement for enhanced reporting of financial statistics, including quarterly expenditure reports on an accruals basis. The LGA understands that this will also be a call on the general increase. So far we have been unable to gather from government officials the provision that has been made in the CSR spending figures for this;
  - Increase in proposed Audit Commission fees; particularly for shire districts, of up to 33% on current levels by 2010-11. This is also in response to increased reporting requirements.

- **The Government should set out transparently how these matters have been dealt with in the settlement. If they are not incorporated in the settlement calculations, additional grant funding should be provided.**

### **RSG Top-slice**

- The amounts proposed to be top-sliced from the settlement for some of the specified bodies differ from the recommendations put forward by the LGA. Discussions with officials have not produced any satisfactory explanation for the discrepancies. **The Government should therefore amend the settlement to restore the top-slice amounts as recommended by the local government sector, or otherwise make good the shortfalls in funding.**

### **Council tax**

- The Minister's letter to Councils dated 17 December states the Government's expectation that the average council tax increase in England will be substantially below 5% in 2008-09. This statement appears to recognise that there will be a range of increases, and that it is uncertain where significant cost pressures that are not fully met by grant will fall. But the Minister's letter also indicates that the Government intends to take decisions on capping principles after authorities have set their budgets. The LGA believes, as did Sir Michael Lyons, that there is no principled justification for capping. The Government's proposed approach in practice to capping determinations, involving retrospective review of decisions for which locally elected representatives are very obviously democratically accountable, is misguided and unworkable. Furthermore, there is no evidence that it is necessary. Councils have proved themselves adept in managing financial pressures and delivering significant efficiencies for their residents. **We therefore see no case for any continuation of Council tax capping.**

### **Key spending pressures**

- As detailed in our submission to the Comprehensive Spending Review, the following are the key pressures facing local government

### **Adult Social Care**

- We estimated that there is total pressure of £2.6bn over the Spending Review period arising from the increased demands due to demographic challenges and independent sector costs
- 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.
- 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.

### **Waste**

- As the LGA said in its Autumn Statement 2006, the cost of waste to English local authorities 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 authorities are successfully diverting waste away from landfill. This is supposed to be 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 would be at least £78m/£150m/£215m. **The government should therefore clarify, in line with its previous pledges, exactly how it has ensured the landfill tax escalator is revenue neutral to Councils.**

### **Children's Services**

- 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; Local authorities 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%;

### **Concessionary Fares**

- Since the 2006 extension to the concessionary fares, authorities 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 authorities.

- Authorities 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.

### **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.

### **Population projections and migration**

- The LGA notes that 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.
- The LGA also notes that many authorities 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 consider that **CLG should 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.**

### **Formula reviews**

- We note the government's decision to set up reviews into the area cost adjustment and the fire formula. The LGA looks forward to participating in these. We also note that it has not been possible to come up with a new method of calculating estimated numbers of day visitors. The current indicator is

now out of date and we look forward to work continuing on this in time for the next round of formula changes.

### **Differential impact of the grant settlement on authorities and the floor level**

- All authorities are facing the pressures detailed above (though a significant minority of authorities have settled equal pay claims), but the grant settlement has led to differential increases.
  - Shire districts, where around a third of all 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;
  - Around a third of all authorities with responsibility for children's services and social care will also receive a minimum increase of 2%, 1.75% and 1.5% in the CSR years. This particularly affects authorities which are affected by formula changes, such as the discontinuation of social services damping for children and younger adults within the relative needs formulae;
- In our response to the formula grant consultation, we said that all councils were likely to face difficult choices about priorities. Councils also need to support a range of investments, funded on revenue as well as on capital account, to improve performance and efficiency. We noted that there would be particular difficulties for councils on the floor, if this was set at a low level, as well as for those above the floor if there was a high scaling factor, and that these difficulties would be exacerbated the more the Council had taken steps to maximise its efficiency and reduce its spending.
- **The government should re-examine carefully whether the level of floors for all authorities for the three year spending review period is likely to be sufficient, in the light of evidence received.**
- We also note that the floor level is 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 floor level of grant. The LGA repeats its request for the floor to be funded in full without the need for scaling back or ceilings.
- Supported borrowing within formula grant, which we have drawn attention to in previous submissions, is still a concern for authorities. Authorities report to us that they cannot afford to undertake borrowing to fund capital investment when they receive no more than the floor level or when the additional support is scaled back. For example, one shire county reports that, reluctantly, they are planning not to take up approximately 30% of their borrowing allocations for 2008/09 to 2010/11, amounting to £46m, in order to limit the effect on council tax. This will particularly affect borrowing allocations for schools and local transport. In our response to the 2007/08 settlement we called for supported borrowing to be allowed for in the grant baseline from 2008/09; we repeat this request.

## **The future of the local government finance system**

- 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.