Local Government Explained

Part 1: Types of councils

May 5, 2021

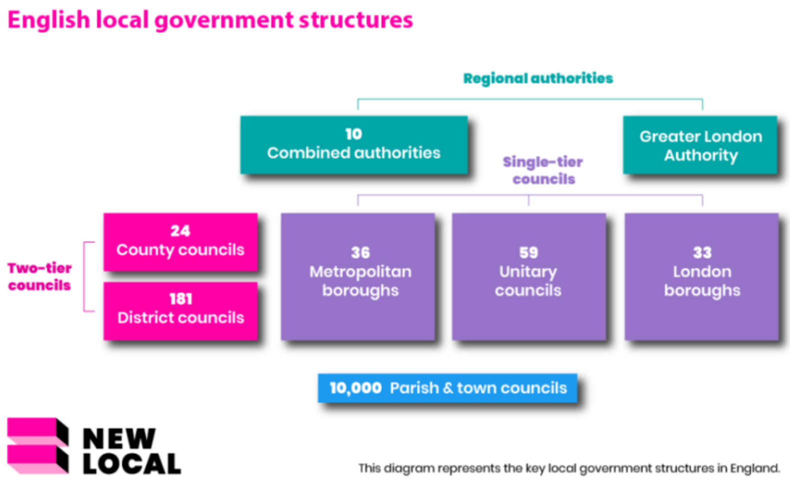
Jessica Studdert

Local government can seem complicated, but it’s where local democracy happens. We start our explainer series by looking at the different types of council in England and what they do.

There are a total of 333 local authorities in England.

The system of local government in England that we have today is the product of our unique history, culture and waves of local government reform over the years.

Like other parts of government, it is complicated – so this short guide will answer your local government questions.



What are the different types of councils? And what does this actually mean?

There are two different forms of council set-up.

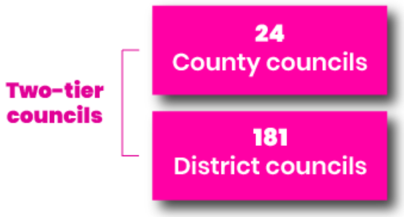
In some areas there is just one council, responsible for every local government function. These are known as ‘**single tier**’ councils.

In other areas, there are two councils – one smaller and one larger – and they split local government functions between them. These are known as ‘**two-tier**’ areas.

Two-tier councils

There are two different types of **two-tier** council, where local government functions are split between two councils: a county council and a district council.

(Sometimes county councils are referred to as ‘upper tier’ and district councils as ‘lower tier’.)



- ## County councils

There are 24 county councils. They tend to cover large historic, more rural county areas such as Surrey, Warwickshire and Nottinghamshire.

County councils are mostly responsible for strategic services such as transport and people-facing services such as public health, children’s services and adult social care.

- ## District councils

There are 181 district councils, and they represent a much smaller area within a county council.

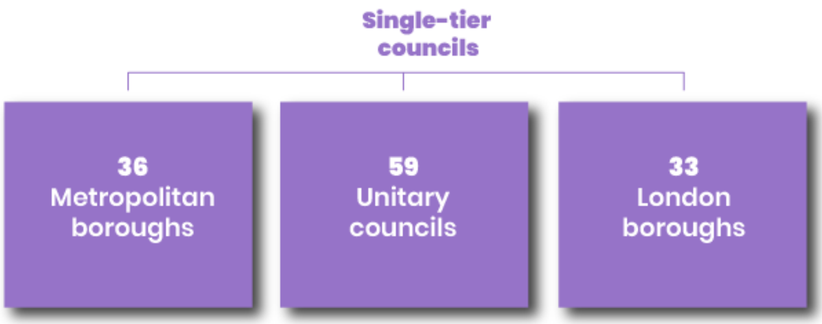
Within any area covered by one county council, there will be approximately 5-7 district councils.

District councils are mostly responsible for more place-related services such as housing, planning and licensing.

They can cover small cities, like Cambridge, and more rural areas, like Fenland, which are both districts within the county of Cambridgeshire.

Single-tier councils

There are three different types of **single-tier** council, where just one council carries out all local government functions:



- ## Metropolitan boroughs

There are 36 metropolitan borough councils, representing the largest urban areas outside London.

Between them they cover the areas of Greater Manchester, Merseyside, South Yorkshire, West Yorkshire, Tyne & Wear and the West Midlands.

Some represent big cities directly such as Manchester or Newcastle, and some represent an area which contains a few different towns alongside the suburbs and rural areas between them, such as Wakefield or Dudley.

- ## London boroughs

There are 33 borough councils in London, and between them they cover the capital city.

One of these is slightly different – the City of London, which represents the historic financial district. It performs the same functions as the others, but it is not formally a London borough – it has an ancient ceremonial status as a county, in fact the smallest county in England.

- ## Unitary councils

There are 59 unitary councils.

These are all in areas that were previously two-tier, but which went through a process of reform known as 'unitarisation' – in other words they were merged.

One local authority now carries out all the functions of a county and district council.

Unitary councils are the hardest to categorise together because they are each the product of a particular local government reform at a certain point in time, mostly during the 1990s and 2000s.

They come in all sizes:

- Some big unitary councils cover large county areas such as Cornwall, Wiltshire and County Durham.
- Some unitary councils cover a city or large town which sit within a wider county area that is administratively separate, such as Derby City Council in Derbyshire or Blackpool Council in Lancashire.
- Some unitary councils are basically former counties split in two or three. For example, Cheshire, which is now covered by East Cheshire Council and Cheshire West & Chester Council.
- A few unitary councils are smaller, and cover areas previously similar to district size councils. An example of this is Berkshire, which has six unitary authorities, including Wokingham and Slough.
- One unitary council defies all other attempts at categorisation: the Council of the Isles of Scilly, which serves only 2,000 people. The Isles of Scilly are a separate administrative entity to Cornwall, although in practice some services such as health are shared between the two. For ceremonial purposes the Isles are considered part of the county of Cornwall, and they are part of the Duchy of Cornwall.

What about the other types of local government?

There are a few other types of local government bodies, which exist in many but not all areas of the country.

Some exist at a smaller, more local level and others at a larger, more strategic or regional level to councils.

- ## Parish councils

At a smaller, hyper-local level, are parish councils.

There are approximately 10,000 parish councils in England. They can variously be known as town councils, neighbourhood councils or village councils.

(They are sometimes referred to as 'local councils', and to distinguish them from single or two-tier councils the latter can be collectively referred to as 'principal councils'.)

Usually operating in rural areas, parish councils cover small areas mostly representing under 2,500 people and just under a third of the country is covered by one.

Their only legal duty is to provide allotments, but they also have powers to run local neighbourhood facilities such as community buildings, parks, playgrounds and public toilets.

Regional authorities

At a larger, strategic or regional level there are two types of authority.

- ## Combined authorities

There are ten combined authorities in England.

Since 2009, groups of local authorities outside London have been able to seek permission from Government to “combine” by pooling responsibilities and then receive certain new strategic powers in areas such as transport and economic policy.

The councils within a combined authority remain separate entities delivering their existing council functions, but are able to carry out new activities collectively across their region.

Ten regional areas have been successful in their bids to establish combined authorities.

Examples include

- Greater Manchester and Sheffield City Region, which combine their respective metropolitan boroughs
- Cambridgeshire & Peterborough, which includes the two-tier county and districts councils of Cambridgeshire and the unitary council of Peterborough.

Most combined authorities have been required to create a new role of directly elected mayor as part of the new arrangements. These are often known as the ‘metro mayors’.

(The North East Combined Authority is the only one without a directly elected mayor.)

- ## **Greater London Authority** (GLA)

London has its own unique form of ‘strategic authority’.

The GLA is made up of two parts: an executive – the Mayor of London, and the London Assembly, which scrutinises the decisions of the Mayor and is made up of 25 Assembly Members.

The GLA has a range of strategic responsibilities including in areas of transport, policing, housing and economic development.

Differences between the GLA and combined authorities

There are lots of differences between combined authorities and the GLA.

Notably, London borough councils have no legal relationship with the GLA, which operates strategically across them and has entirely separate powers and remit.

But combined authorities are directly composed of groups of councils, which means the leaders of each constituent council have formal decision-making powers as part of the combined authority executive, along with the directly elected mayor.

Conclusion

Councillors are elected to represent neighbourhoods, so your councillors will always live close by and know your area.

Depending on where you live in England, you could have between one and five tiers of local government representing you.

In future parts of our explainer series, we will be looking more closely at what functions councils carry out, how they are funded and how local elections work.

Local Government Explained

Part 2: What do councils do?

May 27, 2021

Jessica Studdert

Most people know that councils collect bins and fix potholes. But they do much, much more. Councils are responsible for a vast range of services that touch many aspects of our daily lives. They also provide ongoing support for people going through the hardest times in their lives.

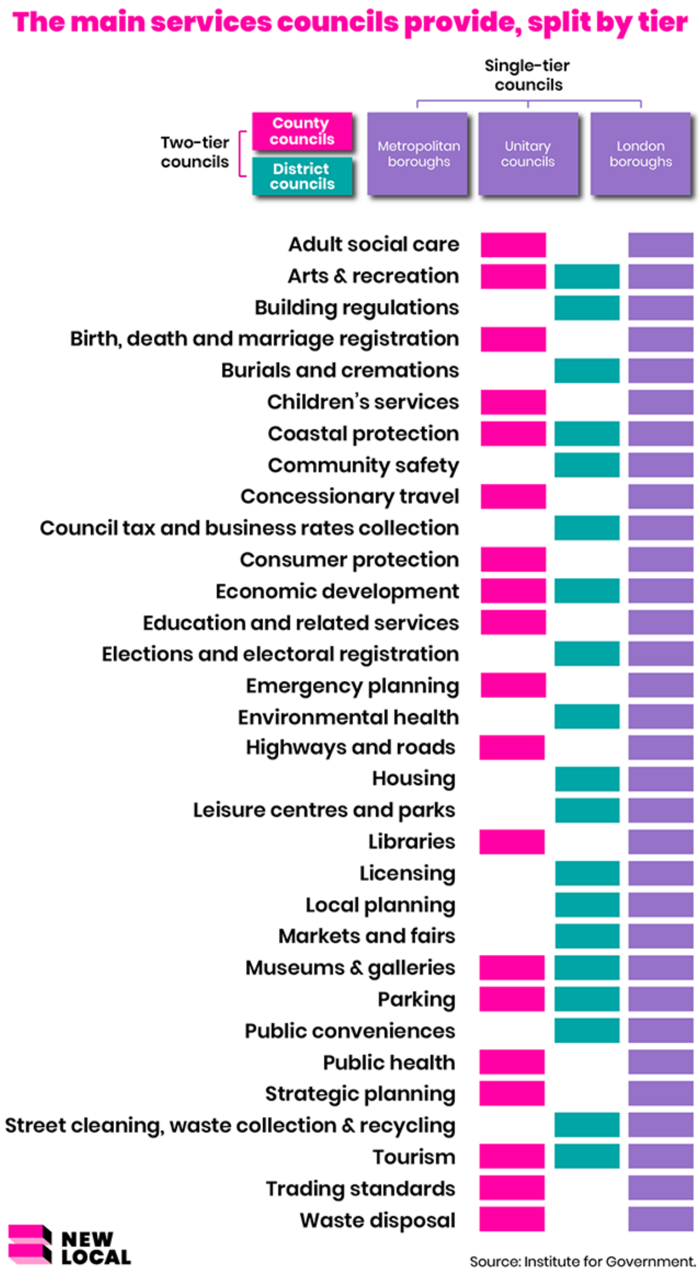
Our previous edition of Local Government Explained looked at the structures of English local government. This, Part 2 in our series, will look more closely at what councils actually do and the contribution this makes to our society.

What do councils do?

Councils provide more than 800 services to their communities. They are obliged by law to offer most of these services (which are known as **statutory**). But for some services, they have more flexibility over whether and to what level they provide them at (these are known as **discretionary**).

In single-tier areas, the council (a metropolitan borough, London borough or unitary) will be responsible for all services. In two-tier areas, responsibilities are split between the county and the district. Find out more about structures here.

Here's a list of the main services councils provide and how they are split between tiers.



Why are services split between two tiers of local government in some areas?

Areas where services are split between a county and a district tend to be those in which populations are more spread over a larger area, as opposed to being more densely concentrated in a predominantly urban area.

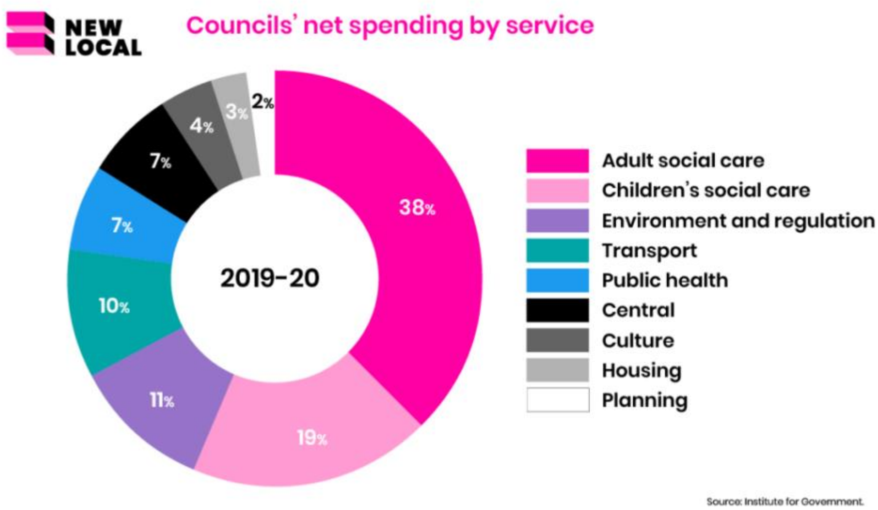
Services which are more directly related to place, such as housing, street cleaning and building regulations, tend to make more sense to be run over a smaller footprint. But services that are strategic such as highways, or which serve a specific population group that is more geographically spread out, such as children's and adult social care, are carried out at the larger scale of a county council.

However, this distribution isn't the case in all areas. There are some large counties and some smaller authorities that have been unitarised and operate the whole range of services across their footprints.

The two-tier system is not without its quirks. For people living in one of these, their bins will be collected by their district council and the waste disposed of by their county. When a person in a two-tier area dies, their death will be registered with the county but they will be buried or cremated by their district council.

So, what do councils spend their money on?

Of the many services councils run, some take up more capacity than others. The chart below shows the proportion of overall council spend on different service areas.



From our perspective as people who use council services, the wide range of what councils do affects seemingly endless aspects of our daily lives. From mending the pavements we walk on, to collecting our bins; from running the markets and licensing the pubs we frequent, to tending the parks and playgrounds our children play in. But it's a lesser-known fact that all this amounts to only a minority of what councils actually do overall.

Nearly 60 per cent of all the money councils spend is on social care – children's and adults. This means that the most significant area of activity for councils is for people who need the most intensive support: children who have challenging family circumstances, working-age adults with learning disabilities and elderly adults with care requirements.

So, the full range of non-social-care services that councils provide, covering public health, housing, planning, the environment, transport and culture-related activity, in addition to central operating costs, adds up to just over 40 per cent of what they spend overall on average. This also accounts for why district councils have much smaller budgets, proportionately to single-tier councils, because they do not have responsibility for social care.

Has it always been like this?

The picture of council spend is not static. Over the last ten years the resource available to councils has decreased due to austerity policy. This, combined with other factors such as the wider lack of a policy to reform the financing of adult social care, is creating pressures within local government budgets.

NEW LOCAL

Percentage change in councils' net spending by service 2009-10 to 2019-2020

Source: Institute for Government.

As the chart shows, over the ten years from 2009/10 to 2019/20, the average proportion of local authority budgets spent on children's and adult social care has remained relatively protected. Children's social care spend has gone up slightly overall by two per cent, and adult social care spend has decreased by seven per cent. Meanwhile, the proportion of budgets available to spend on other core service areas has decreased more significantly: between 24 and 59 per cent.

This is where the difference between statutory and discretionary services is important. Councils have increasingly had to focus available resource on the statutory services for which demand is growing – children's services and adult social care. Indeed, demand is growing so fast due to trends like deepening inequality and our ageing population, that even relatively static budgets over ten years are in practice a real terms cut, and even children's services and adult social care have faced reductions. But councils have both a moral and a legal duty to provide these services to the best of their ability for the people who need support at the most critical times of their lives.

Because councils operate within fixed budgets largely determined by Government policy, local government struggles to provide the full range of services that they did pre-austerity. As we see from the chart above, areas like housing, transport and culture have all experienced significant decreases in spend. And in many cases, discretionary services, such as youth services, have been even more affected because councils are not obliged by law to provide them.

So, in seeking to protect areas of spend for children and adults in the most acute and immediate need, councils have often had no other option but to take the decision to spend less in other service areas. This includes discretionary services, and in practice will have meant reducing or completely stopping some services.

The next in our series of Local Government Explained will focus in more detail on how councils are financed and how this is changing. It will also address what this means in practice for the resources available to councils to spend on local services and with their communities.

Note:

The data for this article is drawn from the Institute for Government's explainer on local government, which is also very useful further reading.

Local Government Explained Part 3: How are councils funded?

July 23, 2021

Jessica Studdert

Local government finance can be mystifying. Taxes, rates, grants; shifting parameters and endless micro reforms. And yet how councils get their money, and the fall in their funding, has huge consequences. Luckily, Jessica Studdert is on-hand to shed a light on all, in part 3 of our series Local Government Explained.

Local government finance is never going to win any awards for being the most glamorous policy area. It is perceived as complex and technical – understood by a handful of specialists and hard to convey in human-speak.

Yet how our local services are funded affects many aspects of our lives, and the communities we are part of. And Government policy decisions over the years have had a significant impact on local services because they have shifted how, and to what extent, the councils who provide them are financed.

Local Government Explained Part 1 looked at different types of councils. Local Government Explained Part 2 explored what councils do. This third and final edition of Local Government Explained aims to demystify the niche policy area of council funding, specifically with regard to policy in England, and hopefully play a part in beginning to make local government finance everyone's business.

How are councils funded?

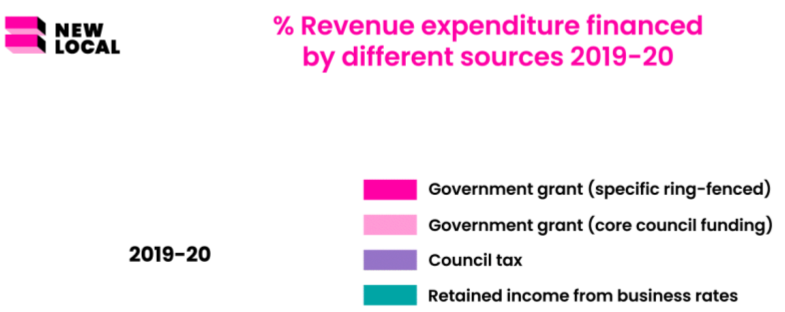
Councils get their money from three main sources: direct funding from national government **(central government grants)**, a tax on commercial properties **(business rates)** and a tax on residential properties **(council tax)**. Each source of income is very different and has particular quirks. This section will explore them in turn.

1. Central government grants

Local government receives various grants from central government, which broadly fall into two categories: those that councils pass straight on to other services without touching (‘specific ring-fenced grants’) and those that councils can spend directly on the services they run (referred to here as ‘core funding’).

- **Specific ring-fenced grants** simply pass through councils’ accounts and onto the beneficiary. They include funding for schools, sixth form colleges, police and for housing benefit payments and administration.
- **Core funding** includes grants that councils can spend directly on the services for which they are responsible. The main grant is called ‘revenue support grant’. There are other grants linked to particular services or functions, including: public health grant, new homes bonus and the social care support grant. Confusingly, some of these are ring-fenced too, in that they are earmarked for specific activity, but crucially they are for council-run services, so they go into each council’s ‘general fund’.

This distinction is important, because sometimes the way statistics about local government finance are presented by Government can make it appear as if councils have more funding than they do. The total amount that councils *receive* is a much larger figure than the amount they have available to *spend*.



The chart above gives an indicative breakdown of the proportions of local government income overall split between the four main sources: central government grants (specific ring-fenced and core), council tax and retained business rates, based on 2019-20 data. It is important to note that within the overall category of ‘central government grant’, only about a third is actually available to councils to spend on local services. The other two thirds represent funding pots for schools and police services which just pass through council accounts.

How has grant funding changed in recent years?

Focussing only on core central government grant funding that councils receive, there are a few important ways in which this has changed over the years.

- **The amount of grant funding has decreased overall, for all local authorities**: It is estimated that grant funding to local authorities reduced by 49.1 per cent in real terms between 2010-11 and 2017-18. This was slightly offset by smaller increases in council tax and business rates over the same period, so the overall 'spending power' of local authorities reduced by 28.6 per cent, according to the National Audit Office.

- **The terminology here is important.** Opposition political parties will always refer to 'cuts in council funding' which relates to core central government grants *only*, and is a larger figure. Meanwhile the Government will always refer to 'spending power', which includes council tax and business rates, in addition to grants. This wider definition enables a smaller figure to be presented as the overall reduction. But according to either classification, the resource available to councils to spend has decreased significantly in the last decade.
- **Cuts to grant funding have hit some local authorities harder than others:** Partly, this is because some councils are more reliant on grant funding as a proportion of their overall budgets. This is strongly linked to levels of deprivation. Councils in more deprived areas are likelier to have less income from council tax and business rates due to lower property values, and they are likelier to experience greater demand for their services from their local population.

  Some other changes have disproportionately benefitted more affluent areas. For example, some grant funding is now routed through the New Homes Bonus, designed to incentivise housebuilding. This rewards high-value areas disproportionately, because it involves larger payments for properties with higher council tax bands. It is also easier to take advantage of in areas with high demand for new housing (as opposed to areas where the priority is to regenerate existing housing).

  The IFS estimates that overall, the pattern of cuts and changes to the allocation of central government grants has meant that between 2010-11 and 2017-18, spending per person in the most deprived fifth of councils fell from 1.52 times to 1.25 times the level in the least deprived fifth.

- **Grant funding has become more complicated:** While the revenue support grant has reduced, other new grants have emerged alongside it. Some, like the public health grant, came with new responsibilities – public health functions moved from the NHS to local government in 2013 (this grant has then been cut in successive years since). Others, like the social care support grant, were put in place as a response to deepening crises in particular services.

  These additional new grants add up to an increasingly complex set of different funding pots – many of which are small and linked to particular priorities. It is estimated that in any one year there are up to 250 different grants, a four-fold increase from 2013/14. This proliferation reflects separate responses to rising service pressures and insufficient council funding overall. But they create their own demands. About a third don't last beyond a year which makes service and workforce planning hard. And about a third are only allocated competitively, meaning councils have to compete with each other to receive them, with no guarantees.

  The LGA has explained how this has played out in homelessness services, which have had 12 short term grants since 2015, half of which were allocated through a competitive process. This takes already over-stretched staff away from the priority of running the service, to instead focus on understanding, scoping and completing application processes. It may also require them to spend the funding they do receive according to predetermined conditions attached, rather than their own locally-defined priorities.

Given the reduction of central government grants, all councils have become more reliant on two sources of local taxation for their income. While the proportion of local government budgets coming from grants has gone down, the proportion coming from business rates and council tax has increased. We take a look at these in turn now.

2. Business rates

Business rates are a tax on commercial properties paid by businesses. They are also known as National Non-Domestic Rates (NNDR). They have a strange name for a tax because they have ancient roots, where in previous centuries 'rates' were collected locally to provide 'relief' for the poor. Some historic terminology remains, but business rates have been in their current form since 1990.

Although business rates are collected locally, councils actually have very little control over the tax itself and how it is applied. How much each business pays depends on the 'rateable value' of their premises, which is decided by a national government body, the Valuation Office Agency. Rates are calculated based on a fixed property valuation took place on one particular day, which is reviewed and updated every five years.

National policy also determines which businesses must pay business rates, and which are entitled to a discount (known as a 'relief'). Local authorities have no ability to use the tax as, for example, an incentive to nurture particular types of businesses or encourage business behaviour that would benefit people locally, such as paying the living wage.

How have business rates changed in recent years?

Until 2013, councils simply collected business rates in their areas and passed them straight to the Treasury in central government. They were then distributed back to councils, allocated using a formula that calculated each area's relative needs (the main grant pot was previously known as 'formula grant'). In 2013, a new system of business rates 'retention' came into force (known as Business Rates Retention Scheme or BRRS). Local authorities now keep half the income they collect from business rates.

The remaining 50 per cent share is still sent to the Treasury and then redistributed back to local authorities as core grants. The total given to each local authority is subject to either a further reduction – a 'tariff', or an additional payment – a 'top up', depending on whether a local authority is deemed more or less able to generate business rates based on their local economic circumstances.

For example, a local authority such as Westminster in central London, has a huge concentration of businesses with high property values. It therefore collects a lot more in business rates than a council in a former industrial area, for example, which is likely to have seen a decline in local business or manufacturing activity and lower have overall property values – trends which are largely outside the ability of that council to influence. Westminster is therefore one such council subject to additional tariffs, which go towards funding the top-ups of other councils who do not have such inherent economic advantages.

What's wrong with business rates retention?

Despite the recognition of different councils' diverging funding starting points, which the tariff and top-up system compensates for, business rates retention was designed to increase council 'self-sufficiency' overall. This is intended to be done by increasing the incentives for local authorities to boost their local economies, because they can now keep a share of locally-generated taxation growth.

However, in addition to the constraints on the tax outlined above, there are a couple of further factors which mean this link between business rates and capturing the 'rewards' of growth is weak in practice:

- **The amount each local authority retains in business rates is still fixed at the original assessment made in 2013.** The relative circumstances of each council has not been re-evaluated, or 'reset', since then. This means there hasn't yet been an opportunity for any local authority to move towards the stated aim of 'self-sufficiency' in practice.

- **Using the value of business premises as a proxy for economic activity is a crude measure:** it doesn't capture productive economic value per se, only the floor space of premises. For example, a large warehouse which pays the majority of its workers the minimum wage would generate a significant amount of business rates. But a small company based in a single-floor office which is highly productive, employs a skilled workforce and supports a wider local supply chain would generate a much smaller amount of business rates. Arguably, other taxes are better proxies for 'good' economic activity such as income tax (based on wages) or VAT (based on transactions). But these taxes are both solely national and not considered as potential local growth incentives.

3. Council tax

Council tax applies to domestic properties and is paid by residents. It was introduced in 1993, and its basic form hasn't changed since. Properties are categorised in one of eight bands based on their value assessed at 1991 prices.

Council tax is the only tax collected and fully retained locally, although the total residents pay includes a police precept which contributes to police funding. Despite its local nature, local authorities are subject to controls on the tax set by central government. These include:

- **No flexibility over exemptions and discounts**: There are certain exemptions on properties and people that are mandated by national government, which local authorities have no control over, despite their local circumstances. For example, students are totally exempt, which disproportionately affects areas with a high concentration of students, and single people are entitled to a 25 per cent discount regardless of how much they earn.

- **No flexibility to apply the tax**: Since council tax bands were set in 1991, house prices have increased overall, and the difference in value between the cheapest and the most expensive residencies has widened. Yet councils have no ability to increase the highest rate of council tax on high value properties, or to reduce it on the lowest value homes to keep pace with these changes. In this way, council tax is often referred to as 'regressive', because increasingly the wealthiest pay proportionately *less*, while the least wealthy pay more proportionately *more*.

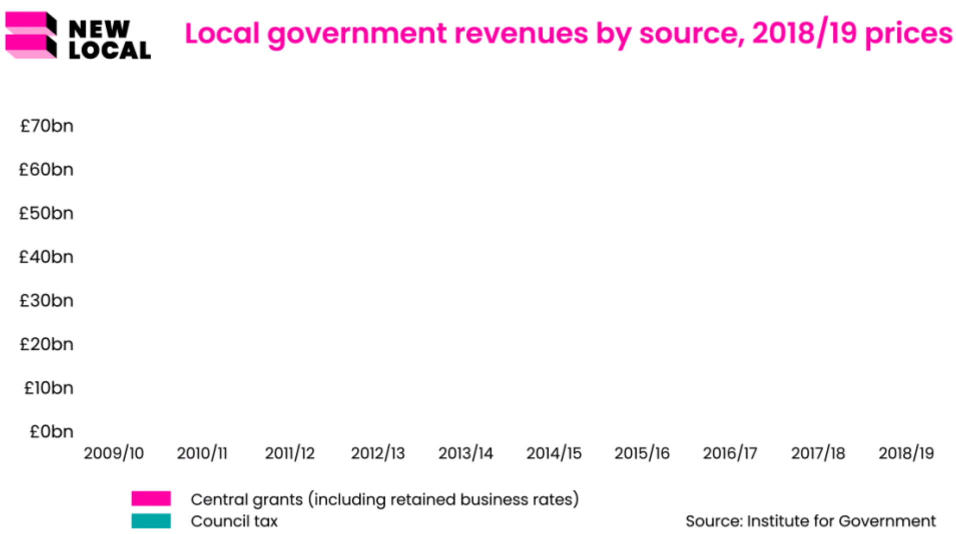
- **No ability to increase the tax beyond a set threshold**: Council tax increases are capped at a level decided by government each year, which has mostly been set at 2 per cent. If any council wishes to increase council tax beyond this set level, they must hold a local referendum for residents to decide. This requirement to take a direct vote to increase a tax is not applied to any form of national taxation, such as income tax, national insurance or corporation tax, all of which are set at the discretion of an already democratically elected Government.

- **Limited responsiveness to local service pressures**: Since 2016, upper-tier authorities with social care responsibilities (counties, unitaries, metropolitan and London boroughs) have been able to set an additional 'social care precept' of up to 3 per cent to respond to those specific service pressures. However, this has not resolved the large social care funding gap, and it has amplified the regressive and distributive problems associated with council tax. The amount each council can raise through the social care precept is directly related to local property values 30 years ago, rather than any assessment of local demand for social care today.

What does all this mean for council budgets?

The cumulative effect of recent reforms to the three main sources of income for local government is a highly complex picture within each local authority. Every council has a different local tax base, and is at the receiving end of a particular set of decisions by government about what funding it is entitled to. These in turn are largely (and over the years increasingly) decoupled from the reality of service demand pressures and needs within that council's local population. Managing this systemic mismatch between funding and demand is the job of council leaderships across the country.

In terms of the overall picture of local government finance, the Institute for Government has produced a useful graph to show how local authority income has reduced in the last ten years, and within that overall total, how the component parts have shifted.



**Given the interplay of business rates which fund grants, the two are taken together in this chart. This also allows for a like for like comparison over the years, despite the reforms to business rates in 2013.*

The graph shows that council tax plays a much bigger part as a proportion of council income at the end of the decade than it did at the start – shifting from a third of the total, to over half. So, over the last ten years, funding for local services has grown more reliant on council tax, despite the shortcomings of the tax identified above.

Do councils have any other sources of income?

Beyond these three main sources of income, there are a few other ways in which councils have access to further resource. These are much more limited and ad hoc, but do have an impact on available revenue spend:

- **Fees and charges:** Councils have the power to put fees and charges on a range of discretionary services they run, such as for planning services and the use of leisure centres. There are tight rules governing these. They are not permitted to use fees or charges for services they have a legal duty to provide, such as libraries. Any income generated through fees and charges must be spent within that service area – so parking charges must be used for parking services, road repairs or restriction enforcement, for example. Often the use of fees and charges is small scale within overall budgets, but part of a wider strategy to be more enterprising in response to budget pressures.

- **Commercial investment:** While revenue sources have become more constrained, councils have still had access to borrowing at relatively low rates from the Public Works Loan Board (the national body that loans money to public bodies for capital investments, since last year merged into the Treasury). This has enabled them to make commercial property investments that can create revenue returns or savings – for example, investing in building a care home to reduce social care costs or shopping centres within wider regeneration plans.

  Increasing numbers of local authorities are pursuing this course: the National Audit Office (NAO) has estimated local councils spent £6.6 billion on commercial acquisitions between 2016 and 2019, which is up 14 times on the previous years. The NAO has highlighted the long-term risks associated with using commercial property income to fund services and some reports have focussed on a few councils, mostly districts, whose borrowing is significant relative to small budgets. Yet as a recent report from the Housing, Communities and Local Government Select Committee has found, most local authorities balance these risks in practice, follow the prudential borrowing code and see it as a legitimate way to manage budgets and local priorities together. It should also be noted that because councils operate within a highly uncertain financial environment, partly as a direct result of government policy, there are also risks attached to doing nothing.

- **Reserves:** This is not an income stream per se, but worth mentioning here. In the same way as most people would find it sensible to save a bit of money for a 'rainy day', it is also a sign of prudent financial management for councils to ensure a healthy balance of reserves. Especially over the years of austerity, councils putting aside money into their reserve pot has been attacked by Government or in the press as unnecessary 'hoarding'.

  Yet councils are legally required to balance their budgets each year, so having a minimum amount of reserves is wise financial planning to deal with an increasingly risky financial environment and unexpected shocks to budgets. Indeed, during the Covid response, it is estimated that councils used £500 million of reserves as short-term contingencies to meet some of the costs they were suddenly faced with. Yet just as with our own individual savings in a bank, reserves can only be spent once. They are not a substitute for sufficient income for day-to-day spending – but they serve to create some much-needed flexibility in constrained budgets.

What local government finance reforms are on the horizon?

There are several changes expected and reforms underway that will affect local government finances, including:

- ## Spending Review 2021

The 2020 Spending Review was supposed to set out multi-year budgets for local government, which would have given more planning certainty for councils to invest in services. But this was disrupted by the urgent demands of the pandemic and in the end was only for one year. Local government did receive a larger settlement for the financial year 2021-22 than it did the previous year, in recognition of the increased costs associated with the Covid response. But the LGA estimates a £2.5bn shortfall in the next financial year 2022-23 following the prolonged impact of the pandemic.

There are other long-term challenges which have ongoing impacts on local government finance, such as much-delayed plans to fund social care properly. So far, spending rounds have created new grants or adjusted the social care council tax precept to plug immediate gaps in funding. But long-term reform is getting increasingly urgent, and is something the Housing, Communities and Local Government Select Committee has called for. There are recent signs the Government is considering increasing national taxation to fund social care, but the implications of such a move for local government funding and delivery of social care are not clear.

- ## Fair Funding Review

The challenge at the heart of local government finance policy is how funding should be distributed in a way that recognises the different starting points of local authorities. In other words, the differing business rates and council tax revenue bases councils have, and the differing service pressures they face, linked to population or geographical characteristics such as deprivation or rurality.

Where is the line to be drawn between incentivising areas to grow and penalising areas that need to work harder to grow? How much should the way councils are financed promote 'self-sufficiency' for all or ensure 'equalisation' between local authorities? And how should service demand pressures – 'needs' – be defined and measured?

The Fair Funding Review is the live process that is supposed to address these questions. But the definition of "fairness" is intensely political and contested both between political parties and amongst the representative groups of different types of local authorities. For example, density and deprivation are significant factors for urban (mostly Labour-run) metropolitan local authorities, whereas rurality and large operating geographies are significant factors for (mostly Conservative-run) county councils. Within two-tier areas, counties run huge demand-driven services such as social care and children's services so statutory service pressures are a big priority, whereas district councils have smaller budgets but also considerable pressures in areas such as housing, which also require recognition and funding.

In short, there is no easy answer on funding allocations that doesn't involve simply rearranging 'winners' and 'losers' in a new system. The way the Government has framed 'fairness' is limited to a zero-sum wrangle within the local government sector. In other words, the review is looking only at how to divide an existing meagre pie between councils, rather than how to make a bigger pie (the ingredients for which might include new powers to raise local taxes and grow income overall).

Perhaps unsurprisingly, despite having been underway for five years already, there is no fixed date set for the outcome of the Fair Funding Review, which was said to be imminent before Covid hit.

- ## Business rates retention

The government has long planned to increase the share of business rates that local authorities can retain locally from 50% to 75%, and several local authorities have taken part in piloting this approach. However, rolling out this measure everywhere would need to involve agreement on how frequently business rates need to be 'reset' – in other words, how often an assessment of local authorities' baseline funding levels and business rates baselines need to be calculated. As mentioned in the business rates section above, this has not happened since 50% retention was introduced in 2013.

This reform measure is linked to the Fair Funding Review, because again, it cuts to the heart of the core challenge for local government finance policy: the trade-off between incentives to grow in the future and equalisation for sufficiency now. More frequent resets would arguably create *fewer* incentives for councils to promote local economic growth that expands business rates baselines, since baseline funding levels would be frequently adjusted to account for spending pressures. On the other hand, less frequent resets would arguably create *more* incentives to promote business growth, since central core grant adjustments would not kick in so frequently, but this would put more risk onto individual local authorities.
Again, this is all incredibly political and contested. Local authorities who deal with more deprivation, less robust innate local economic circumstances and greater service pressures, will be wanting the assurance of a strong safety net, as their resource base tips ever more towards increasingly locally-raised revenue and diminishing needs-based funding.

What big problems with local government finance remain?

Although there is widespread agreement that our system of local government finance is not fit for purpose, there is not consensus about how to reform the system. The two reform processes underway – the Fair Funding Review and further Business Rates Retention – are both very narrowly framed.

Neither question the fundamentals of how councils are resourced in this country, or seek to broaden the sustainability of local government finance over the medium-to-long term. Moreover, the way each process is set up creates competition between councils over how scarce resource is allocated and how diverging needs are defined. So as reforms develop and are implemented, it all looks likely to be highly fraught for the sector, which will be divided and therefore more easily ruled.

While these narrow reform measures run their course, some important systemic challenges for local government finance will be left unaddressed. These include:

- **UK local government has very limited revenue-raising powers compared to other similar countries**.

  According to the Institute for Government, every other G7 nation collects more taxes at a local or regional level. 12% of the UK's taxes are collected locally, compared to 17% collected locally or federally in Italy, 30% in Germany, and almost 50% in Canada. This makes local government in the UK uniquely dependent on national government funding and decisions for its resourcing.

  As a result, there are frequently calls for 'fiscal devolution', which would increase the ability of local authorities to raise revenues either by creating new taxes such as a tourist tax or by partially devolving existing national revenue streams such as income tax or VAT. To an English policy audience these measures sound incredibly radical, but a combination of these is the norm in other comparable countries. The IFS has suggested that income tax would be the most promising candidate for partial devolution in England.

As discussed in the section on business rates, there is potential to explore how devolving shares of national taxes could be used as incentives to boost productive growth, since local authorities would have a direct stake in stimulating local wage growth and business activity. But local government finance policy is deemed largely separate and apart from national economic policy, which tends to focus either on specific sectors or on capital investment to "level up". The systemic relationship between local government finance and productivity is rarely considered within government.

- **Existing revenue-raising powers are both forms of property taxation, which is increasingly problematic in the context of highly distorted property values**.

  This will become a greater problem the more reliant councils are on business rates and council tax for their funding.

  Business rates are an extremely unpopular tax, particularly in the context of high street decline and increasing online commercial transactions. Council tax is related to property wealth, which are now so distorted that any revaluation would create too many losers for this measure to be viable politically.

  Measures to broaden out the tax base of local authorities would reduce the negative and regressive consequences of over-reliance on unsatisfactory forms of taxation. This is related to the previous section on productivity – because as things currently stand, there is a risk that councils become increasingly incentivised to generate revenue by simply building large retail or office units (for business rates) and higher band housing (for council tax). A wider, more dynamic local revenue base would incentivise measures to stimulate more dynamic and higher value local economic growth, which would ultimately better benefit people locally.

- **The narrow and complex income base for councils creates too much dependency on national government decisions and weakens resilience in our system overall.**

  The cumulative effect of centralised finance, a decade of austerity and a hand-to-mouth reliance on short term funding to plug gaps, is a highly complex operating environment for local authorities. In a mature democracy and to ensure a resilient state, the sustainability of local government should be a priority for national policymakers. Yet too often, successive national governments have taken decisions which undermine the ability of local government to respond to local populations' service needs. It is very easy to hide behind the complexity of council finance when making decisions that are highly technical, but have big real life consequences.

Further reading

If you have read this far, well done! Hopefully, this article has explained and demystified some elements of local government finance, if not outright proved to you that the policy area (and potential for reform) cuts to the heart of the big social and economic challenges of today. If you would like some further reading, there are some great organisations out there who analyse and explain local government finance in more detail. They include:

- The Institute for Government produce excellent explainers on local government, including local government funding.
- The Institute for Fiscal Studies (IFS) has a research strand focussed on local government finance. They produce a number of useful reports and up-to-date analyses of the picture of local government finance, including a recent report on how Covid has hit local authority budgets.
- The Housing, Communities and Local Government Select Committee frequently interrogates the circumstances of council funding, and has two specific inquiries currently open: on the Spending Review and Local Government Finance and on Local Authority Financial Sustainability.
- The National Audit Office produces excellent analyses of the state of local government finance and the impact of national policy decisions, the most recent being an inquiry into local government finance in the pandemic.
- The LGA produce regular information bulletins and responses to key national policy developments related to local government finance.

END