

A Plain English Guide to the Local Government Finance Settlement for 2011-12

A Plain English Guide to the Local Government Finance Settlement 2011-12

Introduction

The Local Government Finance Settlement determines how much grant central Government will give to each local authority in England over the next two years.

The Spending Review announced the **total formula grant all local authorities will receive** over the next four years. The Local Government Finance Settlement sets out **how that grant will be distributed** between authorities over the next two years in a fair and sustainable way, and **how much each individual authority will receive**.

This year's settlement reflects the unprecedented economic circumstances the nation faces. The Spending Review set out how the Government would tackle the catastrophic levels of public debt and put the public finances back on a sustainable footing. This has involved tough decisions throughout the public sector. But unfortunately given our economic inheritance, these have been essential, responsible decisions. The most recent forecasts from the Office for Budget Responsibility confirm that we were right to take these difficult steps. Their message is that Britain's economic recovery is on track, and the Government is on course to balance the books.

Now the provisional settlement has been published, there is a statutory consultation where councils and other interested groups have the chance to comment on the proposals. After any changes are made, the final settlement for 2011 – 12 will be debated and approved by the House of Commons in the new year. Legally, the Government cannot formally finalise the figures for 2012-13 at this point, but we do not expect to change the provisional allocations except under entirely exceptional circumstances. The Government will consult on the final 2012-13 settlement at this time next year in the usual way.

Given the unprecedented economic circumstances for this year's settlement, we have made several changes to the way that grant is shared out between authorities. This is in direct response to requests from the local government community.

The effect of these changes is to:

- Insulate the poorest and most vulnerable areas from the most significant formula grant reductions
- Limit the need for councils to 'front load' the cuts into the first year of the settlement

In other words, without the changes that we have introduced:

- The poorest areas would be worse off relative to other areas

- The reductions to councils spending power would be much more substantial in the first year

This settlement also affirms the Government's commitments, set out in the Spending Review, to protecting council tax payers and to funding adult social care.

This document explains the different features of the settlement in more detail and includes general background details of the way local government is funded.

Focusing resources on the most vulnerable communities

Some areas of the country are much more reliant on central government grant than others. These tend to be more deprived communities, with more significant social challenges. Council tax receipts in these areas are therefore lower while the need for council services is often higher. Some areas rely on central government for 75 per cent of their total budget: other areas which collect more council tax and are more self-sufficient only rely on government grants for 20 per cent of their budget.

This means that applying an equal percentage reduction (a 'salami slice') to the grant would leave the poorest areas disproportionately worse off. This is easiest to explain through an illustration: if a 10 per cent reduction to grant was applied across the board, a council which relies on central government grant for seventy per cent of its budget would see that budget fall by seven per cent: while a council which only relied on government for 20 per cent of its budget would see the budget fall by only 2 per cent. This would be regressive, hitting the poorest areas hardest.

The Government has acted to mitigate this by changing the way that the grant is calculated: paying more attention to the levels of need in the area, and distributing less money per person.

In the past, Government has set a single 'floor' to limit the effects of changes from year to year. This is also called '**damping**'.

Instead of just a single floor, this year councils have been grouped into four bands with four different floors. These bands are based on the percentage of the budget that the authority receives from central government formula grant. By setting different floors for authorities in different circumstances, Government has capped the reductions in grant for more needy authorities at a lower level than more self-sufficient areas. Again, this insulates the most dependent places from the sharper grant reductions they would otherwise have had. This is a fairer and more progressive system than in the past.

It is also important to remember that more needy areas receive significantly more grant per person than places which are better off. Taking into account the financial circumstances and all the changes this year, people in Hackney

still receive £1043 per head, while residents in Wokingham receive only £125 per head.

Reducing the need for councils to ‘front load’ the reductions

Tackling the public deficit head on in order to achieve sustainable economic growth is the Government’s most important priority. That has meant some tough, but essential, decisions about the timing of the reductions. At the same time, however, the Government recognises that councils need to manage the impact of those reductions sensibly and effectively over the spending review period.

Over the past few months, councils and the Local Government Association (LGA) have expressed concerns that the reductions might have to be too heavily ‘front loaded’ – meaning they would hit disproportionately hard in the first year. The LGA asked the Government to tackle this by focusing on councils ‘**spending power**’ rather than just formula grant. Spending power is also made up of other government grants, NHS support for health and social care, and council tax receipts.

By focusing on spending power, as the LGA asked, the Government has been able to ensure that no authority will see their spending power fall by more than 8.9 per cent in either 2011-12 or 2012-13. The average fall is 4.4 per cent in 2011-12.

In order to guarantee this, we have ‘topped up’ the amount of grant going to councils:

- With an extra £30 million in formula grant
- And a further £85 million in 2011-12 and £14 million in 2012-13 shared between the councils who would otherwise have seen the sharpest falls in their spending power

Together, this smoothes the impact and limits the need for councils to front load their spending reductions to the first year.

Protecting council tax payers

Hardworking families and those on fixed incomes, like pensioners, have often found the successive increases in council tax hard to cope with. This year, the Government has acted to protect these families by setting aside £650 million to ensure that **every council can freeze council tax next year** without a knock on effect in local services. Instead, the Government will provide councils that choose to freeze council tax with the equivalent of a 2.5 per cent increase in funding.

The Government also wants to ensure council tax payers are protected against any authorities which choose to reject the offer and impose excessive

council tax rises. Through the Localism Bill, the Government plans to introduce a power for residents to veto excessive council tax increases through a referendum. In the meantime, the Government can take capping action against councils who propose excessive rises.

Funding social care

The Spending Review recognises the importance of social care to hundreds of thousands of adults of all ages, backgrounds and identities: supporting their independence and helping them to make full and active contributions to their communities. It also recognised the pressures on adult social care and committed additional funding over the spending review period to protect access to services while improving quality and outcomes. £1 billion of this is coming from NHS funding, with the intention that this should help break down the barriers between health and social care, offering people a more coherent, effective service. To fund this commitment, we are directing more resources to authorities that deliver social care, rather than the district councils who do not have this responsibility.

Further support for local government

Despite all the changes, local government is still facing significant challenges. The vast majority have already begun to plan how they will meet these.

To support them, the Government is driving **the most radical shift in power for a generation**: giving councils a real say over the issues that matter to local people – such as housing, planning, the local economy and the local health services. Many of these new powers will be delivered through the Localism Bill. To free councils to focus on the frontline, the Government has substantially reduced the burdens of inspection, regulation, and regional bureaucracy. This is giving councils the powers, the freedom and the flexibility they need to tackle these challenges head on.

The Government is also giving councils **much greater control over their purse strings**. In previous years, there have been many more different funding streams and grants for different projects. This was very restrictive for councils as it meant they had to spend their money on priorities set in Whitehall, regardless of what their residents wanted.

The number of grants has been cut from over 100 to around a dozen. With two exceptions (schools grant, and a new public health grant) these grants will no longer be ring fenced. This means:

- The funding system is now much simpler and more streamlined
- And councils have much greater control over how they spend it – there are no strings attached to the money in the form of grant conditions – which means they can focus on local priorities and respond to local needs without being hamstrung by central government requirements

The Government also plans to change the law so councils will be able to borrow against the proceeds of future business rates (known as **tax increment funding**) in order to invest.

The Government is also providing **substantial financial incentives** for councils to invest in longer term projects, such as the New Homes Bonus available over the next four years for councils investing in new housing, and the £1.4 billion Regional Growth Fund.

How can councils respond?

All this gives councils the ability to concentrate on what their residents want – protecting front line services.

Many councils are already responding to this challenge by:

- Improving transparency – allowing the public to see where money is being spent, suggesting changes; making suppliers more competitive, and changing the culture among those entrusted with public money
- Sharing services – to achieve greater efficiency and improved services
- Cutting out waste – particularly in back offices
- Improving procurement practice – achieving more competitive prices by making full use of their purchasing power
- Bringing senior pay under control – including sharing senior managers among councils

More fundamentally, councils need to take this opportunity to radically rethink and transform their services.

Those councils which have substantial reserves should also consider using these to address short term costs and pressures, and invest now in order to realise savings in the longer term. Local authorities currently have around £10 billion in reserves, but low interest rates mean they are earning very little interest.

To support councils in their efforts, we have set aside £200 million as a capitalisation facility to help councils modernise: reducing back office costs so they can focus on the front line.

What does the future of local government finance look like?

This is an inherited system of financial tax finance which is extremely complicated and has given rise to a number of problems.

- It makes certain areas heavily reliant on hand outs from central government. Some depend on government for up to 75% of their total income. This is part of the trend that has seen some areas of the country becoming increasingly reliant on the public sector rather than private enterprise

- It stifles local innovation and weakens local accountability
- It makes it difficult for councils to plan and set long term budgets
- It means there is little incentive for councils to invest in their local economy – since the rewards they would have received in the form of increased business rates receipts simply disappear into a central pot to be shared out by central government

So as part of the white paper on Local Growth, the Government announced a review of business rates with the intention that in future local government will be able to keep what they collect. The Local Government Resource Review will begin in the New Year.

This shift in policy will set councils free from dependency on government. Ultimately, those councils which invest and support the local economy will be better able to finance themselves.

Appendix A: Local Government Finance: The Basics

Local Government has three main sources of income:

- Grants from central government
- Council tax
- Other locally generated income – which includes things like fees and charges for services and rents on council housing

Council tax is collected by local authorities (the ‘collecting authority’) but certain proportions – known as ‘precepts’ – are then distributed to other authorities – primarily the police and fire authorities. In London, there are also precepts which fund the Greater London Authority.

On average, councils receive 53 per cent of their income from central government grant, though this significantly varies from around 20 per cent to around 75 per cent.

Councils spend their money on three different areas:

- Capital projects, like roads or school buildings
- Council housing
- Local public services (including pay for those delivering the services). This includes:
 - children’s services
 - adult social services
 - police
 - fire
 - highway maintenance
 - environmental, protective and cultural services – which includes things like planning, libraries and concessionary travel

The distribution of grants for these local public services makes up the bulk of the local government finance settlement. There are two types of grants:

- **‘Formula grant’** which comes with no strings attached and which councils can spend as they see fit. Formula grant is mainly made up of the **business rates** which councils collect from their local businesses as their contribution to the cost of local public services. This is paid into a central pool and redistributed by central government in the finance settlement. Formula grant also includes funding from central government, known as **‘revenue support grant’** and money from the Home Office to fund police authorities, called ‘principal formula Police Grant’. In 2011 – 12, formula grant is approximately £29 billion.
- **Specific grants**, which aren’t technically part of the settlement but are announced at the same time to help councils plan. Excluding schools, in 2011 – 12, these total around £7 billion, and include, for

example, the £1.3 billion Learning Disabilities and Health Reform Grant.

Formula grant is based on a complex formula which takes into account

- **'relative needs'** – which reflects factors that affect the costs of service delivery, such as levels of deprivation or labour costs in different areas. More needy areas will receive more formula grant.
- **'relative resources'** - which reflects the income that councils are able to raise locally by collecting council tax. Areas with a higher council tax base will receive less formula grant.
- **'central allocation'** which is shared evenly out on a 'per capita' basis
- The way that certain specific grants which this year have been included in formula grant were previously allocated
- 'Damping' in order to limit the effect of changes from year to year

This year the Government has changed the way formula grant is calculated to take greater account of relative needs and less account of central allocation.

The amount of formula grant each authority receives also depends on the type of authority they are: because they have different responsibilities - not every authority delivers every service.

Lower tier – usually “district” or “borough” councils (such as St Albans) – smaller councils which deal with more local, community-related issues such as waste collection, social housing and homelessness, planning (development control), council tax collection, administration of housing and council tax benefit.

Upper tier – or “county councils” (such as Hertfordshire) – councils covering a larger area (several districts) responsible for higher volume services such as education, children’s services, social services, waste disposal, etc.

Unitary councils – (such as Plymouth) are responsible for all local government functions and services in their area.

Fire and rescue authorities – oversee the policy and service delivery of the local fire and rescue service. Their duties include promoting fire safety, firefighting, and dealing with road traffic accidents.

Police authority – responsible for securing efficient and effective policing of the area through the police force.

These different types of authorities have been set different floors in this years settlement. Full details can be found at

www.local.communities.gov.uk/finance/1112/grant.htm