

Rethinking Public Finance: How to change national and local government spending processes to create better outcomes

Executive Summary

Local government has been hit hard over the past decade by changes to the scale and type of funding that it receives. Funding certainty and fairness are needed if we are to achieve inclusive growth and deliver the local services required to reduce inequalities, create resilience, improve health and increase lifetime outcomes.

In April 2023, the Centre for Progressive Policy and Metro Dynamics convened a roundtable discussion to address this topic. Based on the issues raised, we have suggested four principles and reforms to both local and national government to underpin better outcomes.

Principles

1. **Necessity:** the role of local government has been diminished over many decades. We must clearly establish the purpose of local government and then consider the appropriate level of needs-based funding to meet those objectives. Local government has an important role to play in economic development as well as prevention; creating better outcomes in areas from health to the wider economy. The current focus on social care and planning is too narrow, but also underfunded, diminishing the capacity to look at other essential policy areas.
2. **Stability:** local government provides key services that people rely on and value in their communities. Certainty is required if local government is to deliver effectively yet the current system leaves local government waiting upon central government.
3. **Simplicity:** central government dislikes hypothecated funding for itself but is content to tie up local government in centrally dictated criteria and audits. Consolidated funding streams would free up areas to focus on value for money and delivery.
4. **Accountability:** in return for greater simplicity and stability, local government can be more accountable to those it serves and have a clearer relationship with central government. This should be built on shared best practice across authorities and transparency on outcomes and expenditure.

Reforms

To implement these four principles in practice, the following reforms would provide the necessary certainty for local government planning and partnership with national government.

A new **Local Government Act** that:

- a. sets out the key responsibilities and basis of local government including the power of general competence
- b. provides a new framework for multi-year funding based on three year settlements; aligned to a new Spending Review (SR) process set out below

- c. creates a new independent body to make recommendations on the distribution of funding to local authorities
- d. sets clear parameters (e.g. population, deprivation) for allocation of funding to local authorities based on advice from the new body
- e. consolidates grants into the Revenue Support Grant (RSG) unless Parliamentary approval given (e.g. in a crisis)
- f. sunsets grants into the RSG at the next SR unless reauthorised by Parliament

Underpinned by a new **Fiscal Responsibility Act** that puts fiscal events on a firmer statutory footing to provide greater certainty for local government and public services with:

- g. Spending Reviews take place every 2 years setting 3 years' worth of budgets
- h. Budgets (focusing on tax and macroeconomic stability e.g. inflation, output gap, inclusive growth) to take place annually with a requirement for an Office for Budget Responsibility forecast

History and context

Local authorities are highly dependent on national government legislation and funding. This is set in a context of typically annual local government finance settlements and uncertainty over medium term expenditure which is meant to be provided by Spending Reviews. Leaving local authorities entirely dependent on their own revenue would have serious distributional implications, but the degree of central control in the UK is higher than many other countries. This short paper provides an overview of local government and national spending processes.

Local government in the UK emerged and expanded through individual local initiatives, with early pioneers expanding the role of the state through local rates which paid for local public goods such as sanitation, gas, water and public order. As successful municipalities expanded citizen expectations of their local governments, central government stepped in to set legal requirements for minimum service levels. Over time, local government shifted from providing public goods to local service provision, with concerns over a “postcode lottery” driving increased central control.¹ Consequently, central grants took centre stage as a mechanism for central government to direct local service provision.

This shift has also been backed by a political dynamic, incentivising successive central governments to shift the emphasis from local to central taxes. Local taxes levied on property are politically controversial, particularly increases linked to revaluations. At key moments, such as the 1966 Green Paper or in the 1980s, it has been easier to subsidise local government finance with central grants. Funding has since been particularly squeezed from 2009/10, with cuts of 37% to central grants to 2019/20.² Thus the local role in wider policy areas like economic development and prevention has been diminished.

More recently, government has promoted ‘devolution’ to some areas in a largely piecemeal fashion to reverse some of this centralisation. This has included business rates retention, with some areas leveraging this for tax increment financing. The most advanced of these devolution deals were agreed in Greater Manchester and West Midlands in Spring 2023 looking to departmental style settlements at the next Spending Review for those areas. Systemic reform would embed this, providing the certainty needed to achieve change.

Spending Reviews

The Spending Review (SR) process has been used since 1998 to set medium term expenditure plans for government. The process focuses on Departmental Expenditure Limits (DELs) including the DEL allocated for Local Government. This process sets the context for the Local Government Finance Settlement (LGFS) which is outlined in more detail below.

When SRs were instituted in the late 1990s, it was meant to set clear spending allocations over the medium-term.³ This replaced the annual spending rounds usually announced before the relevant financial year (typically as ‘Autumn Statements’).

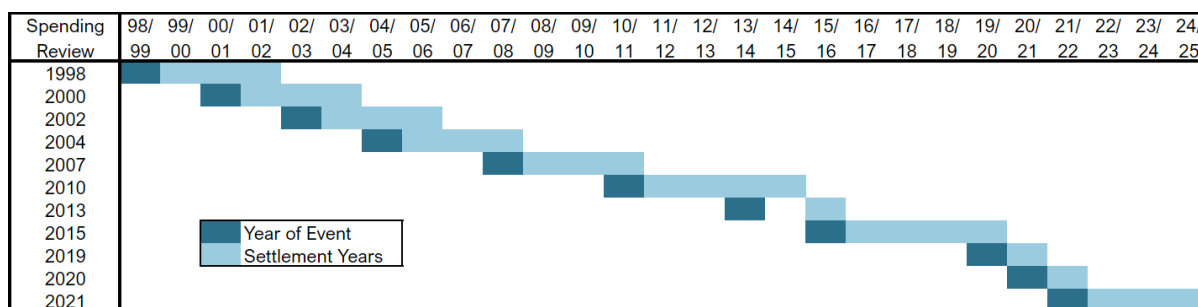
¹ Tony Travers and Lorena Esposito. *The Decline and Fall of Local Democracy*. ([Link](#))

² Institute for Government. *Local government funding in England*. ([Link](#))

³ Civil Service World. *A Short History of the Spending Review*. ([Link](#))

However, the new SR process was given no legal underpinning. The legal authority to spend is still provided by the annual Estimates process. After two decades, the early aspiration to provide certainty for public services and major projects has instead been replaced with ad hoc events driven by short term political considerations. It is important that governments have the flexibility to respond to crises or other short term considerations, but it is fair to question whether the vast majority of public services and major projects need to be subject to the kind of uncertainty shown in Figure 1.

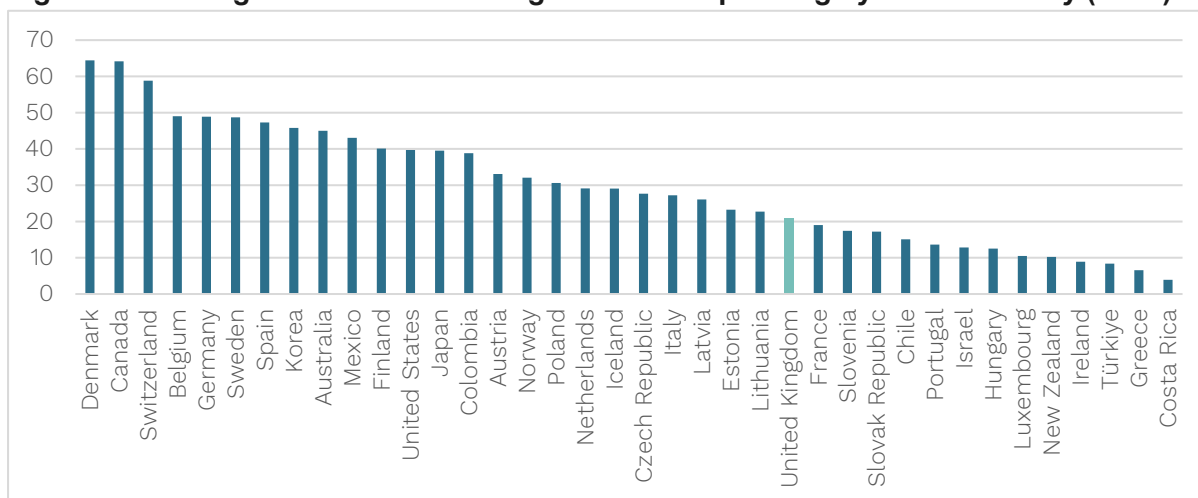
Figure 1 – Spending Reviews processes and settlement lengths since 1998



Local Government Finance

Local government revenue comes either from central grants (including Business Rates) or from locally raised sources (e.g. Council Tax). Locally financed expenditure represents 31% of total local authority spending.⁴ According to the OECD (shown in Figure 2), local government in the UK represents only 20.7% of total government spending; and this includes spending elements such as schools grants which are centrally controlled.

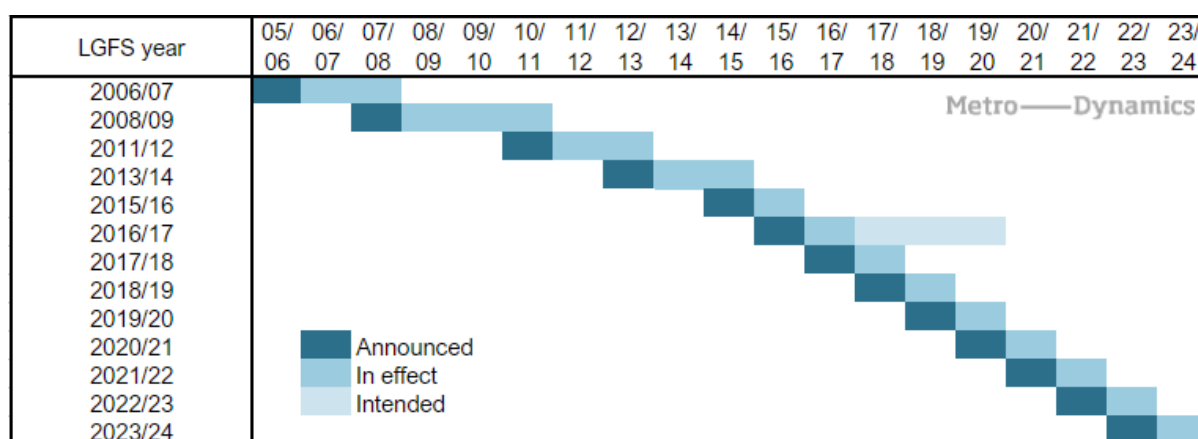
Figure 2 – Local government share of government spending by OECD country (2020)



⁴ Office for Budget Responsibility. *Locally Financed Expenditure*. (2022): [Link](#)

The Local Government Finance Settlement (LGFS) is an annual allocation for England which distributes settlement funding (£17.1bn in 2023/2024). Given the importance of the Revenue Support Grant (RSG) and Business Rates, the settlement effectively determines the core spending power for each local authority, when combined with local revenue raising via the council tax system. In the past, settlements have included provisional allocations for subsequent years; however, recent settlements have been single year only. For example, a four year settlement offered for 2015-16 through to 2019-2020 was undermined due to ad-hoc, if welcome, additions (e.g. social care grants).⁵

Figure 3 – LGFS processes and settlement lengths since 2005



This LGFS process was established by the 1988 Local Government Finance Act, which created the community charge (replaced with Council Tax shortly afterwards in 1992) and uniform business rates.⁶ This was intended to set out the central and local share for local authorities, and the distribution of business rates across the UK.

The following components were announced for 2023/24 as part of or alongside the LGFS, in addition to council tax raised and retained locally:

- **Business Rates:** revenues are pooled and then redistributed according to a funding formula (since 2013, local authorities also retain 50% of their share, subject to a levy which distributes income between authorities). This makes up the single largest proportional element of the LGFS; in 2023/24 it represents £15.2bn.
- **Social Care Grant:** has grown rapidly in recent years, having only represented £241m when introduced in 2017/18. This is in response to increasing demands on local government finances and represents a total of £3.85bn in 2023/24. Unlike the RSG and business rates equalisation, social care grant must be spent within a certain area and is therefore not treated as part of general government revenue.
- **Revenue Support Grant (RSG):** will be worth £2.7bn to councils in 2023/2024. Until 2013/2014, the RSG shifted resources between councils in order to offset relative

⁵ House of Commons. *Public Accounts Committee: Local Government Spending*. (January 2019): [Link](#)

⁶ House of Commons. *Local Government Finance Act. Schedule 7B* (1988): [Link](#)

spending needs. However, in the present day, the RSG is much smaller as a proportion of income (partially offset by more uncertain Business Rates Retention) and is allocated according to actual council tax revenue, rather than notional tax revenue, which has tended to subsidise councils with lower actual council tax rates.⁷

- **Other grants** – including the Services Grant £483m, the £291m New Homes Bonus and the £133m Funding Guarantee.

As seen in Figure 3, the settlement effectively operates on an annual basis hampering long-term budget planning. However, the most recent settlement was published alongside a paper covering the 2023/24 and 2024/25 years, which was intended to provide greater certainty by making several commitments, like increasing business rate income and the RSG by CPI.⁸

Challenges to the system

The current system of local government faces several key challenges. The first two relate to the type of funding given to local government whereas the second two relate to the quantum.

Type of Funding

The need for a long-term funding footing. Annual settlements reduce certainty over funding streams for local authorities. Over 1/3 of grants are discontinued between one year and the next.⁹ Other new policy, such as business rates retention, could achieve more with a longer term commitment, allowing local authorities to raise capital for investment by borrowing against retained rates. This uncertainty is driven by and exacerbated by the uncertain environments created by Spending Reviews.

Number and fragmentation of grants. Outside of the RSG, there are also a series of supplementary grants and funding streams, such as the public health grant, social care grants, the New Homes Bonus and homelessness prevention grants. Over time, the number of central government grants have increased, with the LGA finding that this has increased to an average of 250 grants from 61 in 2013/2014.¹⁰ Many of these grants are also competitive – 32% in 2018/2019 – which costs each council an average of £2.25m per year in resourcing claims. This has been an issue since the earliest days of local government - without clear legislation or rules, grants tend to multiply over time.¹¹ As well as being a bureaucratic burden, such fragmentation also removes the vital ability of local government to join up issues in a place, aiming for wider economic development and focusing on prevention.

⁷ Institute for Fiscal Studies. *Does Funding Follow Need?* (2022): [Link](#)

⁸ DLUHC. *Local Government Finance Policy Settlement 2023-24 to 2024-25*. [Link](#)

⁹ LGA. *Fragmented Funding Report*. (2020): [Link](#)

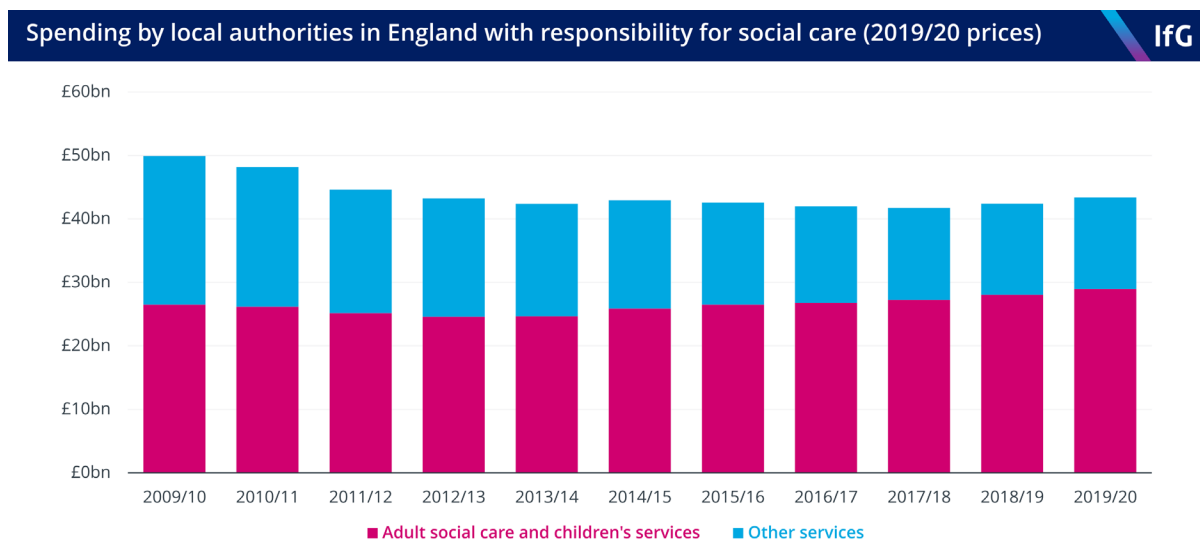
¹⁰ LGA. *Fragmented short term government grants* (2020): [Link](#)

¹¹ Tony Travers and Lorena Esposito. *The Decline and Fall of Local Democracy*. ([Link](#)). For example, a 1918 study identified that over 50 separate education grants had sprung up in recent years.

Quantum of Funding

Outdated spending needs assessments: Current assessments of spending need date from 2013-2014 and some of the relevant data goes back as far as 2001. However, since then there has been substantial economic growth in some areas of the UK, such that these original needs assessments do not reflect the current distribution of need and faster-growing places have faced relatively higher constraint in local budgets. In 2016, the UK Government set out plans for a “[Fair Funding Review](#)”, which would reallocate funds based on current spending needs. However, the outcomes of this review are now not expected until after the next General Election.

Social care responsibilities. The growing share of social care as an unreducible part of council spending poses a challenge to councils. The LGA estimate that councils with responsibility for children’s and adults social care now spend around 2/3 of their budget on this field.¹² This has been recognised in recent Government policymaking; in 2023-24, councils with social care responsibilities have been allowed to raise additional council tax and have received additional grant funding. This dynamic has crowded out local government’s capacity to spend on or focus on other areas that residents and businesses care about.



Source: Institute for Government analysis of MHCLG, Local Authority Revenue expenditure and financing in England: individual local authority data – revenue outturn. Excludes grants for education services, police and public health. 

The principles and reforms set out in the Executive Summary seek to address these challenges, particularly by focusing on the type of funding. In a world of finite resources, the quantum of funding will always be a challenge but this does not excuse the piecemeal system of unstable grants which has become a key and unwanted feature of the local government funding system in recent years.

¹² LGA. *Local Government Settlement Briefing*. (2022): [Link](#)