Why the government needs to pay up before levelling up

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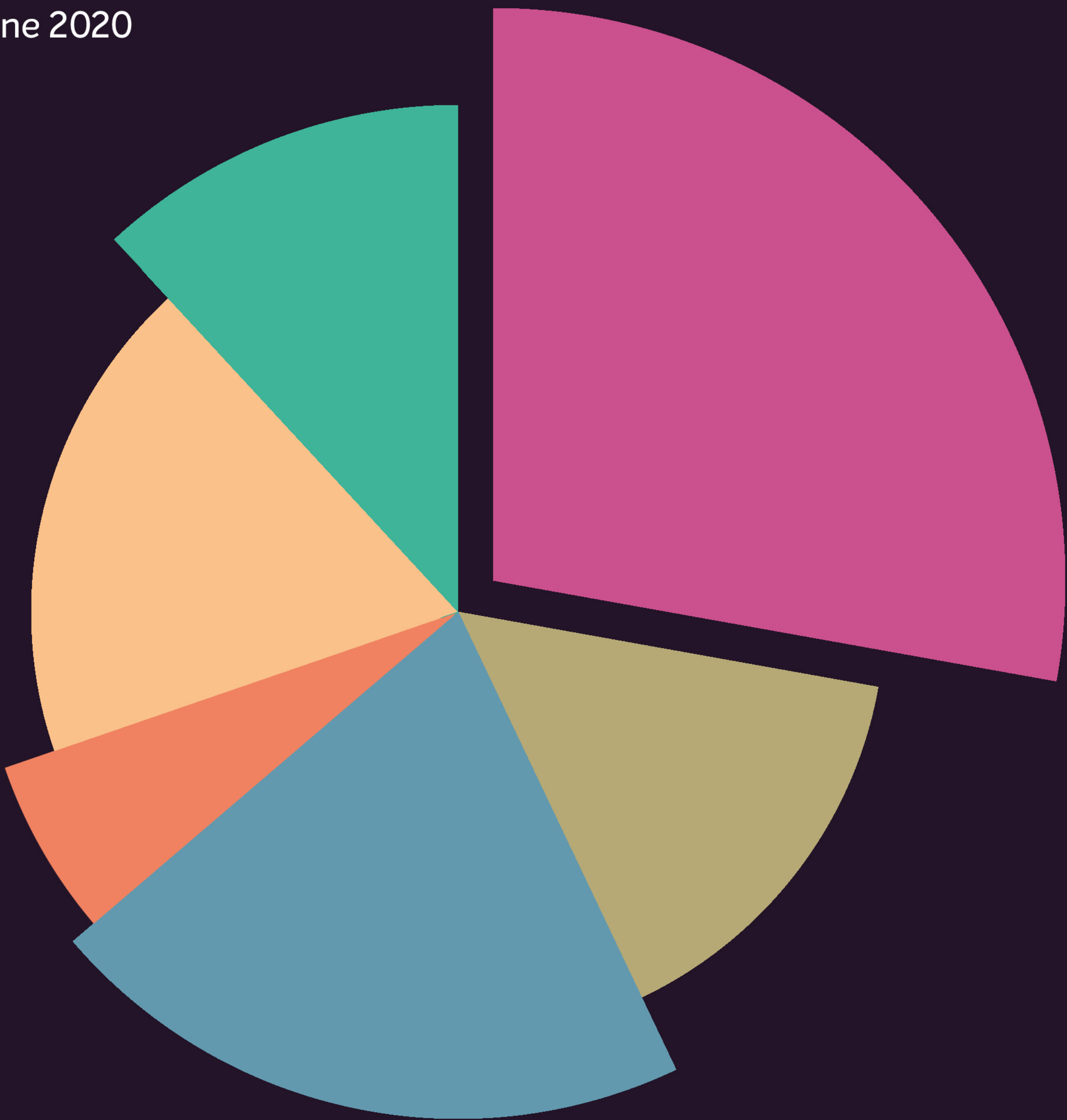

centre for progressive policy

Executive Summary

This report sets out why the government needs to fully compensate local authorities for lost income and additional costs as a result of the Covid-19 crisis before it can turn back to the levelling up agenda.

- The government is yet to give their full financial support to councils for the substantial income losses and cost increases as a result of the Covid-19 crisis.
- According to the Local Government Association (LGA), an additional £6bn is likely to be needed this year by councils. This is beyond the £3.2bn in non-ringfenced funding provided to date for the first three months of the crisis.
- CPP analysis of local government unallocated reserves on the eve of the crisis shows that, despite emergency non-ringfenced Covid-19 funding, 131 upper tier councils (of 151 in England)[1] do not have sufficient funds to make up for projected increased costs and reduced income due to Covid-19. This includes 18 (of the 19) upper tier authorities which significantly feature former Red Wall constituencies.[2] Councils require unallocated reserves as a buffer against ongoing financial headwinds.
- Without full financial support to councils in response to Covid-19, deprived local authorities will be hit hardest. The relative cost of financing the gap in funding per person will be higher in more deprived places whilst the ability of local government to raise additional funds through council tax and business rates will be particularly limited. This is against a backdrop of falling council tax and business rate revenues and constraints in the ability of local areas to raise taxes through the local tax base or borrowing.
- This will compound the effects of a decade of austerity. According to the Institute for Fiscal Studies (IFS), over the past decade, deprived local authorities saw the highest level of service reduction, exactly in the places where council services, including social care, public health, children's services and support for vulnerable families, are needed most. [3]
- As a result, the government needs to recommit to giving its full financial support to councils for Covid-19 losses before it can return to the levelling up agenda. Following a decade of hollowed budgets, historic inequalities in funding and lack of financial flexibility, councils are currently financially unable to respond adequately to the current crisis.
- The government should ensure deprivation and need are the default criteria for the distribution of any further funds to protect the most deprived communities.
- Local government needs to be recognised as central to the levelling up agenda. Looking ahead, once Covid-19 costs have been met, central government should use the HM Treasury Green Book review, Shared Prosperity Fund distribution, Stronger Towns Fund and Fair Funding Review to mainstream levelling up into government decision making and give local areas the opportunity to drive inclusive recoveries in their areas.

Covid-19 puts local government finances in the spotlight

Just three months ago, the government was focused on levelling up the UK economy and reducing the inequalities between places. Then Covid-19 arrived and disrupted all existing plans. This crisis has exposed the existing financial problems faced by local government and deepened them. As a result, local authorities are starting to make very difficult decisions about reductions to services that are already at a limit after a decade of austerity. The government needs to lend its full support during this crisis, before decisions can be made about the longer-term funding of local government and how it will level-up.

A decade of austerity exacerbated inequalities between places in the UK.[4] The existing productivity gaps between local authorities across the UK are the developed world's worst[5] whilst pre-crisis gaps in healthy life expectancy of 16 years between local authorities demonstrate the human cost of an unbalanced economy.[6]

The Covid-19 crisis has added multiple additional pressures on local government. It is dealing with increased demand for existing services whilst delivering new government schemes to support businesses and communities. Meanwhile it has been taking a big hit to

[1] The 151 'upper tier' local authorities in England referred to in this report comprise 33 London boroughs, 36 metropolitan boroughs, 56 unitary authorities and 26 shire counties

[2] A former Red Wall local authority is defined as one in which at least a third of its population also live within a former Red Wall constituency, that is, one which the Conservatives won from Labour in the 2019 election in the Midlands or North of England. This definition includes the following upper tier authorities: Blackpool, Bolton, Bury, County Durham, Cumbria, Darlington, Derby, Kirklees, North East Lincolnshire, North Lincolnshire, Nottinghamshire, Redcar and Cleveland, Rochdale, Rotherham, Sandwell, Stockton-on-Tees, Stoke-on-Trent, Warrington and Wolverhampton. Darlington is the only former Red Wall local authority assessed as having sufficient funding.

[3] Institute for Fiscal Studies (2020) *The Fair Funding Review: is a fair assessment of councils' spending needs feasible?* Available at: https://www.ifs.org.uk/uploads/publications/comms/R148.pdf

[4] Gray, M. and Barford, A. (2018) *The depths of the cuts: the uneven geography of local government austerity.* Available at: https://blogs.lse.ac.uk/politicsandpolicy/the-uneven-geography-of-austerity/

[5] 2070 Commission (2020) *Make No Little Plans: Acting at scale for a fairer and stronger future: Final report of the 2070 commission.* Available at: http://uk2070.org.uk/wp-content/uploads/2020/02/UK2070-FINAL-REPORT.pdf

[6] Centre for Progressive Policy (2019) *Beyond the NHS: Addressing the root causes of poor health.* Available at: https://www.progressive-policy.net/publications/beyond-the-nhs-addressing-the-root-causes-of-poor-health

local incomes on which they have become increasingly dependent. The perfect storm.

How Covid-19 funding for local places is allocated during this crisis matters. The government has rightly responded quickly to help shore-up local finances and has so far provided £3.2bn of direct, non-ringfenced emergency revenue funding.[7] The first tranche comprised social care need criteria and the second tranche population size.[8] According to the Local Government Association this has been sufficient during the first three months of this crisis but more will be needed yet.[9] As it stands more deprived local authorities are set to lose on both the level of funding and its distribution.

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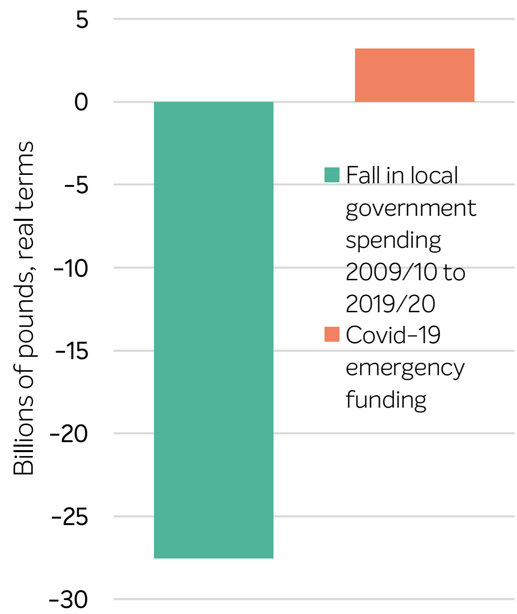
This short working paper seeks to set out how government efforts to respond to the financial pressures caused by Covid-19 could undermine the levelling up agenda and, looking ahead, how the government can address this.

A long-standing hollowing out of local government combined with new Covid-19 pressures

Local government's capacity to coordinate and deliver a response on the ground to Covid-19 has been undermined and hollowed out as a result of a 40% cut in spending on non-statutory services over the past decade. Preventative spend in areas that would have helped boost resilience to Covid-19 has been falling, including an 8% decrease in local public health spending between 2013/14 and 2017/18.[10] But diverting funding away from preventative investment has largely been to ensure the sector is able to meet its statutory requirement to provide social care – a system chronically underfunded as the current crisis has laid bare.

In the aftermath of the last financial crisis, George Osborne's programme of austerity was only meant to last the length of Parliament. In reality it would last a decade, with cuts to council services to 2019/20 ranging from a 70% reduction in expenditure on the regulation of private landlords to a 42% cut to concessionary bus passes. Councils increasingly had to rely on fees and charges during this time to close widening budget gaps, including a 47% increase in local income from car parking charges. All told, the run up to Covid-19 was characterised by a substantial reshaping of council services and budgets.[11]

Figure 1: Covid-19 emergency funding (March-May 2020) compared to reduction in local government spend over the past decade (£bns, real terms)



At the same time, there has been a move away from redistribution between places through the Revenue Support Grant (RSG) towards locally raised revenues, primarily through council tax and business rate retention. Some places have moved towards 100% retention of the growth in business rates, exposing local areas to the success or failure of local business (with some upper and lower floors to that exposure – see Box 1). Whilst many places called for this change, it was anticipated that it would be accompanied by additional levers of policy and financial autonomy. The devolution of economic and social powers, particularly to mayoral combined authorities, has been welcome. But the ability of local government to tailor and strategically coordinate interventions or to enable, incentivise and invest in local outcomes remains limited.

On council tax, councils can increase the level of tax year-on-year, but not beyond a certain level set by central

[7] To put this in context, this represents 3.6% of forecast expenditure of local authorities in 2019/20

[8] Based on ONS population projections for 2020/21. More information available at: https://www.gov.uk/government/publications/covid-19-emergency-funding-for-local-government

[9] Local Government Association (2020) Coronavirus: certainty needed over ongoing COVID-19 funding for vital local services. Available at: https://www.local.gov.uk/coronavirus-certainty-needed-over-ongoing-covid-19-funding-vital-local-services

[10] Buck, D. (2018) Local government spending on public health: death by a thousand cuts. The Kings Fund. Available at: https://www.kingsfund.org.uk/blog/2018/01/local-government-spending-public-health-cuts

[11] Institute for Fiscal Studies (2019) English local government funding: trends and challenges in 2019 and beyond. Available at: https://www.ifs.org.uk/publications/14563

government (currently 1.99% plus 2% adult social care precept for relevant authorities). If they wish to increase council tax beyond this level, they must hold a referendum to do so, following the Localism Act 2011. This means that even in normal times they are increasingly exposed to local financial risk, with limited flexibility to increase revenues.

Meanwhile, councils' income has been falling as a result of Covid-19 from both losses of council tax and business rate revenues. [12] The strain is also being felt in the less publicised area of sales, fees and charges (SFCs). In 2017/18 local government raised £12.7bn from SFCs alone.[13] Expenditure is being stretched too across key services including housing, schools and adult and children's social care.

Just from the current crisis, the size of the local government funding gap could be as large at £6bn this year according to the LGA.[14] This is despite supplementary support from central government, in addition to the £3.2bn non-ringfenced emergency funding, including (but not limited to) business rate relief offered to retail, leisure and hospitality businesses (to be reimbursed by central government), a £600m Infection Control Fund for care homes, a £500m Hardship Fund to provide council tax relief, a £50m Reopening High Streets Safely Fund and a £63m fund for additional welfare support this summer.

Box 1: Business rate retention

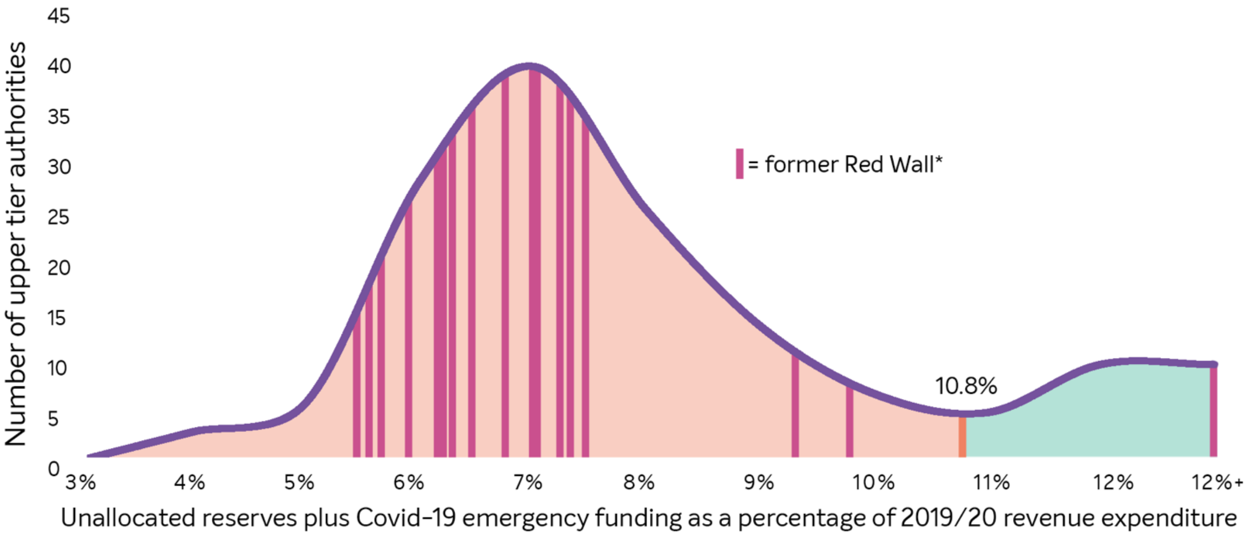
Business rates are a tax levied on business premises. Business rates were previously collected into a single, national pot which was then distributed to local authorities according to the formula grant. This changed in April 2013, following the Local Government Finance Act 2012 and subsequent regulations. The new legislation was an effort to create incentives for councils to promote local business growth by tying their income to it. It gave local authorities the power to keep up to 50% of growth in business rate income, with the remainder going to central government and redistributed in the form of revenue support grants and other specific grants. Since 2017, the government has been piloting 100% retention schemes in certain areas, such that currently over half the population lives in councils which retain all growth in business rate income.[15] The government currently plans to move to this model of full business rate growth retention.

To create a safety net for councils who see their income drop by more than 7.5%, councils face a levy on high business rates growth, the proceeds from which are redistributed.[16] Despite these provisions, the scheme shifts a large amount of risk onto councils compared to the previous business rates arrangement.

During the current crisis, the government has underwritten business rates for all businesses in the retail, hospitality or leisure sectors in England, for one year in 2020/21, to provide some protection to exposure to business failure.

[12] Local Government Association (2020) Coronavirus: certainty needed over ongoing COVID-19 funding for vital local services. Available at: https://www.local.gov.uk/coronavirus-certainty-needed-over-ongoing-covid-19-funding-vital-local-services
[13] Ministry of Housing, Communities and Local Government (2019a) Local Government Financial Statistics England No.29 2019. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/814118/Local_government_financial_stats_number_29_2019_Web_Accessible.pdf
[14] Local Government Association (2020) Coronavirus: certainty needed over ongoing COVID-19 funding for vital local services. Available at: https://www.local.gov.uk/coronavirus-certainty-needed-over-ongoing-covid-19-funding-vital-local-services
[15] Institute for Fiscal Studies (2018) *100% business rate retention pilots: what can be learnt and at what cost?* Available at: https://www.ifs.org.uk/publications/12913
[16] Local Government Association (2015) *Business rate retention: the story continues*. Available at: https://www.local.gov.uk/sites/default/files/documents/business-rate-retention-s-96f.pdf

Figure 2: Distribution of upper tier authorities' level of unallocated reserves plus Covid-19 emergency funding with former Red Wall areas highlighted



*A former Red Wall local authority is one in which at least a third of its population also live in a former Red Wall constituency, that is, one which the Conservatives won from Labour in the 2019 election in the Midlands or North of England

Local government's unallocated reserves provide an insufficient buffer

CPP assessment of councils' unallocated reserves position pre-crisis and post emergency funding shows that **most local authorities do not appear to have sufficient funds to make up the difference between government support and increased costs and reduced income**. In any case, in normal times, councils rely on unallocated reserves as a buffer against ongoing challenges to their finances.

Pre-crisis English upper tier authorities had £2.6bn in unallocated reserves overall (forecast end March 2019/20). Post distribution of Covid-19 emergency funding English upper tier authorities had £5.5bn (in effect)[17] of unallocated reserves (forecast end March 2019/20) representing an average of 7.1% of their revenue expenditure for 2019/2020.

131 upper tier councils (of 151 in England) do not have sufficient funds to cover the crisis, which amount to a projected increase of 10.8% of upper tier councils 2019/2020 expenditure.[18] **This includes 18 (of the 19) upper tier authorities which significantly feature former Red Wall constituencies.**[19]

The LGA have said councils are projected to need £6bn more than the £3.2bn emergency funding provided so far, the equivalent of a total of 10.8% increase in overall expenditure for upper tier local authorities.[20] The London Borough of Hackney has already publicly stated they expected the cost of the crisis to be £72m or a 13% increase in their expenditure.[21] This shows that unallocated reserves are highly unlikely to solve the gap

[17] Councils have been using emergency funding to directly fund services – in would not in practice be held as reserves – this is to illustrate unallocated fund then available to councils.

[18] These 131 councils are those for whom the sum of unallocated reserves (projected end March 2019/20) and non-ringfenced government Covid-19 funding is less than 10.8% of revenue expenditure (budgeted 2019/2020). The 10.8% threshold represents the projected additional requirement for upper tier authorities in 2020/21 of £8.4bn (£2.9bn of the government's initial Covid-19 funding plus the same proportion of the additional spend required as projected by the LGA of £5.5bn) as a percentage of total revenue spend for upper tier authorities in 2019/20 (latest available data) of £78bn.

[19] A former Red Wall local authority is defined as one in which at least a third of its population also live within a former Red Wall constituency, that is, one which the Conservatives won from Labour in the 2019 election in the Midlands or North of England. This definition includes the following upper tier authorities: Blackpool, Bolton, Bury, County Durham, Cumbria, Darlington, Derby, Kirklees, North East Lincolnshire, North Lincolnshire, Nottinghamshire, Redcar and Cleveland, Rochdale, Rotherham, Sandwell, Stockton-on-Tees, Stoke-on-Trent, Warrington and Wolverhampton. Darlington is the only former Red Wall local authority assessed as having sufficient funding. A further 14 local authorities which have a smaller proportion of their residents living in a former Red Wall constituency are not included.

[20] Local Government Association (2020) Coronavirus: certainty needed over ongoing COVID-19 funding for vital local services. Available at: https://www.local.gov.uk/coronavirus-certainty-needed-over-ongoing-covid-19-funding-vital-local-services

[21] Sheridan, E. (2020) *Coronavirus: Town Hall needs tens of millions more in emergency funding, report reveals.* Hackney Citizen. Available at: https://www.hackneycitizen.co.uk/2020/04/21/coronavirus-town-hall-millions-more-emergency-funding/

in funding caused by Covid-19 for either individual councils or the sector as a whole.

The implications for deprived local authorities of Covid-19 funding distribution and levels

The distribution of emergency funding matters, particularly for deprived authorities. The government has so far distributed emergency funds through a mix of criteria. The first £1.6bn was distributed on the basis of social care need and deprivation[22] whilst the second £1.6bn was distributed on the basis of population size.[23] The first tranche alone is unlikely to be able to reflect the differences in deprivation between places. A Ministry of Housing, Communities and Local Government (MHCLG) spokesperson reported to the BBC journalist Lewis Goodall on the 14th May 2020:

"The per capita allocation for the second tranche is a fair and balanced response to the national effort in tackling coronavirus; and there is no evidence to suggest that deprivation drives extra Covid-19 costs".[24]

It is a strong assumption that the financial impact of Covid-19 will be felt evenly across places.

There are certainly Covid-19 related costs that do make the crisis more expensive for deprived local authorities, which suggests distribution of funds should be linked to deprivation, not only population size. For example, on the expenditure side, councils have set out the additional costs of providing emergency food supplies and medicine to those in need, or extra funding for community programmes in more deprived places. Whilst the overall relationship between Covid-19 costs and deprivation has not yet fully emerged, this does not mean it should be dismissed.[25] Given the uncertainty, some form of deprivation weighting is a safer default: the outcome of it being wrong is proactive levelling up and a reduction in inequalities between places.

The level of support also matters for more deprived authorities and yet it remains unclear how far central government is willing to go to reimburse local government for the increased costs and reduced income as a direct result of Covid-19. The government messaging on support for local government has shifted from "whatever is necessary"[26] to "sharing the burden".[27]

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There is a declining level of redistribution between local authorities, which means gaps in Covid-19 funding will disproportionately impact deprived places. A combination of more locally raised finances and a phasing out of the RSG means that the proportionate cost to citizens in more deprived areas of funding the gap post Covid-19 will be much higher, or felt through a higher reduction in services, which deprived areas depend more on.

A lack of local fiscal control increases the likelihood of essential services being cut further in the places that need them most, ultimately to the detriment of the levelling up agenda. Local authorities' have very narrow room for manoeuvre on either business rates or council tax to substantially alter their incomes. The IFS previously found that large spending cuts between 2009/10 and 2016/17 to more grant-dependent (higher needs and more deprived) local authorities led to far larger reductions in services compared to less grant dependent authorities.[28] This means that less than full financial support for authorities during this crisis could end up with deprived authorities cutting services even more than less deprived authorities.

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[22] "Funding for deprived areas is higher not only in pounds-per-resident terms, but also measured as a percentage of spending on adult social care." Institute for Fiscal Studies (2020) *How much emergency coronavirus funding are different councils in England receiving? And is the funding allocation sensible?*. Available at: https://www.ifs.org.uk/uploads/BN282-How-much-emergency-coronavirus-funding-are-different-councils-in-England-receiving.pdf

[23] The second tranche was also split between districts and upper tier authorities

[24] https://twitter.com/lewis_goodall/status/1260712567011409925

[25] Government sources state there is "no evidence" costs are linked to deprivation (see previous citation). Given we have identified multiple drivers that are linked to deprivation, in both ways, this is clearly due to a lack of an evidence base rather than a lack of real effect. As far as we are aware there is no evidence costs are not linked to deprivation.

[26] Ministry for Housing, Communities and Local Government (2020) *Robert Jenrick reaffirms support for councils in their coronavirus response*. Available at: https://www.gov.uk/government/news/robert-jenrick-reaffirms-support-for-councils-in-their-coronavirus-response

[27] Calkin, S. (2020) *Why ambiguity remains over Robert Jenrick's funding promise*. Available at: https://www.lgcplus.com/politics/lgc-briefing/why-ambiguity-remains-over-robert-jenricks-funding-promise-22-04-2020/

[28] "The tenth of councils most dependent on grant funding reduced spending on services by 31% between 2009–10 and 2016–17, compared to 13% for the tenth of councils least dependent on grant funding." Institute for Fiscal Studies (2020) *The Fair Funding Review: is a fair assessment of councils' spending needs feasible?* Available at: https://www.ifs.org.uk/uploads/publications/comms/R148.pdf

What does this mean for Covid-19 funding and the levelling up agenda?

Local government has been dubbed 'the fourth emergency service' during the Covid-19 crisis. Not only has it been delivering its normal services with increased demand, but it has also been the delivery arm of a host of government schemes supporting business, communities, rough sleepers and hospital discharges, all whilst locally raised incomes are down. Central government has reacted at pace to support local councils – but more is expected to be needed in the months ahead to even get them back to where they started pre-crisis. Without additional support, deprived local authorities are again going to be hit hardest, leading to bigger service cuts in places where they are needed the most.

As a result, we recommend that the government must urgently recommit to giving its full financial support to councils for Covid-19 lost revenues and increased costs this year which is anticipated to require a further £6bn this financial year. Additional funds should be distributed by default based on deprivation.

Without this commitment, this crisis will compound the problems local and central government already face in levelling up by undermining their ability to address decades-old economic and social inequalities. As it stands, local government has limited capacity to improve its own financial fortunes; risk is being devolved down, redistribution phased out and the ability to raise funds locally is limited, including a legal requirement for councils not to run budget deficits. The combination puts local government in an impossible bind without further support.

In addition, we also recommend that MHCLG publishes in year updates to local government financial data

Looking ahead, MHCLG Secretary of State Robert Jenrick has promised that the government will "return with gusto to the levelling up agenda". Whilst the government is yet to fully describe what is intended to happen through levelling up, local areas across the UK are increasingly hopeful the agenda will be used to address inequalities of funding and outcomes wherever they exist within and between regions.

Beyond the immediate Covid-19 support, and once the government has fully addressed its financial impact, there are several major opportunities upcoming to demonstrate its financial commitment to the levelling up agenda, in addition to any emergency budget or Spending Review:

- **HM Treasury Green Book Review** – Treasury is currently reviewing the impact of the Green Book on government policy making and investment decisions. In order to bring in the levelling up agenda, as it intends, we recommend that it emphasises the importance of measuring the place-based distribution of benefits of policy and that it requires a measure of 'place-based levelling up' to sit alongside the Benefit Cost Ratio;
- **Shared Prosperity Fund** – due in autumn 2020, the government will need to decide how it is allocated between the countries and regions of the UK and where it is administered. We suggest this should be based on need, assessed by a diversity of indicators (see the five tests set out in CPP's recent report, *Back from the brink*)[29] and administered locally;
- **Stronger Towns Fund** – with deals expected to be announced later this year, two thirds of the £1.6bn Fund is currently to be distributed based on need, whilst £0.6bn is set to be distributed through a competitive bidding process. Levelling up towns across the UK should be the primary criteria, which means it should be all distributed based on need;
- **Devolution White Paper** – due in autumn 2020, the Devolution White Paper could provide greater flexibilities to mayoral combined authorities or local authorities to borrow money to fund borrowing for projects other than capital investment for more than a year. This would need to be considered alongside further fiscal devolution and appropriate redistribution between places.
- **Fair Funding Review (FFR)** - central grant funding is being phased out for local authorities. In 2019/20 only 19% of total council revenue came from a central source. The move towards a system where local places rely on locally raised revenue will likely lead to an increasing gap between the funding of local areas, leaving deprived areas more exposed. Therefore, the FFR's assessment of business rate baselines (which provide each council's starting point for the business rate retention system) will be critical in ensuring more deprived places do not lose out. It should ensure that the distribution system adequately reflects deprivation and will need to take business failures during Covid-19 properly into account.

The government urgently needs to change its thinking and methods so that levelling up to reduce inequalities between places is the default impact of all government policy. To stand a chance of achieving this, the government must first ensure that councils are – at least – in no worse a position than when they entered the current crisis, both to enable them to take their role at the forefront of an inclusive recovery and a longer term levelling up of the UK.

[29] Centre for Progressive Policy (2020) *Back from the brink:* Avoiding *a lost generation*. Available at: https://www.progressive-policy.net/publications/back-from-the-brink

Acknowledgments

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About the Centre for Progressive Policy

The Centre for Progressive Policy is a think tank committed to making inclusive economic growth a reality. By working with national, local and international partners, our aim is to devise effective, pragmatic policy solutions to drive productivity and shared prosperity in the UK.

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