REFORM

SELECT COMMITTEE SUMBISSION

Reform Think Tank's submission to the Housing, Communities and Local Government Committee's inquiry into the Funding and Sustainability of Local Government Finance

About *Reform*

Reform is established as the leading Westminster think tank for public service reform. We believe that the State has a fundamental role to play in enabling individuals, families and communities to thrive. But our vision is one in which the State delivers only the services that it is best placed to deliver, within sound public finances, and where both decision-making and delivery is devolved to the most appropriate level. We are committed to driving systemic change that will deliver better outcomes for all.

We are determinedly independent and strictly non-party in our approach. This is reflected in our cross-party Advisory Board and our events programme which seeks to convene likeminded reformers from across the political spectrum.

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A. Is the local government finance system fit for purpose? If not, what needs to change?

The local government finance system is not currently fit for purpose.

1. **Mismatch between funding and needs**: The system fails to adequately align funding with the varying needs of local authorities. Our report highlights research by others that found a projected combined deficit of £9.6 billion by 2026-27 across the sector, with only 14 out of 317 councils expecting to balance their budgets (in calculations prior to the Budget and draft Finance Settlement). This discrepancy is particularly acute in deprived areas, with less scope to make up the difference with permitted increases to council tax, leading to significant financial strain.
2. **Inadequate incentives for long-term financial planning**: The existing funding framework discourages local authorities from making sustainable, long-term financial decisions. Due to fragmented and short-term funding pots, councils are compelled to focus on immediate crisis management rather than investing in preventative measures or innovative solutions that could reduce future costs. This reactive approach undermines the ability to serve residents effectively over the long term.
3. **Impact of multi-year funding settlements**: The promised introduction of multi-year funding settlements is a positive step towards providing financial predictability.

However, without accompanying reforms, enhanced fiscal autonomy, and an increase to overall funding levels, these settlements may only offer temporary relief. Councils additionally need flexibility within these settlements to invest in prevention and long-term planning, which are essential for sustainable financial health.

4. **Successful elements to build upon**: Strategic or Combined Authorities that have successfully pooled resources for large-scale projects, such as housing and social care initiatives, demonstrate the potential benefits of collaboration and scale. These successes indicate that expanding regional planning and resource pooling could enhance efficiency and innovation across the sector.

B. Where are the most significant funding pressures in local government, and how does the finance system address them?

The most significant funding pressures arise from statutory services:

1. **Adult social care**: This area faces escalating costs due to an ageing population and increasing complex care needs. It is estimated that funding for adult social care must rise to between £14.6 billion and £18.4 billion by 2032-33 to meet future demand. Current funding mechanisms, including the Adult Social Care precept, are insufficient to cope with increasing costs even following recent increases, and social care spending increasingly consumes disproportionate amounts of local authority budgets.
2. **Children's services**: High costs in children's services, particularly for residential care, place substantial pressure on local budgets. The average weekly expenditure per child in residential care is nearly £3,100, with rising costs driven by increased reliance on private providers operating with high debt levels. This reliance creates inefficiencies and market instability, exacerbating financial challenges for councils tasked with meeting statutory obligations.
3. **Homelessness**: The cost of providing temporary accommodation has more than doubled over the past decade, driven by rising evictions, insufficient affordable housing, and increased demand. The Temporary Accommodation Subsidy remains outdated and fails to cover the escalating costs, forcing councils to divert funds from preventative measures to crisis management. This shift limits the ability to address the root causes of homelessness effectively.
4. **Systemic shortcomings in addressing pressures**: The current finance system inadequately addresses these significant funding pressures due to fragmented grants and rigid revenue-raising constraints. Councils are often forced to prioritise statutory services over innovation and long-term savings, perpetuating a cycle of financial instability and escalating service demands.

C. Does the current statutory regime for identifying and responding to financial distress in local authorities support local authorities to get out of financial distress?

The current statutory regime offers limited support for local authorities in financial distress.

1. **Effectiveness of Government interventions**: Exceptional Financial Support (EFS) packages have provided temporary relief to some councils, helping them avoid issuing Section 114 notices. However, these interventions are reactive and do not

address the underlying causes of financial distress, such as chronic underfunding and high service demands, thereby offering only short-term solutions without fostering long-term stability.

2. **Gaps in support mechanisms**: The New Burdens Doctrine requires central government departments to justify new responsibilities and their funding, but it is criticised for being unreliable and inadequately consultative. Our report recommends revising this doctrine to ensure councils receive adequate resources for new duties and developing readiness plans to better prepare councils for additional responsibilities, mediated by an independent entity.
3. **Factors leading to financial distress**: Financial distress in councils is often the result of a combination of high service demand, significant funding cuts, and poor financial decisions, including risky commercial investments. Such investments are likely the result of financial constraints compelling authorities to find alternative sources of revenue, and thus taking unusual risks. Councils in deprived areas are particularly vulnerable due to lower revenue generation from local taxes and higher service demands, exacerbating their financial instability.
4. **Proposed broader support system**: In our work, we advocate for a comprehensive support system that includes early identification of financial risks, tailored interventions for distressed councils, and mechanisms for resource redistribution within regions. Such a system would provide more proactive and sustained support, helping councils to stabilise their finances and avoid future distress.

D. How much control do local authorities have over the levels of funding they receive, including from local taxation, business rates, central Government grants, and returns on commercial investments?

Local authorities have very limited control over their funding sources.

1. **Local taxation constraints**: Council tax is heavily regulated by central government. Additionally, business rates retention is capped, with councils retaining only 50% of business rates revenue while the other half is redistributed by central government, limiting their ability to generate substantial local revenue. On top of this, councils cannot independently set tax rates, bands, or discounts. We recommend much greater levels of autonomy to vary local tax regimes.
2. **Differences based on authority type and devolution agreements**: Control over funding varies among different types of local authorities and those with distinct devolution agreements. Some combined authorities have negotiated better retention rates for business rates, but these are exceptions rather than the norm. This variability creates disparities in funding autonomy and financial resilience across regions.
3. **Impacts of statutory restrictions on capital returns**: Statutory restrictions prevent councils from using capital returns, such as proceeds from asset sales, as revenue funding. This limitation hinders councils' ability to leverage their assets to address budget deficits or invest in strategic projects. While intended to ensure financial prudence, these restrictions reduce flexibility and limit potential revenue streams for local authorities.

4. **Recommendations for increased fiscal autonomy**: Our paper suggests replacing business rates with a Land Value Tax (LVT) and allowing councils to retain a greater share of locally raised income tax. These measures would significantly enhance fiscal autonomy, enabling councils to better align their revenue sources with local needs, incentivise economic activity, and reduce dependence on central government grants.

E. How much control do local authorities have over their costs, including on mandatory services (which they are required to deliver by statute) and demand-led services (for which the level of cost is determined by the needs of residents)?

Local authorities face significant constraints over their cost structures.

1. **Mandatory services dominance**: Statutory duties such as adult social care, children's services, and homelessness obligations consume the majority of local budgets. This dominance leaves little room for discretionary spending or flexibility in resource allocation, forcing councils to prioritise these mandatory services over other community needs.

2. **Increasing demand for services**: The demand for mandatory services has surged due to demographic changes like an ageing population and increased needs in areas such as social care and homelessness prevention. This rising demand drives up costs, making it difficult for councils to manage their budgets effectively and forcing them to divert funds from preventative measures to meet immediate service obligations.

3. **Impact of cost-cutting measures**: When faced with budget constraints, councils often resort to cutting non-mandatory services such as libraries, youth programs, and cultural activities. These cuts disproportionately impact vulnerable populations and reduce the overall quality of life for residents, leading to long-term social and economic consequences.

4. **Flexibility in service delivery**: While councils have some autonomy in how they deliver mandatory services, they are constrained by statutory requirements and funding limitations. This restricts their ability to innovate or adapt services to better meet local needs, perpetuating inefficiencies and limiting the potential for improved service outcomes.

5. **Recommendations for enhanced cost control**: Our report advocates for increased fiscal autonomy (on top of the now-introduced multi-year funding settlements) that allow councils to plan and invest in preventative projects. By freeing up resources from rigid funding structures, councils can better manage costs and focus on long-term sustainability and service improvement.

F. How well does the Government understand the consequences of funding and mandatory service decisions?

The Government's understanding of the consequences is fragmented and insufficient.

6. **Short-term focus in policy decisions**: Government policies tend to prioritise immediate financial relief over addressing systemic issues. For example, funding allocations for homelessness focus on crisis management rather than investing in

affordable housing or preventive measures, which are essential for long-term stability. This short-termism fails to tackle the root causes of financial distress in local authorities.

7. **Inadequate consultation and understanding**: The New Burdens Doctrine is criticised for lacking genuine consultation with local authorities and failing to recognise fluctuating costs. This disconnect leads to disputes over funding adequacy and does not account for the diverse financial landscapes of different councils. Such inadequate understanding hampers effective policy implementation and support.
8. **Impact on service delivery and regional disparities**: The Government's policies do not fully consider the unique challenges faced by councils in deprived areas, where lower revenue generation from local taxes meets higher service demands. This oversight exacerbates regional disparities, making it difficult for less prosperous councils to maintain service quality and financial health.
9. **Recommendations for improved understanding**: *Reform Think Tank* calls for a more comprehensive and consultative approach to policymaking, ensuring that funding decisions are informed by the realities faced by local authorities. This includes revising the New Burdens Doctrine to incorporate readiness plans and independent assessments, fostering a better alignment between central policies and local needs.

***Reform* has published the following papers on the financial sustainability of local government**

'Back from the brink: radical ideas for sustainable local finances'[1]

'Accounting for failure: rebuilding the local audit system'.[2]

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[1] Simon Kaye et al., *Back from the Brink: Radical Ideas for Sustainable Local Finances* (Reform, 2024).
[2] Sean Eke and Simon Kaye, *Accounting for Failure: Rebuilding the Local Audit System* (Reform think tank, 2024).