SOUTH EAST ENGLAND COUNCILS
EXECUTIVE MEETING

Date: 9 December 2011

Subject: **Fair funding: Progress report and draft SEEC recommendations for change**

Report of: Heather Bolton, SEEC Director

Recommendations:
SEEC Executive members are asked to:
i) Note headline findings from the second stage of Local Government Futures' research
ii) Discuss and agree SEEC's emerging recommendations for changing the local government finance system
iii) Comment on the outline format for a SEEC report to Ministers to support recommendations with background evidence and examples, showing unfair funding of South East councils.

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1. Background

1.1 SEEC members are keen to make the case to Government for changes to the local government finance system. Under the current system South East local authorities do not believe they receive a fair funding deal compared to local authorities in other areas of the country.

1.2 Earlier this year the SEEC Executive commissioned Local Government Futures (LGF) to prepare a two stage report on the local government finance system. The LGF work will provide a strong, independent evidence base to support SEEC members' recommendations for changes to the system. A first draft of SEEC's recommendations is presented today for member discussion and approval (see section 3).

2. Local Government Futures' work

2.1 Stage 1 focused on flaws in the system and funding for South East authorities compared to other areas of England. Findings reported to SEEC Executive in June 2011 showed the local government finance system is no longer fit for purpose and needs a radical overhaul to make it fairer and more transparent. They also showed per capita levels of funding in the South East are consistently lower than in other areas of England, affecting revenue, capital and individual service budgets. The South East has also seen rising deprivation and faces higher than average costs for delivering many services.

2.2 Stage 2 focuses on illustrating possible changes to the local government finance system and the impact these could have on funding for South East local authorities. It also looks at proposals for business rate retention and the role and potential of a range of additional financial incentives for councils. The final report is now nearing completion. Key findings include:

- Government's business rate retention proposals would offer only minimal incentives for South East councils. After allowing for inflation, a total of just £8.6m would be available to share between all 74 South East authorities. This is based on an analysis of 5-year growth, including years of strong economic performance. This information has already been included in the SEEC response to Government consultation on business rate retention.

- Funding per 'unit of need' is not allocated equally. Councils above a threshold receive more per unit than councils below the threshold. For example Wokingham receives 18% less funding per unit than the national average. On average South East councils receive 4.7% less funding per unit than the national average. Councils in London receive 3.9% more per unit than the national average. SEEC will draw on this as an example of the unfair underfunding of many South East local authorities.
- The current system is both highly unpredictable and opaque. Unpredictable funding makes it very difficult for councils to plan ahead and lack of knowledge about the decisions taken within the formula undermines accountability. For example, halving the weighting given to deprivation in the funding formula would deliver <u>more</u> money to inner London boroughs, traditionally perceived to have high levels of deprivation. SEEC will argue that such a volatile and unpredictable system is not capable of responding to councils' actual needs and undermines attempts at scrutiny.
- The damping system protects previous spending levels and so prevents councils from receiving changes in funding related to their changing needs. SEEC will use evidence of the distorting effect of damping to argue for a new time-limited transition system to replace damping.

3. Draft SEEC recommendations

3.1 Building on workshop discussions with SEEC members and finance officers, and the evidence base provided by LGF, several recommendations are emerging as SEEC priorities for changing the local government finance system. These are set out below for member comment:

i) Ministers should commit to working with councils on a fundamental review of local authority financing to create a new system that will stand the test of time. Current minor reviews are welcome recognition that the system is broken but we support a bolder approach to fundamental reform.

ii) Create a transparent, accountable grant system with a clear, demonstrable link between what local residents & businesses pay and the services they receive. Central to this is publishing data and weightings that underpin funding decisions.

iii) Design a system based on <u>absolute need</u> (ie numbers of people) – not on the current <u>relative needs</u> (ie percentages) – and ensure all authorities receive equal funding for each unit of need to reduce disparities. This will ensure the new system responds to authorities' actual need to spend on services rather than relying on a complex formula tied to relative rankings where changes in one authority can have a significant impact on all other authorities.

iv) Focus on a small number of key funding streams and remove the level of duplication that distorts allocation of funds in the current system.

v) Replace damping with a time-limited transition to new system. The reliance on damping year after year simply perpetuates previous levels of funding rather than responding to councils' current need to spend.

vi) To deliver shorter term political priorities, establish a small number of financial incentives for local authorities. Incentives must be clearly focused on desired outcomes and must offer genuine benefits to local authorities and their residents without unnecessary duplication of existing core funding streams.

vii) Help achieve the aim of self funding councils by allowing authorities greater local control over business rates. Council tax only raises a small proportion of funding and the current system of centrally-controlled business rates means there is no link between a council's business rate tax base and its need to spend. In a more locally focused system such as this, Government could use national tax income (such as VAT) to top up funds for councils collecting less than they need. This offers an alternative to current equalisation methods.

viii) Help maximise the benefit of public spending by giving local authorities powers to encourage co-operation between agencies on community budgets as a way of reducing spending duplication.

ix) Establish a review body comprising leading politicians and officers from councils across the country to assess the fairness and reasonableness of each local government funding round.

4. Outline structure for SEEC report to Ministers

4.1 The SEEC recommendations for changing local government finance will be supported by a short, focused report for Ministers. Member views are requested on the outline structure for this report:

- Chairman's introduction
- SEEC recommendations
- Illustrating the cost of an inequitable finance system. This chapter will include narrative and examples to demonstrate:
    - Need is not counted or funded equally
    - Funding bias towards metropolitan areas
    - Undue pressure on South East council tax
    - Population pressures are undervalued
    - Absolute need must replace relative need
    - Damping disguises the real level of need
    - London's contribution to increasing South East costs
    - The personal and economic cost of an unfair system in the South East
- Financial incentives – the need to maximise benefit and reduce complexity
- Conclusions.

4.2 Subject to members' approval and input from officers to help refine specific local examples, the target date for completing the full draft report to Ministers is late January/ February 2012. A launch and PR programme will be planned for spring 2012 to raise awareness of the recommendations and supporting report.