# Fair Funding

*Levelling up local government finances*

Chris Tambini

LEVELLING UP TASKFORCE

ONWARD

# About Onward

Onward is a campaigning think tank whose mission is to develop new ideas for the next generation of centre right thinkers and leaders. We exist to make Britain fairer, more prosperous and more united, by generating a new wave of modernising ideas and a fresh kind of politics that reaches out to new groups of people. We believe in a mainstream conservatism – one that recognises the value of markets and supports the good that government can do, is unapologetic about standing up to vested interests, and assiduous in supporting the hardworking, aspirational and those left behind.

Our goal is to address the needs of the whole country: young as well as old; urban as well as rural; and for all parts of the UK – particularly places that feel neglected or ignored in Westminster. We will achieve this by developing practical policies that work. Our team has worked both at a high level in government and for successful thinktanks. We know how to produce big ideas that resonate with policymakers, the media and the public. We will engage ordinary people across the country and work with them to make our ideas a reality.

Onward is an independent, not-for-profit thinktank, registered in England and Wales (Company Registration no. 11326052).

## Thanks

The authors would like to thank Sir Mick Davis and the Blavatnik Family Foundation for their support for Onward's Levelling Up programme.

Onward's research programme is supported solely by the generosity of our network. We are indebted, in particular, to our Founding Patrons: Martyn Rose, Michael Spencer, David Meller, Bjorn Saven, Richard Oldfield, Robert Walters, Tim Sanderson, James Alexandroff, Jason Dalby, Graham Edwards, John Nash and Theodore Agnew. Without this philanthropic support, our work would not be possible.

# Summary of the argument

Local government funding is comprehensively broken. Allocations today are still linked back to historic spending levels - rewarding those who spent the most on services decades ago. This means that taxpayer funding is increasingly badly matched to demand and need, exacerbating existing imbalances between different places.

There are a lot of components of the current system that are woefully out of date. The most significant example of this is that council tax bands are still based on 1991 property values. But this is just one element based on historic data that distorts funding today. For example, the funding allocation model used today dates back to 2006/07 where changes brought in reduced transparency and the link between assessed need and funding.

Up until 2013, some of the key data elements were updated annually. However, from 2013 no further updates have been incorporated and, furthermore, much of the data feeding into the 2013 model was much older. For example:

- Traffic flow data was based on flows observed in 2009 to 2011.
- Child tax credit information was based on amounts received between 2008 and 2011.
- Unemployment data is based on claimant numbers between 2009 and 2012
- The Highways formula (which reflects winter maintenance pressures) includes data relating to the “number of days with snow lying” and “predicted number of gritting days” that is based on averages between 1978-1990 and 1991-2002 respectively. Climate change has seen to the ongoing relevance of that data.

And there is a raft of variables still based on 2001 census data (as the current formula was devised too early to incorporate 2011 data). These include a whole range of indicators which feed into measuring relative deprivation and other measures of need, including but not limited to:

- Country of birth
- Population density and sparsity
- One-person and single parent households
- Children in good health
- Number of rooms per household resident
- Net inflow/outflow of persons working but not resident

These methodological faults in the system contribute directly to a flawed set of allocations to local authorities every year. The vast majority of the data is at least 10 years old and much of it is much older still. A lot can happen in an area in the space of ten years: just look at Stratford in London or Salford in Manchester in the last ten years. It is absurd to still be determining each local authority’s funding level based on data that was collected a decade or more ago.

The system has never been popular. The House of Commons Committee of Public Accounts described the system as “highly complex and not sufficiently transparent, making it virtually impossible to follow the link between calculated service needs and funding allocations.”[1] DCLG has acknowledged that the grant system is “extremely complex.”[2] Even more critical were academics at the University of Plymouth who argued that “behind this complexity the model is, in fact, deeply flawed.”[3]

There is another reason for reforming local government finance. The current system of council tax is regionally highly regressive, benefiting more prosperous regions and adding disproportionate cost in poorer regions. For example:

- Average council tax per head in London is the lowest in England (£481), despite house prices being much higher in the capital than elsewhere.
- Per capita council taxes in London are a fifth lower than in much poorer regions such as the East of England (£593) and South West (£620).
- Council tax as a share of disposable income (GDHI) in London (1.64%) is the lowest in the UK, and just over half that of Yorkshire and the Humber (3.06%) and the North East (2.91%).

These problems are so fundamental that a comprehensive rethink is needed. The Government has already committed to a fundamental review of local government finances. Understandably, it has slipped due to the global pandemic we have experienced over the last year. But we emerge from the grip of coronavirus it is imperative that the Government grasp the nettle once again.

This need not mean reviving the wholesale reform proposed by the Fair Funding Review, although in the long-run fundamental reform of local government financing will be necessary. In the immediate term, the Government could introduce an interim measure, to level up local authority funding to a more sustainable level. By introducing a funding floor, as recently introduced for school funding, the Government could quickly bring the least well-resourced local authorities up to a respectable level without the considerable political risk and fiscal cost of revising the entire funding system in one go. If this were set at 90% of the average core spending power of local authorities, we estimate the costs of this to be around £300 million a year, with around 30 poorer local authorities mainly based in the Midlands and the North of England benefiting from the change.

---

[1] House of Commons Committee of Public Accounts, Formula Funding of Local Public Services: Fifty-fifth Report of Session 2010-2012, 2011, p.7
[2] Cited in National Audit Office, Cross-government landscape review: Formula funding of local public services, 2011, p.26
[3] 17 Cited in Gibson, A. and Asthana, S., Resource allocation for English local government: a critique of the four block model, Journal of the Royal Statistical Society, 2011, p. 530

# The challenge

Funding for local government has always been a difficult issue. No local taxation measure is ever popular, and the biggest challenge has always been to ensure the system allows an appropriate level of equalisation - balancing each authorities' relative levels of service pressures against their capacity to generate funding locally. As research for Onward has shown, council tax cuts are among the most popular of any tax cuts, driving down local tax revenue and increasing demand on the core funding formula over time.

Any changes to a system are problematic as they create winners and losers – and the losers always shout the loudest. We have seen this repeatedly in recent years, not only in local government but also in changes to the police funding formula in 2015/16. It is therefore extremely difficult to make wholesale changes to funding formulae of any kind, and several attempts have eventually been abandoned in the face of opposition. This is one reason why the current formula is so out of date.

Funding allocations have been traditionally calculated based on regression analysis against previous spending levels. This means that those authorities who have spent the most historically will be rewarded with higher levels of funding going forwards. Because successive governments have been reluctant to make significant changes to funding distribution, historic spending levels are still baked into the underlying drivers of funding allocations even today. The net result is that the "haves" continue to benefit and the "have-nots" continue to suffer.

It is time for a brave government with a sizeable majority to address this challenge and fundamentally review the whole system. Doing so would not only better reflect the needs of different communities, in the process helping areas to level up, but also ensure that better resourced local authorities continue to innovate to deliver value for money and better services.

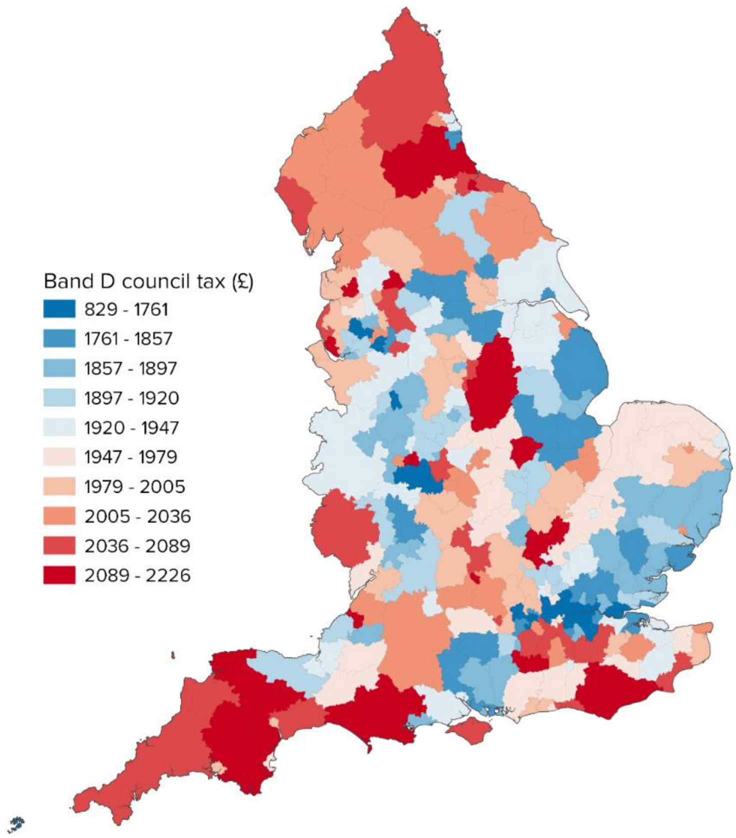
## 1. The current system and the Fair Funding Review

It is no wonder that the current system of local government funding provides such an unreasonable distribution of funds. Council tax levels range from less than £800 for a Band D property in Westminster and Wandsworth to well over £2,000 in a number of rural areas. It is extremely hard to come up with a justification for this variance, especially given the relative affluence of many of the lowest council tax areas and the relative deprivation of those with the highest rates.

We should remember Council Tax is supposed to be linked to the value of the property so these numbers should be close, differences solely being down to the different levels of service provision between the areas. But clearly this isn't the case. The majority of revenue budgets are spent on demand-led services. Service levels in rural areas aren't two and a half times higher than the levels in London

Boroughs. In fact, there is plenty of evidence that indicates London Boroughs have higher service levels.

**Figure 1: Band D council tax by local authority, 2021/22**
*Source: MHCLG*




The unfairness of the current system is demonstrated by the fact that a person living in a Band H Property in Westminster worth many millions of pounds pays less council tax than a person in a modest Band C property in Coalville in Leicestershire. This just cannot be right.

On average Band D Council Tax in Inner London is £1,320 whereas in all areas outside London the average is £1,863 – 41% higher. This is despite property prices in the capital being, on average, around double the average in the rest of the UK. And despite raising much lower levels of council tax, core spending power in Inner London is still 24% higher per head than outside London, reflecting a far more generous allocation of government grant and business rates. It is also interesting to note that council tax in London represents 1.6% of gross disposable household income but in the rest of England the figure ranges from 2.6% to over 3%.

## 2. The misallocation of core spending power

Partly as a result, the core spending power (CSP) of individual authorities varies considerably. If Leicestershire had the same CSP as Kensington and Chelsea it would be £384m a year better off. The current system means that local authorities such as Warrington, Staffordshire and Leeds have low core spending power whilst Islington and Westminster have high CSP. This defies comprehension given the relative needs of the populations of those places – and actively militates against the Government's ambitions to level up.

The extent to which Core Spending Power does not follow expected drivers of demand can be seen in the two graphs below. CSP per head is presented along the x-axis of each chart, with individual indicators presented along the y-axis. A more dispersed, random distribution of points implies a weaker association between funding and relevant need, while a more linear, tighter distribution implies a stronger association. The City of London and Isles of Scilly were omitted from the analysis as their comparatively high funding places them as outliers.

As you can see, on both measures of age-related demand and deprivation, the relationship is the inverse of what we would expect. Places with higher levels of core spending power typically have lower share of population aged 65 or over and separately are ranked higher for multiple deprivation.

**Figure 2: CSP per head vs population aged over 65**

*Source: Annual Population Survey, Onward calculations*

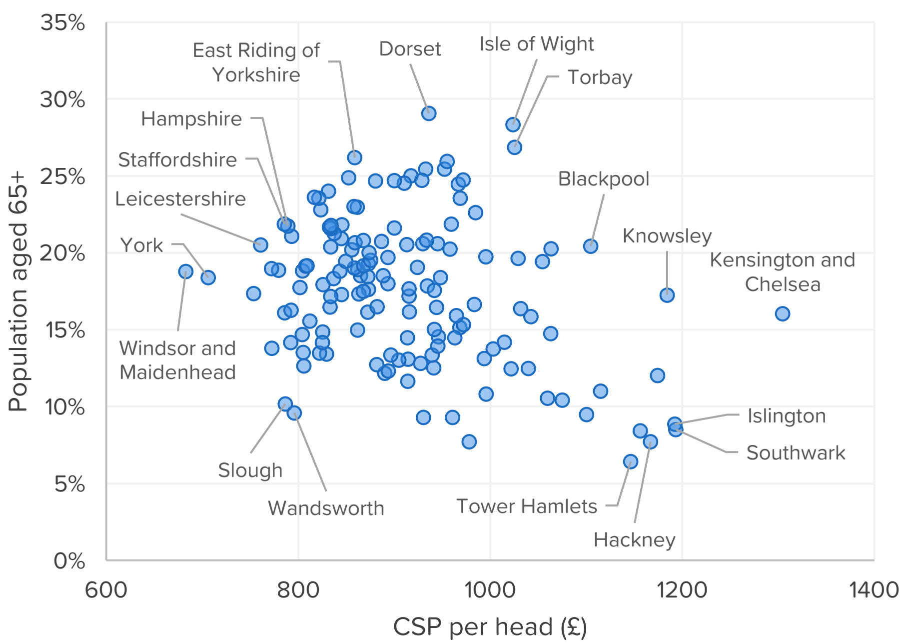


**Figure 3: CSP per head vs deprivation (IMD rank)**

*Source: ONS, Onward calculations*

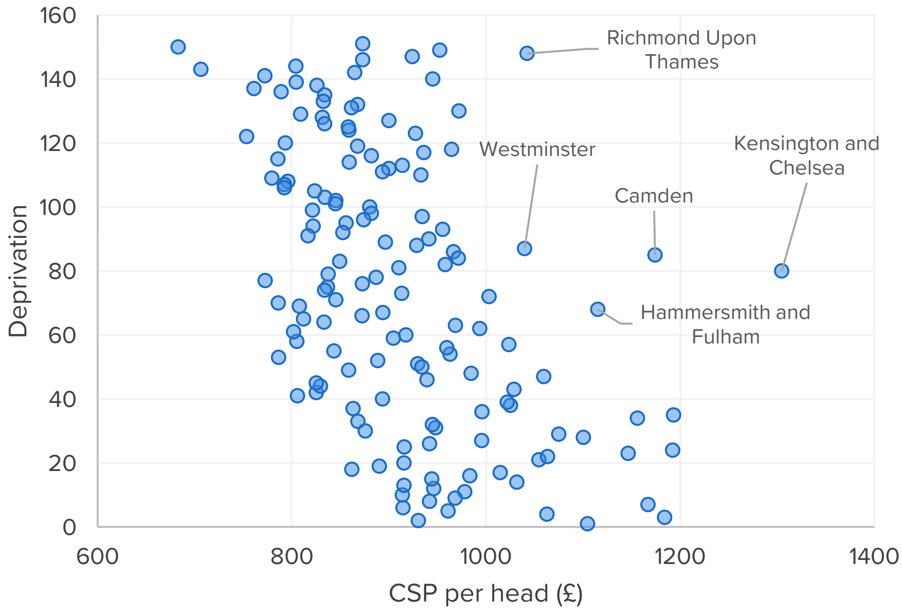
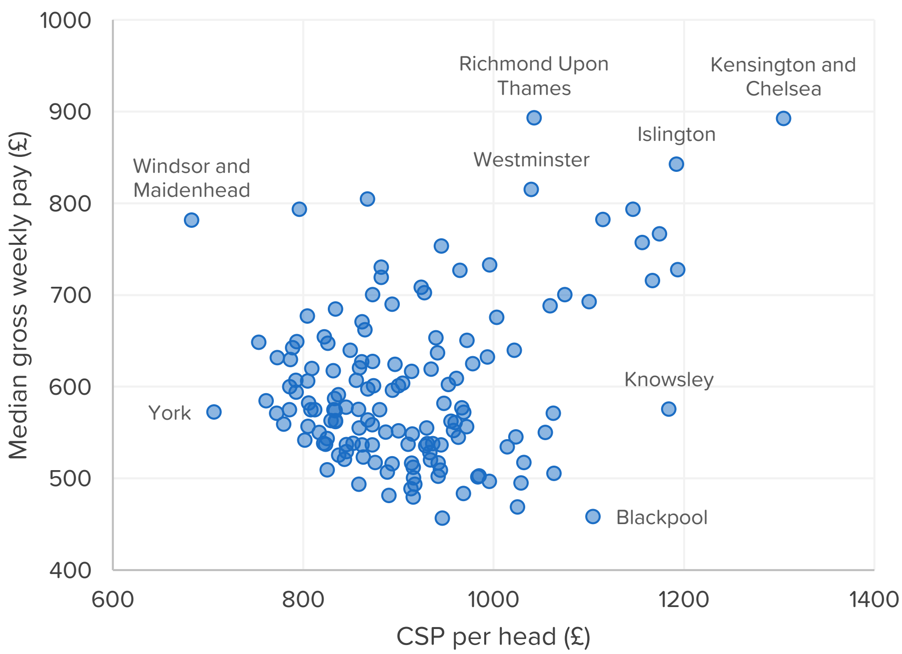



**Figure 4: CSP per head vs gross weekly pay**

*Source: Annual Survey of Hours and Earnings, Onward calculations*



At the same time, we can see below there is a loose positive correlation between CSP per head and gross weekly pay, as London Boroughs again skew the distribution. Generally, these areas receive above average funding, yet exhibit some of the highest gross weekly pay across all authorities.

For example, Kensington and Chelsea is the highest funded authority in England, whilst experiencing one of the highest weekly pay levels. At the same time, Leicester experiences gross weekly pay well below the average for all authorities, whilst at the same time being one of the lowest funded authorities in the country.

Looking at data on employment rate, there is almost no association between CSP per head and employment rates. Lewisham has one of the highest employment rates in the country, but conversely receives one of the higher rates of per head funding.

At the same time Slough has an employment rate well below the average across all authorities, but is one of the lowest funded authorities in England, while Birmingham is funded at around the average rate for all authorities whilst having one of the lowest employment rates in the country.

Finally, we can explore the correlation between spending power and data on population change to 2026. Here, there would again appear to be no real association with funding. Overall, London Boroughs are projected to have higher rates of population change, and receive some of the highest rates of funding. However, there are notable outliers; Kensington and Chelsea are projected to have a population decrease (-0.3 percent), but is the highest funded authority, while Leicestershire (9.0 percent) is projected to have an above average increase to 2026, at the same time being below average for funding. In fact, excluding London, there appears to be a loose negative association between population change and funding.

**Figure 5: CSP per head vs employment rate**

*Source: Annual Population Survey, Onward calculations*

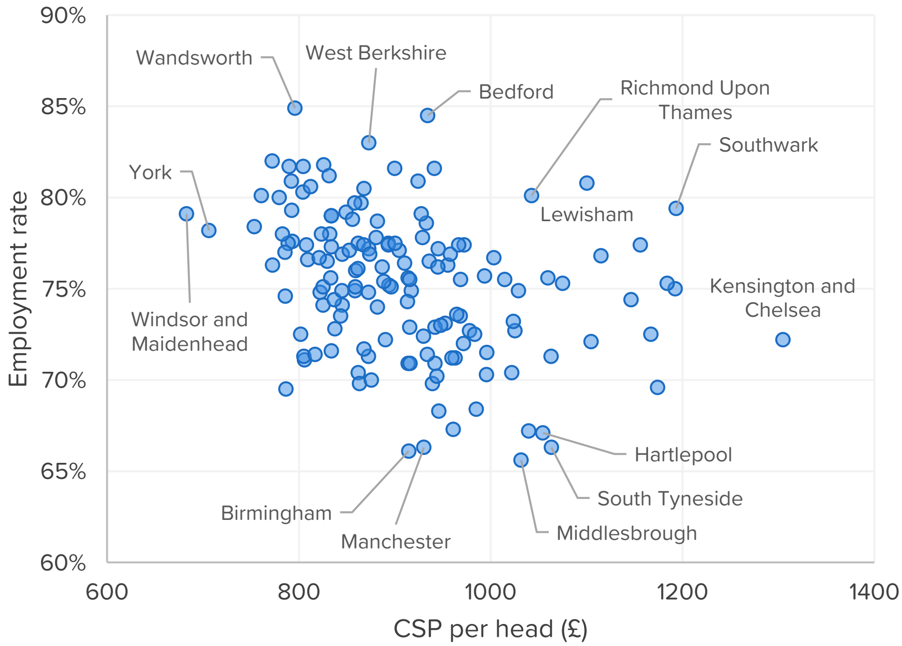



**Figure 6: CSP per head vs projected population change, 2018-2026**

*Source: ONS, Onward calculations*

## 3. The political context

This is not for lack of political attention. In July 2018, the Chancellor Rishi Sunak, then local government minister, recognised the inequity of the current system and said that fair funding was his number one task. A year later he stated that: "upper-tier authorities clearly are facing pressure because they are the ones dealing with statutory social care services."[4]

In relation to the Fair Funding Review, he said: "It will be a fresh look, evidence based, from a blank sheet of paper, so it ought to be the most accurate and contemporary picture we can paint of what is driving need. If it's as good as it should be, the distribution of resource will accurately reflect need where it occurs on the ground." He even made specific reference to the use of the deprivation measure which drives so much of the current funding level differentials, saying: "deprivation was found not to be a particularly significant variable, and it was a way to reduce complexity in the system." These comments show that senior figures in Government recognise the problem.

But nearly two years on, little progress has been made. Those authorities under most financial duress have seen little to suggest there is light at the end of the tunnel. Of course, major reform immediately following a global pandemic is difficult. But if the fair funding review is going to continue to be delayed, some kind of reform is needed in the short term to prevent those authorities at the bottom end of the funding tables being hit the hardest.

The next chapter sets out a short-term measure that could alleviate much of the problem without the political pain or fiscal implications of a wholesale funding review. It is not a replacement for fundamental reform, which ministers should not lose sight of. But it would be a pragmatic way to reduce the inequity of the current system and stabilise some authorities in a way that should be acceptable to those who would not stand to benefit. The proof for this is seen in the recent schools funding uplift that followed a similar model – and was passed with little controversy.

---

[4] Quoted in *Public Finance*, 18 June 2019, link

# The solution

The biggest challenge to long-term funding reform is that, whatever changes are implemented to the system, there will be some local authorities who will lose out. Our suggestion is therefore that additional funding is made available to those authorities who have the double whammy of higher levels of council tax and lower levels of core spending power – levelling up their core spending power without redirecting funding from other places.

Recognising that this is not the ideal way to do things if you were going to undertake a fundamental review, we have modelled a way in which a temporary adjustment could be implemented. It looks at how, if a fixed sum of additional funding was made available, this could be directed at pulling up those authorities with low CSP per head closer to the average.

The calculations use an adjusted CSP per head measure to take account of what the figure would be if a national average council tax rate was charged. This is to avoid additional funding being directed towards authorities who have a lower-than-average council tax level.

We estimate that to bring all authorities with an adjusted CSP per head up to the average would cost around £3bn. This figure is clearly too high and so a mechanism has been built in which allows the floor to be set at different levels relative to the average. So, for example, setting it at 90% of the average would see 27 authorities (or authority areas) benefit at a total cost of around £300m.

The reference to local authority areas is needed because, in order to undertake like for like comparisons, it is necessary to calculate a composite CSP by combining those for each county council and its districts, and also recognising that some authorities, such as the GLA and some fire authorities provide services across a number of local authority areas.[5]

A mechanism such as this could be used to reflect changes over time. So, some or all additional funding available each year could be used to just bring those authorities at the bottom end up, closing the gap between CSP differentials.

[5] Information can be provided to explain how this has been done.

## Impact

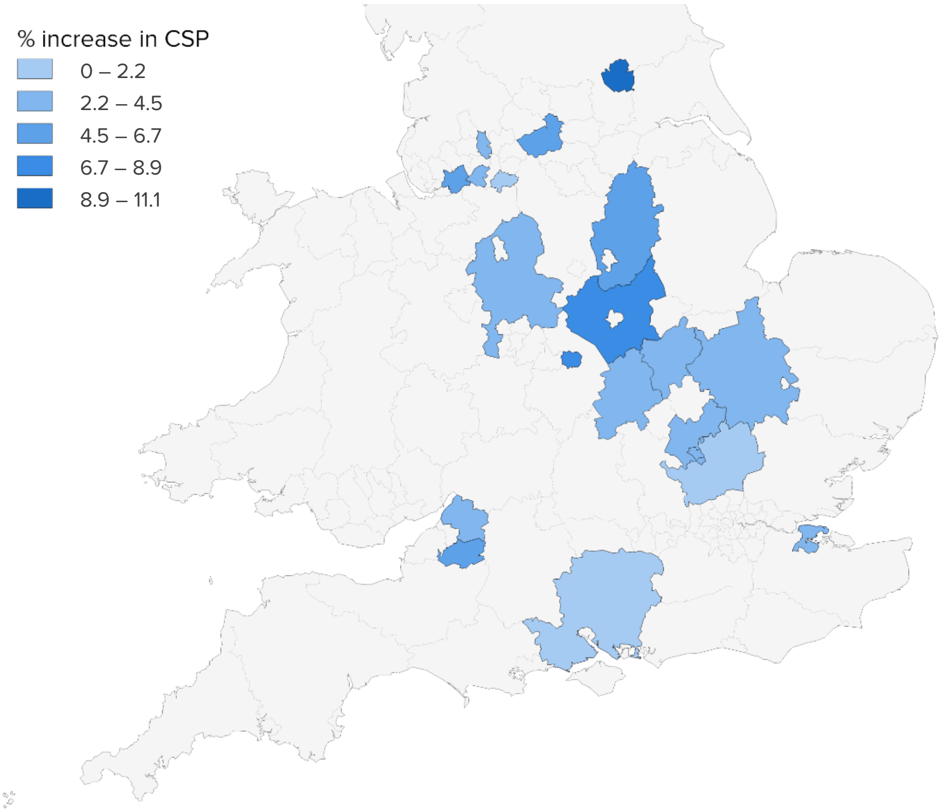
For ease, if £300m was awarded, those authorities that would benefit are set out in Table 1 and Figure 7 below.

It is worth noting that a number of these authorities have been flagged up as having financial difficulties, and Luton has recently been granted capitalisation directions. It is very likely more on this list will be in the same boat within the next year or so, which would mean money would need to be found to support them anyway.

**Table 1: Core spending power floor**

| Authority | 21/22 CSP per head (£) | Addtn. £ per head to match floor (£) | Additional £m to match floor (£m) |
|---|---|---|---|
| Leicestershire | £761 | £63 | £44.7 |
| Nottinghamshire | £845 | £44 | £36.4 |
| Staffordshire | £786 | £29 | £25.3 |
| Coventry | £805 | £55 | £20.5 |
| Hampshire | £789 | £14 | £19.5 |
| York | £706 | £78 | £16.5 |
| Kirklees | £802 | £37 | £16.4 |
| Cambridgeshire | £809 | £24 | £16.0 |
| West Northamptonshire | £783 | £28 | £11.5 |
| South Gloucestershire | £805 | £33 | £9.5 |
| Warrington | £780 | £43 | £9.0 |
| Central Bedfordshire | £826 | £29 | £8.3 |
| Medway | £786 | £30 | £8.2 |
| North Northamptonshire | £790 | £22 | £7.7 |
| Bath and North East Somerset | £772 | £36 | £7.0 |
| Luton | £806 | £31 | £6.7 |
| Trafford | £753 | £24 | £5.7 |
| Hertfordshire | £834 | £4 | £5.0 |
| Stockport | £874 | £17 | £5.0 |
| Bury | £837 | £23 | £4.3 |

Figure 7: Top 20 authorities that gain from increased funding to meet the £819 floor




### Precedent for funding floors: schools

The concept of floors has worked well recently in respect of the implementation of schools funding. The Prime Minister pledged to increase school funding by £4.6 Billion above inflation by 2022/23, taking school funding in total to £52.2 Billion. 2020/21 saw an increase of 5% in school funding over what was available in 2019/20. The additional funding was implemented through making significant increases in the minimum funding per pupil – consistent with the objective of levelling up the lowest funded schools.

To support the measures, previous caps that existed on previous schools' gains were removed. The aim of the change was to make the national funding formula for schools fairer, with more funding directed towards meeting the actual needs of schools and pupils rather due to accidents of geography or history. The positive outcome was that pupils displaying the same characteristics attract the same funding irrespective of the local authority in which they are educated.

# Conclusion

Without additional financial support, those authorities with low core spending power increasingly will struggle to provide essential and valued services to their local communities.

A fair funding review is crucial and needs to be addressed as soon as possible. In the meantime, a temporary mechanism should be introduced which closes the core spending power differentials and provides much needed additional resource to those authorities in most danger of becoming unsustainable and in risk of financial collapse. The temporary solution is not ideal, but would be a sticking plaster that would enable the system to carry on for a little longer.

# About the author


## Chris Tambini


Chris Tambini is Director of Corporate Resources and Finance at Leicestershire County Council. He is a qualified accountant and sits on the Ministry of Housing, Communities and Local Government's Fair Funding technical working group.

He has previously worked in a London Borough, City Unitary and PricewaterhouseCoopers. This paper builds on technical work undertaken for Leicestershire County Council.

ukonward.com

ONWARD