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Wales Fiscal
Analysis

Trends in local government finance: October 2019

Briefing Paper

GUTO IFAN & CIAN SIÔN

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Executive Summary

- The value of Welsh Government grants to local authorities have fallen by around £1 billion in real terms between 2009-10 and 2018-19. This equates to a reduction of £370 per head.
- In a continuation of recent trends, there has been a pronounced shift towards local taxation as a means of financing local authority revenue expenditure. In 2018-19, Council Tax receipts accounted for 19.9% of gross revenue, up from 13.9% in 2009-10.
- The level of unearmarked local authority reserves remains broadly unchanged since 2009-10 although there is considerable variation in practice between local authorities in their use of this facility. However, there has been a sustained fall in the value of schools' reserves over the past decade, resulting in an unsustainable financial position.
- Local authority current service spending fell by £260, or 10.7% per head in real terms between 2009-10 and 2018-19. This equates to a £570 million (7.7%) fall in spending across Wales.
- The areas hardest hit by spending cuts over the analysed period are planning development, coroners' and other courts services (57.2%), libraries, culture sports and recreation (38.7%) and transport (29.4%). Meanwhile, cost and demand pressures for children and families' social services continue to drive up social services costs.
- Capital expenditure has been largely resilient to cuts. Local authorities have increasingly turned to unsupported capital borrowing arrangements in order to finance capital expenditure. The UK government's recent decision to increase the interest rates on new loans taken out by the Public Works Loan Boards means that local authorities are set to incur higher costs when financing future capital schemes. This may mean that some planned capital projects cease to be affordable.
- Grants to local authorities in England funded by increased business rates retained by the UK government (as opposed to English local authorities) have been offset by negative *consequentials* for Wales through the Barnett formula. This issue highlights the importance of growth in non-domestic rates revenues in Wales to avoid shortfalls in devolved and local government funding over coming years.
- Supposing that the Welsh Government decides to increase core NHS spending in line with spending plans for England, the 2020-21 local government settlement could provide a 3.1% (1.2% real terms) boost to local authorities' budgets, bringing the total value of central government support to £5.21 billion.
- However, rising costs and increased demand for local services mean that tough choices and trade-offs are here to stay. Suffice to say, the broader outlook for public spending beyond 2020-21 remains highly uncertain.

Trends in local government finance

OCTOBER 2019

Introduction

The Welsh Government has announced that it intends to publish its 2020-21 draft budget on 19th November 2019. It is expected that this will be followed by the local government settlement the following week. Together, these documents will outline the amount of funding that will be made available to local authorities via the revenue support grant for the 2020-21 financial year. The Minister for Housing and Local Government, Julie James, has also expressed her intention to publish early indications of specific grants to local authorities alongside this year's settlement.

As one of the areas hardest hit by austerity, Welsh local authorities will hope that some of the Barnett consequential resulting from the UK Chancellor's announcements during last month's Spending Round will make its way into their budgets.

This briefing paper summarises recent trends in local government revenue and expenditure using the latest outturn data published for the 2018-19 financial year and presents the outlook for future years.

How are local authorities in Wales funded?

Funding for local government in Wales comes from three main sources, the largest of which are Welsh Government grants. Some of these grants are ring-fenced and hypothecated for particular objectives, however, most of the funding is delivered via the Revenue Support Grant, which can be spent at the discretion of local authorities.

Second, councils generate revenue by levying Council Tax on residents. This is a recurrent tax on a property's rateable value at the time of the last revaluation in 2003. Although local authorities are free to set their own rate of Council Tax, the ratios between the charges applied to different bands (relativities) are centrally fixed.

Non-domestic (business) rates is a recurrent tax on a non-domestic property's rateable value. This tax was fully devolved in 2015 and under the present system, revenues are collected by local authorities, pooled by the Welsh Government and re-distributed back to local authorities according to the Standard Spending Assessment alongside the Revenue Support Grant. Local authorities can provide discretionary relief to businesses although any cost must be met from the council's revenue budget.

In addition, local authorities can charge users for services like council-owned car parks and leisure facilities while imposing fees for other services which are governed by specific regulations. For many services, local authorities are either prohibited from charging more than the cost of provision, or there are nationally prescribed eligibility and charge levels in place and little or effectively no local discretion on these levels.

Financing revenue expenditure

In 2018-19, the value of Welsh Government grants to local authorities stood at £4.1 billion, up 0.4% on the previous year (but 1.4% lower in real terms). Total Council Tax revenues net of the Council Tax Reduction Scheme were £1.26 billion, up 5.8% on the previous year (3.9% in real terms).

Over the past decade, there has been a marked shift in the way local authorities in Wales are funded. Although the Welsh Government has not pursued several of the institutional reforms taking place in England and Scotland (such as the retention of business rates — see **Annex B**), there has been a pronounced shift towards local taxation as a means of financing local government expenditure over the period. This trend is observed both at the national and local authority level.

In 1999-00, Council Tax accounted for 3.6% of total public sector revenue collected in Wales. By 2017-18, this had increased to 5.5%. Over the same period, levels of Council Tax paid per person in Wales has nearly converged with the UK average.¹

On a local authority level, Council Tax constitutes an increasingly larger share of local authorities' revenue. Net of the Council Tax Reduction Scheme, £1.26 billion was raised through Council Tax in 2018-19, supplying local authorities with 19.9% of their gross revenue, up from 13.9% in 2009-10. This represents a real terms increase of 30.6%.

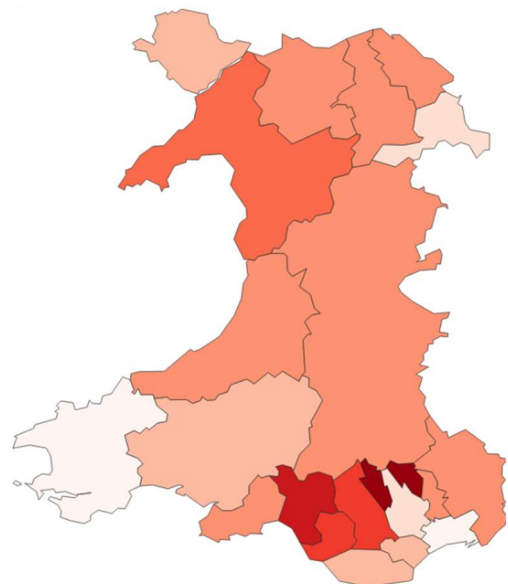
Since 2013-14, many local authorities have authorised significant increases to Council Tax levels to partially ameliorate the effects of declining support from central government. Despite this, in 2018-19, total gross revenue available to local authority was around £630 million (9.0%) lower in real terms compared to 2009-10 levels.

In contrast to the Scottish and UK governments, the Welsh Government did not implement a formal freeze or cap on Council Tax. This has meant that local authorities in Wales have been relatively less affected by austerity measures than some other parts of the UK, but it also means that Council Tax levels have grown much more rapidly.

Figure 1 highlights the variance in the Band D Council Tax levels set by local authorities for 2019-20. The average Band D rate of Council Tax (excluding community and police precept) ranges from £1,092 in Pembrokeshire to £1,648 in Blaenau Gwent.

Figure 2 and **Figure 3** depict the changing composition of local government revenue over this period.

Figure 1
Average Band D Council Tax levels, by local authority, 2019-20

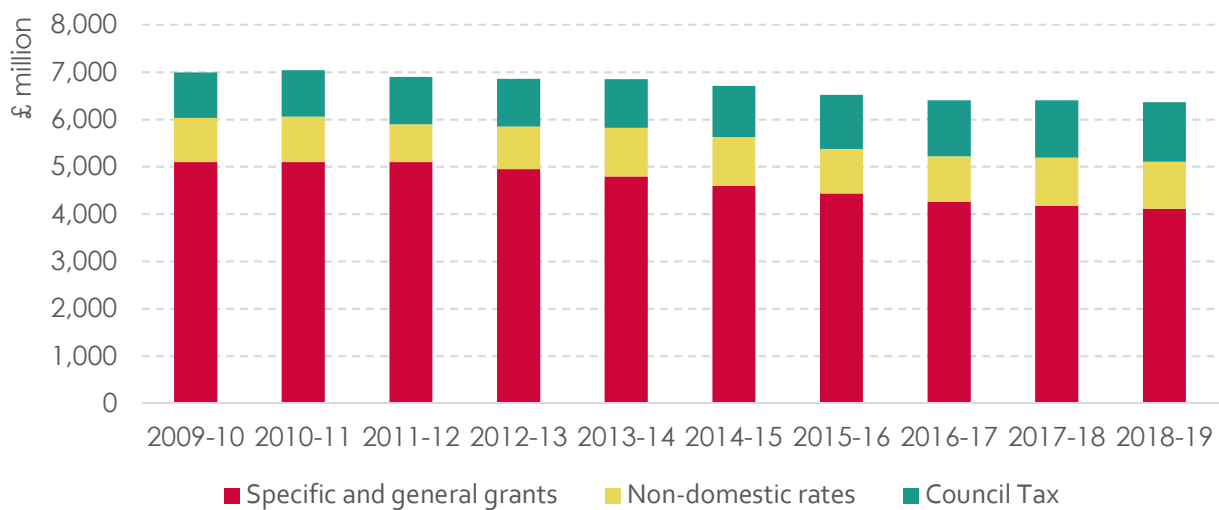


Source: StatsWales (2019) Average Band D Council Tax level (excluding police and community precepts).

¹ Guto Ifan, Cian Siôn and Ed Gareth Poole, *Government Expenditure and Revenue Wales* (Cardiff: Wales Fiscal Analysis, 2019), 25 & 28. https://www.cardiff.ac.uk/_data/assets/pdf_file/0009/1542474/full_gerw_print.pdf

Figure 2

Composition of local government revenue (excluding fees and charges), 2009-10 to 2018-19 (2018-19 prices)



Source: StatsWales (2019 and previous) Financing of Gross Revenue Expenditure and authors' calculations.

The value of Welsh Government grants to local authorities fell by nearly £1 billion (19.4%) in real terms between 2009-10 and 2018-19. This equates to a reduction of around £370 per head. Over the same period, Council Tax revenue (net of the police precept and reduction scheme) increased by £300 million (30.6%) in real terms. This increase has been particularly pronounced from 2013-14 onwards as the value of the revenue support grant to local authority had been relatively protected up until this point. There has also been an increase – albeit a smaller one – in non-domestic rates revenue over the same period, with revenues up by around £60 million (6.5%) in real terms.

Figure 3

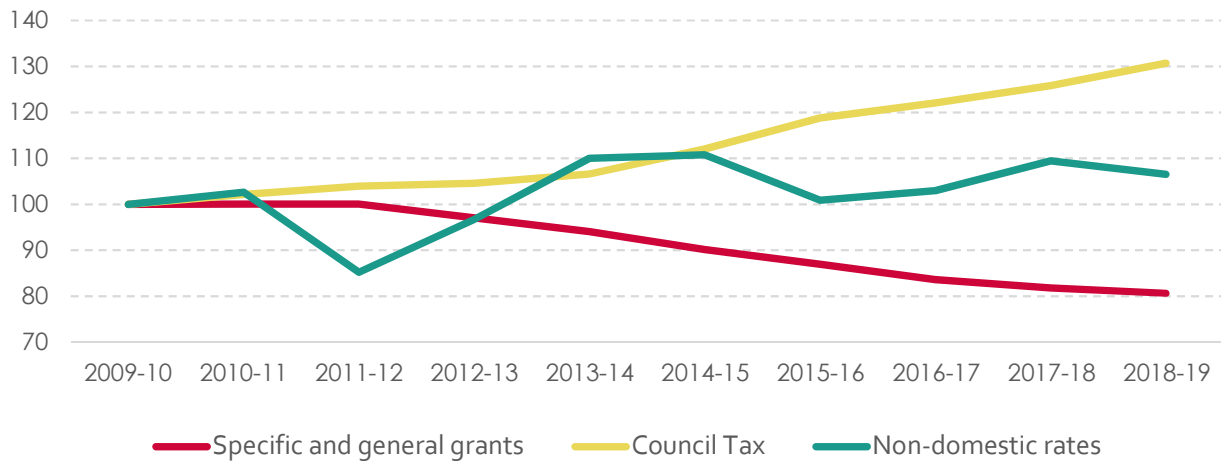
Composition of local government gross revenue, 2009-10 to 2018-19 (2018-19 prices)

	LA revenue (£ million, 2018-19 prices)		Percentage change
	2009-10	2018-19	
Welsh Government grants (excl. HB)	5,096	4,110	-19.4%
% of total revenue	72.9%	64.6%	
Council Tax	965	1,262	30.6%
% of total revenue	13.8%	19.8%	
Non-domestic (business) rates	933	994	6.5%
% of total revenue	13.3%	15.6%	
Total	6,994	6,365	-9.0%

Source: StatsWales (2019 and previous) Financing of Gross Revenue Expenditure and authors' calculations.

Figure 4

Real-term trends in local government gross revenue streams, 2009-10 to 2018-19



Source: StatsWales (2019 and previous) *Financing of Gross Revenue Expenditure and authors' calculations.*

In 2018-19, Council Tax revenues accounted for nearly a fifth of local authority revenue. However, this share varies considerably across Wales, ranging from 14% in Caerphilly to 33% in Monmouthshire. This is partly a reflection of differences in the relative strength of local authorities' property tax bases.

The gap between the most grant-dependent and least grant-dependent authority has widened over the past decade.² Indeed, in 2018-19, the revenue support grant financed less than half of gross revenue expenditure in one local authority — Monmouthshire. These trends likely represent a permanent recalibration in the way local government is funded in Wales.

In addition to these streams of revenue, local authorities receive (and make) payments to other local authorities and non-local authority bodies (e.g. health boards) for joint service arrangements. Furthermore, local authorities can charge users for some services like council-owned car parks and leisure facilities while imposing fees for other services which are governed by specific regulations.

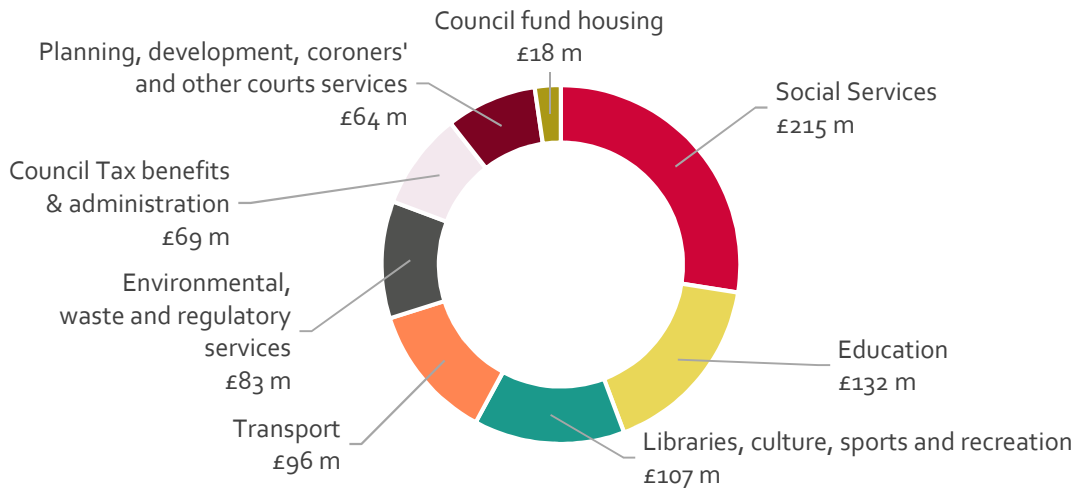
In 2018-19, income raised from sales, fees and charges amounted to £783.7 million. As illustrated in **Figure 5**, the majority of this related to charges for social services (including older adult home care and residential care placements), education (including school meals) and fees levied on users of cultural, sports and recreational venues.

The total amount raised from sales, fees and charges has remained broadly stable in nominal terms over the past decade despite increased spending pressures. This is not entirely unexpected because for many services, local authorities are either prohibited from charging more than the cost of provision, or there are nationally prescribed eligibility and charge levels in place and little or effectively no local discretion on these levels.

² Guto Ifan and Cian Siôn, *Cut to the bone? An analysis of Local Government finances in Wales, 2009-10 to 2017-18 and the outlook to 2023-24* (Cardiff: Wales Fiscal Analysis, 2019), 14.
https://www.cardiff.ac.uk/_data/assets/pdf_file/0010/1448920/local_government_finance_report_Feb19_final.pdf

Figure 5

Local authority income raised via sales, fees and charges, 2018-19



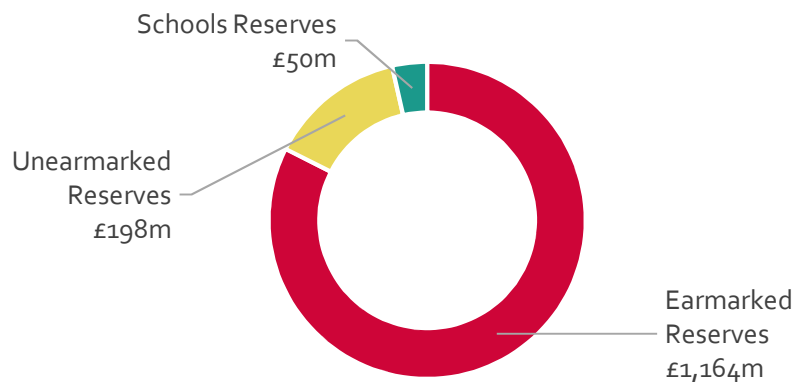
Source: StatsWales (2019 and previous) Local government revenue outturn data and authors' calculations.

Local authorities are also able to supplement their incomes by drawing on reserves. Usable reserves can be used by local authorities to manage their budget flow and provide services, subject to any statutory limitations on their use. These are comprised of general reserves, earmarked reserves and school reserves.

At the beginning of the 2018-19 financial year, total usable reserves by local authorities across Wales stood at £1.4 billion, of which £200 million was unearmarked and £50 million was held within local authority schools' reserves (Figure 6). The level of unearmarked reserves remains broadly unchanged since 2009-10 although there is considerable variation in practice between local authorities in their use of this facility.

Figure 6

Composition of local authority usable reserves, 31 March 2018



Source: Welsh Government (2018) Written statement: reserves held by local authorities. <https://gov.wales/sites/default/files/inline-documents/2018-11/181114reservesheldbylocalauthoritiesen.pdf>

Nevertheless, there has been a sustained fall in the value of schools' reserves over the past decade, primarily driven by secondary schools. Reserves are, of course, a one-off source of financing and will not cover shortfalls in revenue over a prolonged period. A recently published briefing note by *StatsWales* noted that, as of 31 March 2019, total secondary school reserves are now in deficit by £1.5 million.³ Clearly, this is an unsustainable financial position.

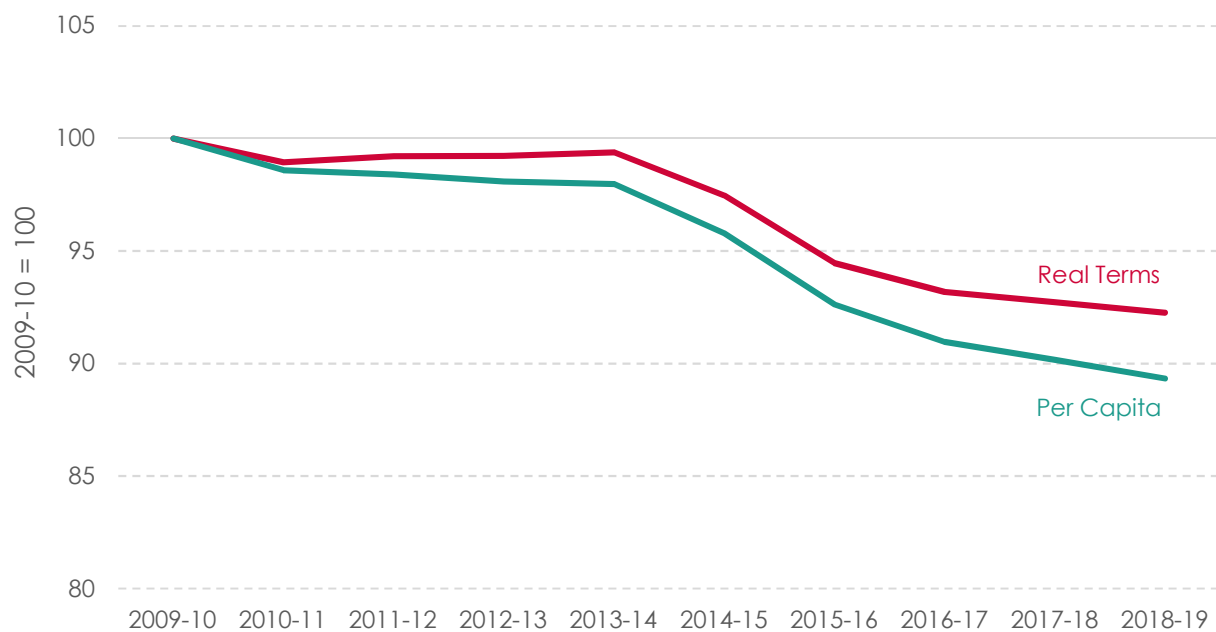
Revenue expenditure

In 2018-19, local authority current service spending (excluding debt financing costs) amounted to £6.8 billion, up 1.3% on the previous year (but 0.5% lower in real terms).

Service spending fell by £260, or 10.7% per head in real terms between 2009-10 and 2018-19. This equates to a £570 million (7.7%) fall in spending across Wales.

Figure 7

Real-terms and per capita trends in total revenue service expenditure, 2009-10 to 2018-19



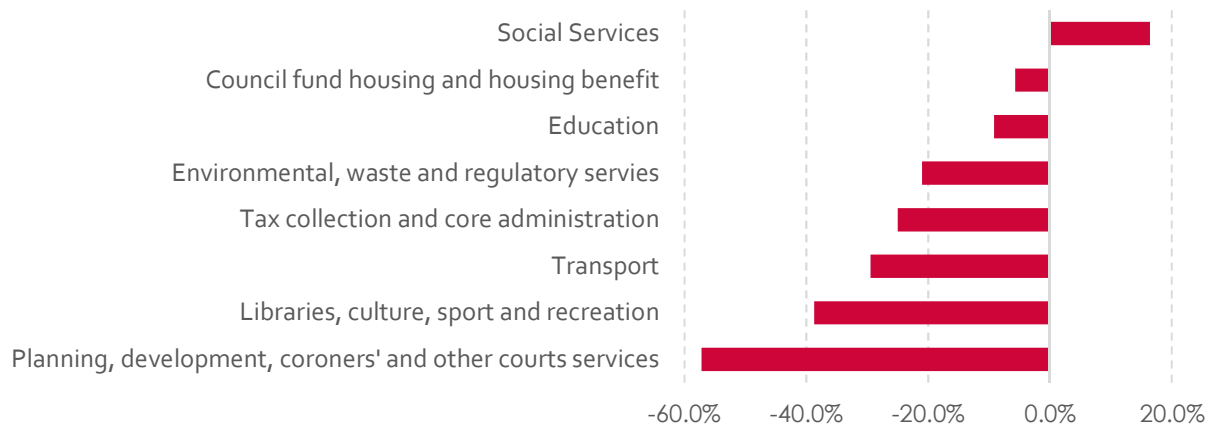
Source: Welsh Government (2018) Written statement: reserves held by local authorities.
<https://gov.wales/sites/default/files/inline-documents/2018-11/181114reservesheldbylocalauthoritiesen.pdf>

Perhaps not unexpectedly, local authorities have continued to prioritise social services and – to a lesser extent – education when allocating service expenditure during this period (Figure 8). This has inevitably meant that 'unprotected' departments have seen large cuts in spending. For instance, expenditure on planning development, coroners' and other courts services has fallen by 57.2% in real terms since 2009-10. Spending on libraries, culture sports and recreation has fallen by 38.7% and transport spending has fallen by 29.4%.

³ Statistics for Wales, *Reserves held by schools in Wales at 31 March 2019*, SFR 97/2019.
<https://gov.wales/reserves-held-schools-31-march-2019>.

Figure 8

Real terms percentage change in net current service expenditure, by local authority spending area, between 2009-10 and 2018-19 ⁴

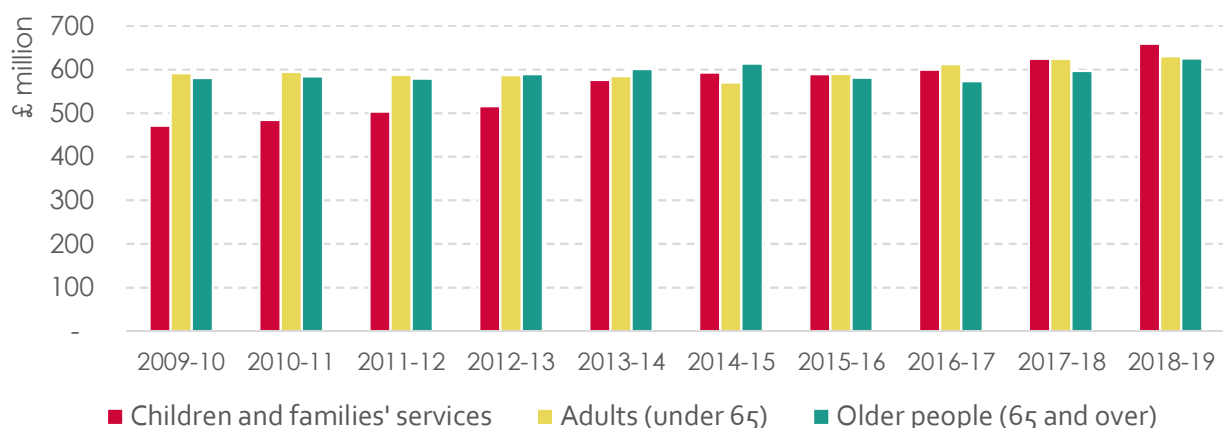


Source: StatsWales (2019 and previous) Local government revenue outturn data and authors' calculations.

As we have previously reported in our work on local government finance, demand and cost pressures associated with children and families' social services have been one of the main drivers behind increased social services spending. In 2018-19, spending on children and families' social services accounted for 34.4% of the total social services spend, up from 28.7% in 2009-10 (Figure 9).

Figure 9

Breakdown of social services expenditure, 2009-10 to 2018-19 (2018-19 prices)



Source: StatsWales (2019 and previous) Local government revenue outturn data and authors' calculations.

⁴ The change in social services and education expenditure is somewhat exaggerated due to the *Flying Start* programme being reclassified as social services spending as opposed to education expenditure from 2013-14 onwards. It should be noted that there may also be other minor differences between the methods used by local authorities to classify spending. The classification of various services may differ slightly to the classification framework used by StatsWales.

Capital expenditure and financing capital expenditure

Unlike trends in revenue expenditure, capital expenditure (i.e. spending on the provision, acquisition and enhancement of fixed assets such as land, buildings and vehicles) has been largely resilient to cuts.

In 2018-19, total capital expenditure on services was up 4.8% on the previous year (2.9% in real terms), largely due to increased capital spending on housing. When compared to 2009-10, capital expenditure has increased by £144.3 million (13.3%) in real terms.

However, this masks an important shift in the way capital expenditure is financed. As shown in **Figure 10**, the value of capital grants from the UK and Welsh Governments, public and private bodies, the European Structural funds and National Lottery has fallen by 18.8% in real terms between 2009-10 and 2018-19.

Aided by historically low borrowing costs, local authorities have increasingly turned to unsupported borrowing arrangements in order to finance capital expenditure over this period.⁵ The majority of these loans have been financed by the Public Works Loan Board (PWLB), a statutory body of the UK government. Earlier this month, the UK government announced that the interest rate charged on new loans taken out by PWLB would increase by a whole percentage point with immediate effect, raising the typical rate from 1.8% to 2.8%. As a result, local authorities are set to incur higher costs when financing future capital schemes through the PWLB. This may mean that some planned capital projects cease to be affordable.

Figure 10

Financing of local government capital expenditure, 2009-10 to 2018-19 (2018-19 prices)⁶

	LA revenue (£ million, 2018-19 prices)		Percentage change
	2009-10	2018-19	
Capital grants and other contributions <i>% of total revenue</i>	526 50.9%	427 36.2%	-18.8%
Usable capital receipts applied to meet expenditure <i>% of total revenue</i>	53 5.2%	65 5.5%	21.9%
Capital expenditure funded from revenue <i>% of total revenue</i>	69 6.7%	214 18.1%	207.4%
Other (incl. borrowing) <i>% of total revenue</i>	385 37.2%	475 42.8%	23.5%
Total	1,034	1,181	14.2%

Source: StatsWales (2019 and previous) *Financing of Gross Revenue Expenditure* and authors' calculations.

⁵ Prudential (unsupported) borrowing powers were conferred on local authorities in Wales by the Local Government Act 2003, allowing them to borrow for capital expenditure without government consent, provided that the loan repayments could be afforded. The sum of unsupported loans taken out to finance capital expenditure has tripled between 2009-10 and 2018-19.

⁶ Figure 4.1 from our previously published report on local government finance, *Cut to the bone? An analysis of local government finances in Wales, 2009-10 to 2017-18 and the outlook to 2023-24*, contained an error whereby the amounts of capital financing by source had been incorrectly stated. The percentage changes and the share of expenditure financed by each source were unaffected by this error. This has been rectified in this document.

The outlook for local government finance

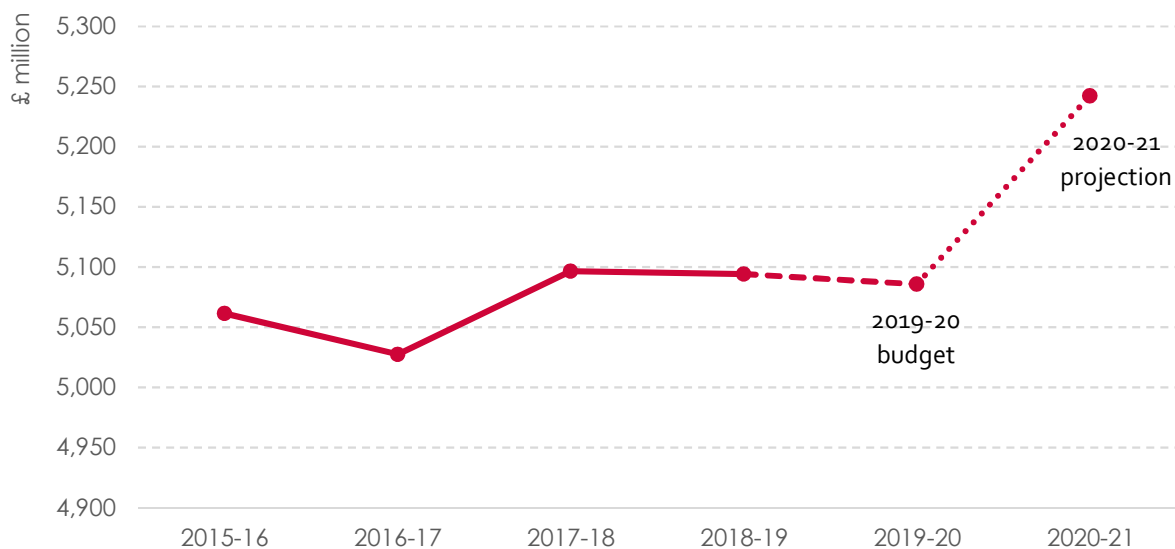
Following last month's spending round, we now know that the Welsh resource block grant is set to grow by £593 million in 2020-21, a 2.3% real terms increase on the previous year.⁷ This is in sharp contrast to the annual real-terms decreases in the value of the block grant that has restrained growth in the Welsh Budget over much of the past decade. However, the state of the UK's public finances beyond 2020-21 remains highly uncertain, not in the least bit aided by the UK Chancellor Sajid Javid's decision to abandon the traditional multi-year spending review in favour of a single year spending round.

Although the outlook for the Welsh Government budget is a considerable improvement on the situation a few years ago, tough decisions and trade-offs remain. Core NHS spending has increased as a share of the Welsh budget to around 50%. Inevitably, decisions around future growth in NHS spending will have a significant bearing on how much funding is available for other areas of spending, including local government.

Supposing that the Welsh Government decides to increase core NHS spending by 3.3% in real terms (broadly matching the planned increase in NHS funding in England) and assuming that support for local authorities then matches growth in all other spending, we can project what the 2020-21 local government settlement might look like (Figure 11).

Figure 11

Projected path of central government support to local government (specific, general grants & NDR revenue) (nominal terms)



Source: Authors' calculations. Growth in specific and general grants are assumed to follow departmental path if Welsh Government matches NHS funding in England. NDR revenues are based on projections made by the Office for Budget Responsibility in their Economic and Fiscal Outlook (March 2019).

⁷ Guto Ifan and Cian Siôn, *UK Spending Review 2019: the implications for Wales* (Cardiff: Wales Fiscal Analysis, 2019), 5-6. https://www.cardiff.ac.uk/_data/assets/pdf_file/0009/1699776/WFA-Spending-Round-2019-Briefing.pdf

After two years of broadly cash flat settlements, under these assumptions, the 2020-21 settlement could provide a 3.1% (1.2% real terms) boost to local authorities' budgets, bringing the total value of central government support to £5.24 billion. In cash terms, this would represent a £157 million uplift for local authorities from the revenue grant, specific grants and redistributed non-domestic rates revenue.

Around £3 billion of grants made to English authorities at the Spending Round 2019 were funded by increased English business rates revenues retained by the UK government (as opposed to English local authorities). This resulted in negative *consequentials* for the Welsh Government budget, a feature of the Barnett formula designed to ensure the Welsh Government does not receive a share of changes in UK government spending funded by changes in business rates receipts in England.⁸ It is unclear how much of these negative *consequentials* are down to a general increase in business rates revenue in England, but the issue underlines the importance of growth in NDR revenues in Wales to avoid shortfalls in devolved and local government funding. In March 2019, the Office for Budget Responsibility (OBR) forecast relatively slow growth in Welsh NDR revenues over coming years, which may be a cause for concern.

Since 2018, responsibility for setting teachers' pay has been devolved to the Welsh Government. On 22 October, the Welsh Government announced a pay deal for teachers for 2019-20,⁹ following the UK government's three-year pay award for teachers in England.¹⁰ The Welsh Government will provide £12.8 million in funding to support the cost of the pay award in this financial year. In addition to staffing costs, a projected rise in the pupil population (particularly the secondary school population) is also likely to put increased pressure on already stretched school budgets going forwards.

Despite nearly a decade of sustained budget cuts, rising costs and increased demand for local services mean that tough choices and trade-offs are here to stay. The *Welsh Local Government Association* estimate that a £254 million (5.0%) uplift to the settlement is required if councils are to meet these pressures in 2020-21 alone.¹¹ Beyond this, the outlook for Welsh and UK public spending remains highly uncertain.

⁸ See page 15 of the 2015 Statement of Funding Policy:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/479717/statement_of_funding_2015_print.pdf

⁹ <https://gov.wales/written-statement-teachers-pay-award-2019>

¹⁰ <https://www.theguardian.com/education/2019/aug/30/english-schools-to-get-three-year-14bn-funding-boost>

¹¹ Welsh Local Government Association, *Resourcing Local Services 2020-21*

<https://www.wlga.wales/SharedFiles/Download.aspx?pageid=62&mid=665&fileid=2482>

Annex A – Methodology for reporting local government revenue and expenditure

There is no single, agreed method for reporting local government revenue and expenditure. This annex sets out the basis used when reporting local government finance in this document.

All figures relating to Council Tax revenue are sourced from the budget line in the outturn data and exclude the Council Tax Reduction Scheme (CTRS) component and police precept. The amount actually collected may differ from the amount budgeted for collection, but any difference is relatively negligible in size.

Figures referring to Welsh Government grants exclude, for the purpose of this analysis, revenues accruing to Welsh unitary authorities in relation to housing benefit and housing benefit administration, which are transferred directly to Welsh councils from the Department for Work and Pensions to match demand. Any additional sums spent by Welsh councils on housing benefit and housing benefit administration above the amount received by the UK government have been included, although these amounts are also relatively small. By excluding housing benefit payments from the analysis, we can generate consistent comparisons between periods preceding and following the rollout of universal credit. Once the universal credit rollout is complete, housing benefit payments will be made directly to the head of household as opposed to local authorities in most cases.

Revenue expenditure is reported net of any income from sales, fees and charges levied by local authorities and net of any transfers between non-local authority bodies. This is labelled as *net current expenditure* in the outturn data. Net current expenditure is generally lower than gross revenue expenditure as the latter does not offset spending against income raised by local authorities. Both gross revenue expenditure and net current expenditure exclude local government spending financed by specific grants.

Annex B – Comparison of local government funding arrangements across the UK †

Wales	England	Scotland
No centrally imposed caps or freezes on Council Tax increases since 2009-10.	Council Tax levels frozen for one year in 2011-12 and then effectively capped as a result of the local referendum requirement (see below).	Council Tax increases capped at 3%. This was lifted in 2019-20.
No business rate retention. Revenues are collected by local authorities, pooled by the Welsh government and re-distributed according to the Standard Spending Assessment.	Since 2013-14, councils' funding has depended partly on business rate revenues raised in their areas. This only affects councils' funding to the extent that they experience real terms change in their business rates revenue. A safety net protects councils against excessive falls in funding.	Since 2012, each local authority that exceeds its individual business rates income target gets to keep 50% of the additional revenue generated. Those who fail to meet the target are compensated by the Scottish Government, so they are not worse-off.
No local referendum requirement for Council Tax increases.	Local authorities proposing "excessive" Council Tax increases must get approval via a local referendum. A set of principles defined by the Secretary of State is used to determine whether any increase is excessive.	No local referendum requirement for Council Tax increases.
Responsibility for the provision and funding of education and social care rests with local authorities.	Academies and free schools are <i>not</i> funded by local government. Councils with social care responsibilities receive ring-fenced grants to deliver these services.	Responsibility for the provision and funding of education and social care rests with local authorities.
Last Council Tax revaluation in 2005. A ninth band (Band I) applies to properties valued above £424,000.	Last Council Tax revaluation in 1991. Eight bands (A- H).	Last Council Tax revaluation in 1991. Eight Bands (A- H). The Scottish Government increased tax rates for bands E - H in 2017.

† Northern Ireland also has a layer of local government. However, the 11 Northern Irish unitary authorities do not perform the same functions as those in the rest of the United Kingdom. They have no responsibility for education, roadbuilding or housing. The system here further diverges from the rest of the UK as property rates (the Northern Irish equivalent of Council Tax) are set and collected centrally by the Land and Property Services agency of the Northern Ireland Executive.

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