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Assessing England's 2021-22 Local Government Finance Settlement



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Executive summary

On Thursday, the government set out its plans for council funding in England next year. In this briefing note we examine plans for both core funding and top-ups for ongoing COVID-19 related costs, and look at some of the issues looming beyond next year.

Key findings

- 1 Of the £2.2 billion (4.5%) increase in core funding projected for next year, less than £0.3 billion is from the government. The other £1.9 billion is from increases in council tax bills of up to 5%, and assumes councils make full use of the allowable increases.
- 2 If they do, the average band D rate would increase to around £1,907, up 29% in cash-terms and 16% in real-terms on its level in 2015-16. Core funding in 2021-22 would be 15% higher in cash-terms and 1% higher in real-terms than in 2015-16. Accounting for population growth though, this amounts to a 3% cut in core funding per capita over the last 6 six years. And this follows much bigger cuts over the period 2009-10 and 2015-16.
- 3 The actual increase in core funding is likely to be lower. This is not only because some councils may not increase bills by the full 5%. It's also because the government's projections assume that the numbers of people claiming means-tested council tax discounts continue to fall as they did prior to the COVID-19 crisis. This almost certainly will not be the case – indeed increases in unemployment will likely mean an increase in claimants. The government is providing £670 million as part of its £3 billion COVID-19 funding package for next year to address this issue. But it is important not to 'double count' this money

as both part of 'core' and 'COVID-19' funding, which is something that the way the government has presented figures may lead people to do.

- 4 The plans imply a further increase in reliance on council tax for overall core funding – 61% in 2021-22, compared to 49% in 2015-16 and more like 40% back in 2009-10. Relying on council tax for funding increases potentially has distributional consequences: councils in poorer areas and in the North and Midlands can raise less via council tax. However, the government has largely addressed this issue next year by allocating more of the increase in grant funding to such councils.
- 5 The extra COVID-19 funding being provided for next year does not look unreasonable if the impacts of the pandemic largely recede by summer as the vaccination programme rolls out and warm weather returns. If impacts persist though, additional funding may be needed, and in this case, the government could call on its £21 billion COVID-19 reserve.
- 6 The picture for subsequent years is less rosy though. There is potential for longer-run and indirect effects of the crisis on the prevalence of chronic ill-health and safeguarding issues, which would come on top of pre-existing demand and cost pressures. This means it is highly likely that a funding gap will open up in future years, unless there are continued large increases in council tax and/or additional funding is allocated or devolved to councils.
- 7 There is also a whole raft of reviews that councils are waiting on – of the adult social care system, funding allocations, business rates reform, fiscal devolution, and post-Brexit regional development funding. Each of these may have major implications for councils' spending responsibilities and needs or revenues in the years ahead. The longer-term financial outlook for local government therefore remains highly uncertain – and challenging.

Introduction and overview

On Thursday, the government published the provisional [Local Government Finance Settlement for England](#), setting out its plans for council funding for 2021-22. These plans show a core settlement of £51.2 billion, up 4.5% on this year's pre-COVID-19 funding levels, assuming all councils increase their council tax rates by the maximum allowed without a referendum of local residents. The vast majority (87%) of this is assumed to come from increases in council tax revenues, with council tax set to be almost 30% higher in cash-terms next year than in 2015-16.

The government has also confirmed additional funding to address the ongoing impacts of the COVID-19 crisis on councils' spending needs and own revenues, which it says totals over £3.0 billion. Not all of this is just for next year though – funding to cover the knock-on effects of falls in tax collections this year is actually to cover the next three years. And there is some double counting, with extra funding to cover increased receipt of means-tested council tax discounts in effect counted in both the core and COVID-19 funding.

As a result, measured on a like-for-like basis, the extra COVID funding being provided next year is just over a third of that provided this year. If the impacts of the pandemic largely recede by summer as the vaccination programme rolls out and warmer weather returns, this wouldn't be unreasonable. And if impacts are more persistent, the government could utilise its £21 billion COVID reserve to provide top-ups.

The picture for subsequent years is less rosy though, and it's less clear if funding is sufficient to address potential longer-run and indirect effects of the crisis on the prevalence of chronic ill-health and safeguarding issues.

Council tax up 29% in 6 years, but likely to raise less than assumed

Taken together, changes in grant funding and redistributed business rates revenues ('baseline funding') are estimated to amount to £292 million, consisting of:

- A £163 million increase in general grant and redistributed business rates revenues;

- A £300 million increase in grant funding for social care services; a new £111 million grant for 'Lower Tier Services' such as refuse collection, leisure, and planning; and £4 million increase in grants targeted at rural areas;
- Partially offset by a £285 million reduction in funding via the New Homes Bonus, as payments for previously-built homes drop out of the system.

This means the vast majority – 87% – of the projected £2.2 billion increase in core funding is expected to come from increases in council tax revenues. The government assumes all councils will make full use of the increases that are allowed without a referendum: 2% or £5, whichever is higher, in the case of shire districts; and 5% in the case of councils with social care responsibilities. Under this assumption the average Band D rate rises to around £1,907, up 29% in cash-terms and 16% in real-terms on 2015-16, just prior to the introduction of the so-called 'Social Care Precept'. This rise in council tax bills equates to an average of £59 per household in England.

The government also assumes that even without increases in tax *rates*, growth in the tax *base* would increase revenues by about 1.7%. This is in line with growth in the tax base between 2016-17 and pre-crisis forecasts for 2020-21. But its rather bullish for next year, given that a hefty chunk of previous growth in the tax base was due to increases in employment and income reducing the numbers receiving means-tested discounts on their bills. The expected rise in unemployment – to 7.5% by Spring 2021 in the OBR's central forecast – means this is unlikely to continue, and will probably go into reverse.

Based on new housebuilding alone, we would expect tax base growth of more like 1%, which would mean £200 million less revenue than the government has assumed. If increases in receipt of means-tested discounts were to offset entirely underlying increases in the number of houses, there would be a revenue shortfall of over £500 million relative to what the government has assumed. And of course, growth in means-tested support could exceed this.

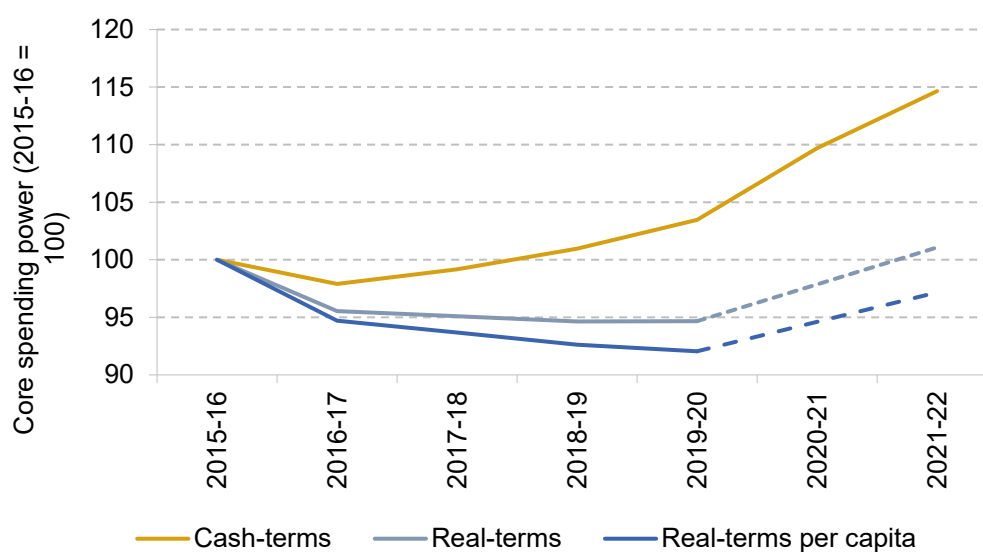
With this in mind, it is worth noting that the government is providing councils with £670 million to meet increases in receipt of these discounts as part of its COVID-19 package. However, it is important not to double-count revenues by ignoring the impact of increases in eligibility when estimating councils' tax revenues and then counting this compensation as extra funding. When the government talks of its £3

billion of 'additional' funding for COVID-19 measures, which includes that £670 million, it risks people doing just such a thing.

Core funding per person still set to be lower than in 2015-16

Taking the government's figures at face value though, core funding in 2021-22 will be 15% higher in cash-terms and 1% higher in real-terms than in 2015-16 as shown in Figure 1. Accounting for population growth though, this amounts to a 3% cut in core funding per capita over 6 years though, also shown in the Figure. This follows very substantial cuts to funding between 2009-10 and 2015-16, and has taken place in the context of increases in underlying service demands and costs. Indeed, the increase in funding planned for next year would mean only around one-fifth of the peak-to-trough fall in real-terms core funding per person between 2009-10 and 2019-20 has been undone.

Figure 1. Core funding in cash, real and real per capita terms



Note: The real-terms and real-terms per capita changes are smoothed for the years 2020-21 and 2021-22. This is because of complex changes in inflation over these years as a result of how output, productivity and hence inflation are measured in the public sector during the COVID-19 crisis.

Sources: Provisional Local Government Finance Settlement: England, 2021-22. GDP deflators at market prices from the 2020 Spending Review. ONS Population estimates and 2018-based mid-year population projections.

Grant allocations appear to compensate for differences in council tax bases

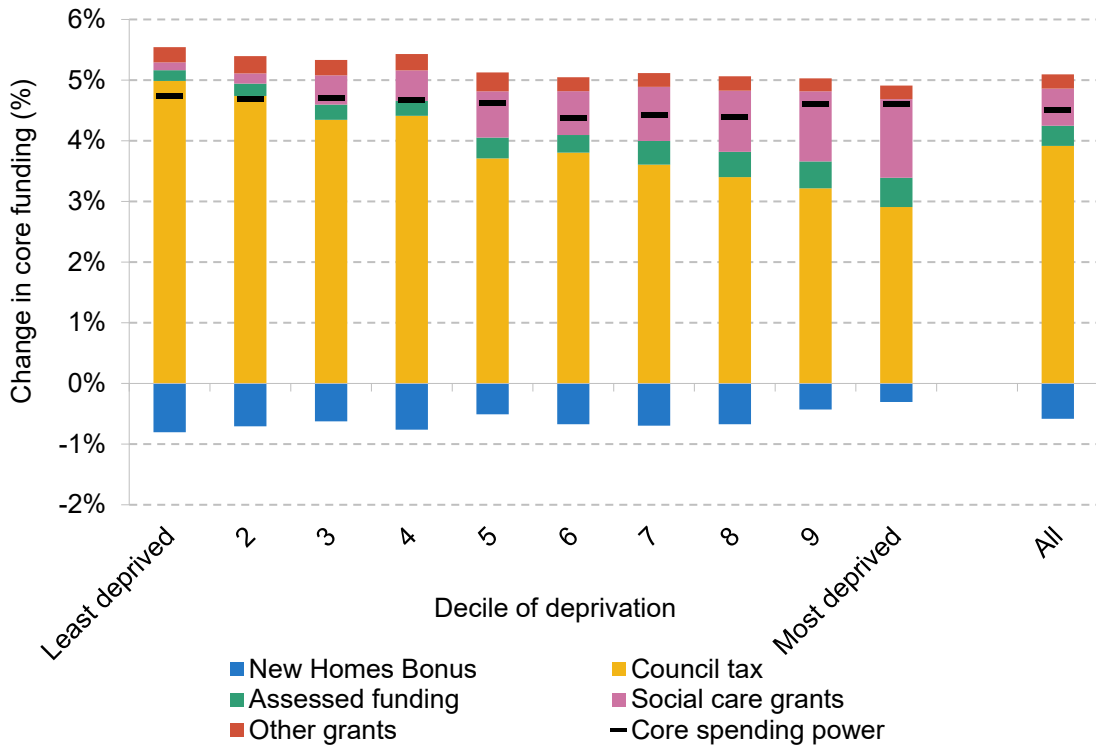
The plans imply a further increase in reliance on council tax for overall core funding – 61% in 2021-22, compared to 49% in 2015-16, and more like 40% back in 2009-10.

This potentially has distributional implications: councils in poorer areas, and in the North and Midlands, where properties tend to be in lower tax bands, can raise relatively less from council tax than those in richer areas and the South. Instead, they rely more on funding from grants and redistributed business rates. This is the main reason why during both the [late 2010s](#) and [especially the early 2010s](#), poorer areas saw bigger cuts to overall funding.

The 5% increases in council tax will therefore raise much less as a share of their overall funding, as illustrated by the yellow bars in Figure 2. In particular, while increases in council tax revenue are projected to raise the equivalent of 5% of core funding in the least deprived tenth of council areas, they are projected to raise just 2.9% in the most deprived tenth.

This regressive pattern can be addressed by allocating grants so as to offset differences in how much councils can raise themselves via council tax though. And this is what the government has done when allocating the extra grant funding for social care services – more has been given to poorer areas. Despite not doing this for other funding streams (such as a general grant funding and redistributed business rates) as well, the pink bars and black lines in Figure 2 show that this has been broadly sufficient to equalise increases in overall core funding, with the least deprived tenth seeing an increase in core funding of 4.7% and the most deprived tenth seeing a 4.6% increase.

Figure 2. Contribution to change in core funding in 2021-22 by different funding elements by decile of deprivation



Note. Deprivation is based on IMD average score of of upper-tier councils.

Source: Provisional Local Government Finance Settlement: England, 2021-22; 2019 English Indices of Deprivation.

COVID funding likely to cover higher unit-costs and lost income, but demand for services may grow

In addition to the core funding settlement, the government has confirmed plans for additional funding to address ongoing COVID-19 related costs.

Councils’ forecasts from late October/early November suggest costs this financial year are substantial – with an increase in spending of £6.1 billion, and a fall in non-tax income of £2.8 billion. And while the government has provided substantial extra money this year, we estimate a gap of between £0.8 billion and £1.6 billion given these forecasts (the range is due to some uncertainty about the range of pressures

councils have included in their forecasts). This means at least some councils will likely have to draw down reserves and/or make cutbacks to other areas of spending.

Looking to next year, the government will provide a total of at least £3 billion for COVID-related pressures although an estimated £762 million of that is to help offset reductions in tax collections this year that councils will have to absorb over the next three years, so it isn't all just for next year. And as already mentioned, £670 million is to compensate for expected increases in the cost of means-tested council tax discounts that the government did not reflect in its estimates of core funding – so shouldn't be double counted.

Even so, will this be enough to address pressures, or will there be another shortfall?

Forecasts from councils are not yet available, but we did make our [own projections in September](#). These assume some persistence in higher costs for adult social care and public health services, and lower income from sales, fees and charges and commercial activities, as well as falls in local tax revenues. Under our middle scenario, and updated for the latest data, these pressures amount to around £1.4 billion; whereas under our upper scenario, they amount to £2.3 billion.

Taking the extra COVID-related funding and these pressures, as well as core funding and underlying (non-COVID) pressures into account, the government has provided more than enough funding to meet our middle scenario for funding needs next year. Indeed, the funding plans could help councils start to address longer-run shortfalls in social care funding.

However, if our upper scenario for COVID-related (and underlying) pressures was borne out though, another funding gap could emerge next year. This means it will be careful to monitor the costs councils are facing – especially if COVID-19 does not abate as quickly as hoped with the vaccination programme and return of warmer weather – and, if necessary, top-up funding from the government's £21 billion COVID-19 reserve.

One factor that could push up spending and that our modelling in September was unable to account for is if the wider effects of the COVID-19 crisis pushes up demand for council services. Past recessions and economic crises have been associated with [increases in ill-health](#) – especially for mental health – and [mistreatment of children](#). Unfortunately, there is evidence of [increases in mental](#)

health problems during the Spring lockdown. And while the number of children being referred to children's social care services fell by 30% compared to last year in May, there was a much smaller fall in the Autumn (and actually an increase in August). It would therefore be sensible to continue monitoring how service demand is changing as a result of the COVID-19 crisis.

Ongoing pressures and looming choices for 2022-23 and beyond

Such increases in demand would take place in the context of more general increases in the demand for and cost of council services. Factors driving this include: the ageing population; rising numbers of younger adults with learning disabilities; increases in the number of children under the supervision or care of councils; and increases in labour costs, in part because of increases in the National Living Wage.

Taken together, these factors mean it is highly likely that a funding gap will re-emerge in future years, unless there are continued large increases in council tax and/or additional funding is allocated or devolved to councils.

Relying on council tax or the devolution of additional tax revenues and powers would, like this year, see poorer parts of England fall behind in terms of funding – unless grant and other funding were redistributed to compensate for these areas' smaller tax bases. This emphasises the need to put in place a rational and transparent system for allocating government grant funding between councils, based on assessments of their needs and their own revenue-raising capacity – something that has been lacking for almost 15 years. The government had planned to re-introduce such a system next year but put those plans on hold to avoid reallocating funding in the midst of the COVID-19 crisis. It has now confirmed it plans to go ahead with this so-called Fair Funding Review at some stage, but has not set out a timeline for doing so.

There is also a whole raft of other reviews that councils are waiting on – of the adult social care system, business rates reform, fiscal devolution, and post-Brexit regional development funding. Each of these may have major implications for councils' spending responsibilities and needs or revenues in the years ahead. The longer-term financial outlook for local government therefore remains highly uncertain – and challenging.