Box C: The state of local government finances

By Jack Shaw

There is a crisis unfolding across local government which has far-reaching implications that are not fully understood. Since 2021, seven local authorities in England have issued what is formally known as a Section 114 but popularly dubbed a 'bankruptcy notice'. This is historically unprecedented.

The Government has explained these notices as examples of 'localised mismanagement' and cited either poor culture or governance. There is evidence that both poor culture and governance exist across a small number of England's 317 authorities, but the majority are well-managed. How did authorities which employ two million people in England, and are responsible for spending tens of billions on public services every year, get into this situation?

Diagnosis

In 2010, authorities received funding via three routes: council tax, business rates and grant funding from central government. As a result of the Government's programme of fiscal restraint, the grant funding made available to authorities fell sharply – from £46.5 billion in 2010 to £28 billion a decade later. This is the equivalent of a 40 per cent reduction in their 'spending power' (Atkins and Hoddinott, 2020).

In order to address the shortfall, authorities have adopted a series of strategies. In the first instance, they identified savings by 'trimming fat': reducing services and corporate costs, such as back office administration, pursuing digitalisation and introducing voluntary redundancies. The Government adopted a blunt approach when it decided where reductions were applied and, as a result, disadvantaged authorities were subject to more aggressive squeezes. Salami-slicing services gave way to more widespread service transformation as authorities were required to identify more substantial savings, including through redesigning and integrating services or sharing them with neighbouring authorities. Services continued to be reduced – or in some cases discontinued altogether – throughout the mid-2010s. Authorities also began to pursue income generation strategies: introducing a broad range of fees or increasing the amount charged for services, from burial and wedding ceremonies to waste collection and parking, and investing in commercial property, primarily retail and office space, were chief among them. In 2015-16, authorities invested £236 million in commercial assets (NAO, 2020). In 2016-17, that increased seven-fold to £1.8 billion.

Throughout the pandemic, relatively generous support from the Government combined with the temporary closure of services (e.g. leisure centres and libraries) reduced financial pressure and enabled the sector as a whole to increase its reserves. Not all authorities benefitted and in other cases the reduction in income had an adverse effect. Though nuanced, this increase in reserves during Covid-19 has bred scepticism in government that the financial challenges facing authorities are as acute as suggested. This has shaped the Government's response until now.

As authorities came out of the pandemic, service transformation, commercial investment and salami-slicing have increasingly become inadequate to address shortfalls. This is in part driven by post-pandemic pressure on services, with suppressed demand arising from the temporary closure of services increasing late-stage, costlier interventions across social care and public health.

The acuity of the challenge has also been driven by the macroeconomic environment. High inflation has increased the cost of delivering services. High interest rates have increased the cost of borrowing and in some cases revenue streams have become unviable. The cost-of-living crisis has continued to increase the demand for services, while the rise in council tax arrears has increased the debt owed to authorities. Pay awards set by the National Joint Council for the sector has also increased pressure on authorities.

These cost pressures are outpacing economy-wide inflation and by 2024-25 the pressure on authorities will increase by £15 billion, which is equivalent to a 29 per cent increase in the cost of delivering services relative to 2021-22 (LGA, 2023). The rising cost of homelessness and social care have been especially problematic. The cost of homelessness is 26 per cent higher and children's social care 16 per cent higher for the period of April-September 2023 compared with the same period in 2022 (IFS, 2023).

The culmination of over a decade of pressure has upped the ante on authorities. Voluntary redundancies have returned, and in many cases mandatory redundancies have replaced them. In Bradford, 113 employees are at risk of redundancy and in Birmingham that figure is 600. Emergency spending controls have been introduced in dozens of authorities in the last 24 months. And credit ratings agency Moody's has raised concerns about the debt held by authorities, downgrading Warrington Council in 2022.

Given the number of interdependent challenges facing authorities, there is no clear 'typology of failure'. Large urban authorities with high levels of deprivation and affluent suburban authorities are at risk in equal measure, often for different reasons.

How has the government responded?

While the Secretary of State for Levelling Up, Housing & Communities, Michael Gove, acknowledges the challenges facing authorities, the Government has expressed some doubt. Gove told the Levelling Up, Housing & Communities Select Committee that the number of authorities reported by the LGA at risk of failure is an "overestimate" and accused the sector of "crying wolf" (DLUHC, 2023c).

This may explain why the Local Government Finance Settlement (the annual funding allocation for authorities) will be less redistributive in 2024-25 than in 2022-23, with no additional funding for disadvantaged authorities (IFS, 2023). Though upper-tier authorities are entitled to increase council tax by 5 per cent, the Government has 'capped' them from increasing tax further without a referendum.

Curiously, the Government has given a small but growing number of authorities a 'dispensation' to increase council tax by more than 5 per cent without a referendum. This contravenes the spirit of the 'principle of excessiveness' enshrined in the Localism Act (2011) and amounts to a tacit recognition that the framework that underpins local government finance is increasingly out of kilter with the acute challenges. From April 2024, Thurrock, Slough and Woking, which have all issued high-profile Section 114s, are able to raise council tax by up to 10 per cent without a referendum. Birmingham City Council, which supports over one million residents, has requested a dispensation to raise council tax by 21 per cent by April 2025.

An increasing number of authorities have also requested Exceptional Financial Support. These requests are under consideration by the Government. If approved, they will enable authorities to cover day-to-day spending through the sale of assets or by spreading expenditure over multiple years. Requesting this support is indicative of financial distress. In recent weeks Havering, Bradford, Stoke-on-Trent, Dudley, Middlesbrough and Somerset have announced that they are in this position. More are expected to follow and up to one in five authorities are at serious risk (LGA, 2023b).

Over the last 18 months the Government has adopted a wait-and-see approach. Beyond approving requests for Exceptional Financial Support, it has been non-interventionist prior to bankruptcy notices. When authorities have issued a Section 114, the Government has appointed Commissioners, but it has done so inconsistently. This has led to accusations that their appointment is politicised and Nottingham City Council recently appealed against the Government's decision to introduce Commissioners.

In the medium-term, the pressure on authorities is unlikely to recede. Under the current spending plans announced in the Autumn Statement, investment in public services is expected to fall by 1.4 per cent in real terms between 2024-25 and 2027-28 (Hoddinott, 2023). The Shadow Chancellor, Rachel Reeves, has similarly ruled out substantive investment in public services. Reducing investment in the criminal justice system and schools will also displace pressure, including onto local services.

What more can be done?

Given criticism about Westminster's inaction, it is welcome that the Government is now exploring alternative financial instruments, having launched a new consultation that could give authorities the ability to capitalise day-to-day spending without having to request it (DLUHC, 2023a). This has been met with tentative opposition though following concern that the Government risks normalising an approach which it concedes is neither "prudent or sustainable". It is entirely legitimate to ask questions about the productive capacity of £23 billion in local assets, but there is a risk that if authorities are required to sell assets, it may provide short-term relief but erode their medium-to -long-term resilience (Shaw, 2024).

Financial instruments as yet unexplored are also available. While authorities are required to set a balanced budget every year, NHS Trusts are not. The NHS has greater autonomy over its finances and its 'breakeven duty' enables NHS Trusts to balance their books over three years (or, exceptionally, five). The NHS Act has given NHS Trusts this flexibility since 2006. Likewise, the re-introduction of multi-year settlements, which has been used by both Conservative and Labour governments, could help authorities with longer-term financial planning and enable them to make more strategic decisions. Neither of these alone address the root issues facing authorities, but they should be given consideration.

Announcing a clear set of priorities for local government as part of the Public Sector Productivity Programme is also warranted. While public sector productivity has increased by 0.7 per cent each year from 2010 to 2019, social care – the largest cost for most authorities – has stagnated or become less productive (TPI, 2022). This is not unconnected to the failure to address its inadequate funding model.

The crisis facing authorities also provides the opportunity for a more radical revision of the purpose they serve and the value they add. While a new constitutional settlement may appear distant from the lives of ordinary citizens, there have been issues arising from the lack of clarity over the statutory duties incumbent on authorities, of which not a single authority in England has a full understanding. This is no reflection on the sector. For example, social care is governed by at least 58 Acts of Parliament. Or take the more concrete example of the Public Libraries and Museums Act (1964), which places a statutory duty on authorities to "provide a comprehensive and efficient library service". Yet what 'comprehensive' and 'efficient' mean are subject to multiple interpretations. The number of libraries, their opening times, the services they run, the books they stock and the maintenance their buildings receive are at the discretion of authorities. And even when Birmingham issued a Section 114, it still could not identify its statutory duties. With public satisfaction and trust in authorities at its lowest since 2012, a national conversation is sorely needed (LGA, 2023a).

Despite the challenges with determining the contours of statutory and discretionary services, one option set out by Barnet Council in 2009 is to adopt an 'easyCouncil' model, based on airline EasyJet. Under this model, services could simply retrench to a minimum 'core service' with duties interpreted narrowly. This is undesirable for both authorities, who are at greater risk of judicial review, and citizens, who will receive a poorer service or be denied access to a service to which they are entitled. It will also adversely affect the most vulnerable, including homeless people and those with special educational needs.

The most impactful interventions are either unpalatable to Westminster or have repeatedly been kicked in the long grass. Additional investment for authorities is not likely – or will be limited in scope - given fiscal restraint exercised by central government. Even new tax-raising powers for authorities have failed to earn support from the Government or HMT.

The deeply regressive council tax, based on 1991 property values, requires reform. It has not been re-evaluated since it was introduced, though the Scottish and Welsh devolved governments have managed to do so. The Government should follow in the footsteps of the Welsh Government, which is currently consulting on making council tax fairer (Welsh Government, 2023).

And the long-awaited Review of Relative Needs and Resources (the Fair Funding Review) was designed to address the outdated funding formula that underpins the series of grants the Government allocates to authorities, though it will take place no earlier than 2026.

Though the options on the table might provide authorities with some relief, without both serious reform and substantive investment, more authorities are at risk of failure, confidence in public services will suffer and the public will be denied services which can enrich their lives, protect their health, and support local economies.

Further reading

Atkins, G. and Hoddinott, S. (2020) Local government funding in England | Institute for Government

Brien, P. and Sandford, M. (2023) Local Government Finance Settlement, 2023-24 | House of Commons Library

Davies, N. et al (2023) Performance Tracker | Institute for Government

Department for Levelling Up, Housing and Communities (2023a) Local government call for views on capital measures to improve sector stability and efficiency

Department for Levelling Up, Housing and Communities (2023b) Local government finance policy statement, 2023-24 to 2024-25

Department for Levelling Up, Housing and Communities (2023c) Oral evidence given to the Levelling Up, Housing and Communities Select Committee by Michael Gove

Game. C. and Wilson, D. (2011) Local government in the United Kingdom

Hoddinott, S. (2023) The Government has abdicated responsibility for public services | Institute for Government

Local Government Association (2023a) Polling on resident satisfaction with councils: Round 34

Local Government Association (2023b) Section 114 fears for almost 1 in 5 council leaders and chief executives after cashless Autumn Statement

National Audit Office (2020) Local government investment in commercial property

Odgen, K. and Phillips, D. (2023) The 2024-25 Local Government Finance Settlement: the real pain is still to come | Institute for Fiscal Studies

Pike, A. (2023) Financialisation and local statecraft

Shaw, J. (2024) Is selling off assets the right solution to the crisis in local government finance? | UK in a Changing Europe

Van Ark, Bart. (2022) Making public sector productivity practical | The Productivity Institute

Welsh Government (2023) Consultation on a Fairer Council Tax: Phase 2