Fiscal issues facing Local Government in Scotland

A final report for the Scottish Local Government Partnership
March 2017

University of Strathclyde Business School

UNIVERSITY of STRATHCLYDE
FRASER OF ALLANDER INSTITUTE

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The following report has been prepared by the Fraser of Allander Institute (FAI). The FAI is a leading independent academic research institute focussed on the Scottish economy.

The report was commissioned by the Scottish Local Government Partnership (SLGP). SLGP determined the specific research question to be analysed.

The technical analysis, methodology and writing of the final report and conclusions was undertaken independently by the FAI.

The FAI is committed to informing and encouraging public debate through the provision of the highest quality analytical advice and analysis. We therefore are happy to respond to requests for factual advice and analysis.

The FAI does not have (and will not take) a position on the specific policy objectives of the report or how it is interpreted.

Any technical errors or omissions are those of the FAI.

Fraser of Allander Institute
March 2017

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1. Introduction

Local government is responsible for delivering essential public services in education and early years learning, social work, housing, local public transport and transport infrastructure, and local environmental services (including waste collection). It also has responsibilities in local economic development, and the provision of recreational and cultural facilities.

The question of how local authorities fund these services is critical to their quality and sustainability, and the outcomes that they support.

Like almost all other parts of the public sector, local authority budgets have faced a real terms squeeze in recent years. Local budgets have also increasingly been impacted by historic commitments and conditions imposed by central government.

Given the ratio of own-source revenues to central government funding, local authorities have limited scope to raise significant amounts of revenue directly.

The Fraser of Allander Institute was commissioned in October 2016 by the Scottish Local Government Partnership to undertake a review of fiscal issues facing local government in Scotland.

An interim report was published in December 2016. This report considered recent trends in local government funding and provided an outlook based upon different scenarios for how the Scottish Government may choose to prioritise areas in its (then upcoming) Draft Budget. The report also provided a brief overview of the operation of the local government allocation process.

This final report updates this analysis to take account of the 2017/18 Scottish funding settlement and considers further the different commitments and constraints that local government could face in the years ahead.

The report is structured as follows:

- Section 2 examines the 2017/18 funding allocation in detail – building up from the initial allocation in December's Draft Budget and subsequent additions – and then considers the 2017/18 settlement in a longer-term context.

- Section 3 considers how the distribution of local government spending has changed since the start of the period of fiscal consolidation.

- Section 4 examines how funding is allocated across Scotland's 32 local authorities, and considers the strengths and weakness of the current approach.

- Section 5 considers the outlook for local government funding over the remainder of this parliament.

- Section 6 concludes.

2. Government funding to local government

Background

Local government revenue is derived from a number of sources:

- The General Resource Grant from Scottish Government
- Specific Revenue Grants from Scottish Government
- Non-Domestic Rates Income
- Council Tax revenues
- Income for a variety of other service fees and charges (ranging from parking fees to income from social care services).

The financing arrangements for local government are complex. The General Resource Grant and ring-fenced Specific Revenue Grants are paid by the Scottish Government to local authorities. Non-Domestic Rates on the other hand, are collected by local authorities, paid into a central pool and then re-distributed. It is the Scottish Government that sets the tax rate – i.e. the poundage. Council Tax revenues raised by each local authority are retained.

The revenue funding provided by the Scottish Government consists of the General Resource Grant, Specific Revenue Grants, and, Non-Domestic Rates Income (NDRI). The Scottish Government guarantees to provide to local authorities the total of General Revenue Grant and NDRI – in other words the Scottish Government bears the risk that NDRI revenues come in below forecast.

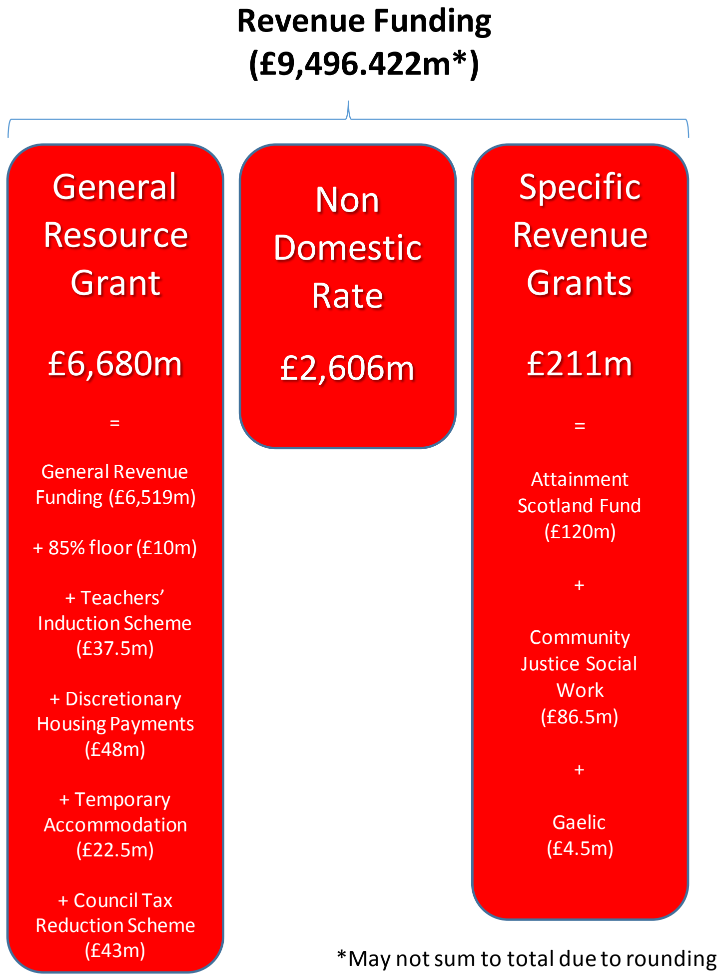
In this section we consider all the Scottish Government elements of funding specifically.

When taking into account how much support to provide each local authority, the Scottish Government considers both the amount of money from grants and Non-Domestic Rates.

The structure of the resource settlement – using the Draft Budget finance circular for 2017/18 as an example – is shown in Figure 2.1[1].

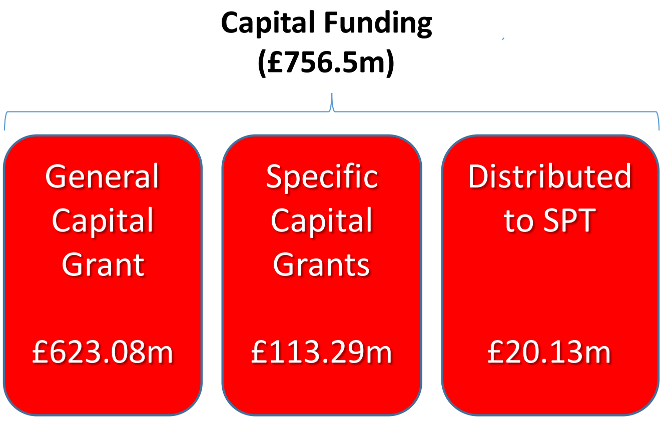
[1] The Draft Budget Finance Circular was published on 15 December 2016, coinciding with the publication of the Scottish Government's Draft Budget. A revised Local Government Finance Circular will be published on 9 March 2017, immediately after the Local Government Finance Order has been approved by Parliament. The figures in this report coincide with those in the 15 December Circular, and will be updated once the revised circular has been published.

Figure 2.1: Components of revenue funding (2017/18)[2]



Alongside this, local government receives a capital settlement each year - £756.5m in 2017/18. This is made up of a General Capital Grant, Specific Capital Grants, and an amount distributed to Strathclyde Partnership for Transport (SPT), (Figure 2.2).

Figure 2.2: Components of capital funding (2017/18)



[2] http://www.gov.scot/Topics/Government/local-government/17999/11203/lgfcircular1718

In the next two sections we outline the detail behind the 2017/18 settlement. To help with interpretation of the key numbers, we firstly set out the initial settlement put forward by the Scottish Government in their Draft Budget as published on 15th December[3]. We then outline how this was then modified as part of the Stage 1 Budget negotiations.

2017/18 Draft Budget Settlement

Table 2.1 shows the Local Government Settlement for 2016/17 and 2017/18 as laid out in the Finance Circular released on 15th December[4].

Relative to the latest 2016/17 finance settlement figures, the general revenue budget (i.e. the General Resource Grant and redistributable Non-Domestic Rates combined) was expected to fall by 4.8% in real terms in 2017/18 (Table 2.1) – or 3.4% in cash terms. This is typically interpreted as the level of resource available to local government to use on a discretionary basis. An additional £120m of ring-fenced grant was made available to support educational attainment through specific revenue grants.

Combining discretionary and specific grants, the total revenue funding available to local government was forecast to fall by just over £200m in cash terms, equivalent to 3.5% in real terms.

On the capital side, the Finance Circular laid out a £150m cash terms (28% real terms) increase in the General Capital Grant. However, this requires careful interpretation.

Prior to the initial 2016/17 settlement, the Scottish Government and local authorities agreed for £150m of capital funding to be re-profiled into future years. In effect therefore, the capital settlement remained flat in cash terms between 2016/17 and 2017/18 but £150m of 2016/17 funding has been transferred to future Budgets.

Overall, the total funding available to local government represented a decline of about £60m in cash terms (2% real terms reduction)[5].

[3] See www.gov.scot/Publications/2016/12/6610

[4] Figures for 2016/17 and 2017/18 both come from the latest finance circular (9/2016). This means that the comparisons being made are between near final 2016-17 figures with initial (Draft) figures for 2017-18.

[5] If initial figures for 2016/17 from Finance Circular (7/2015) are compared instead, then the decline is around £47.4m.

Table 2.1: Local Government Settlement, Draft Budget 2017/18 (£m)

	2016/17	2017/18	Cash change (%)	Real change (%)
General Resource Grant (GRG)	6,845.3	6,679.7	-2.4%	-3.8%
Non-Domestic Rates (NDR)	2,768.5	2,605.8	-5.9%	-7.2%
General Revenue Budget (GRG + NDR)	*9,613.8*	*9,285.5*	*-3.4%*	*-4.8%*
Specific Revenue Grants	91.0	211.0	131.9%	128.6%
Total revenue	*9,704.8*	*9,496.4*	*-2.1%*	*-3.5%*
General Capital Grant	480.6	623.1	29.6%	27.8%
Specific Capital Grants	110.2	113.3	2.8%	1.3%
Distributed to SPT	16.0	20.1	25.6%	23.8%
Total capital	*606.9*	*756.5*	*24.7%*	*22.9%*
Total funding	**10,311.7**	**10,252.9**	**-0.6%**	**-2.0%**

Source: Local Government Finance Circular 9/2016; FAI Analysis

In presenting its Draft Budget, the Scottish Government stated that spending to support local authority services would increase by over £200m between 2016/17 and 2017/18. Yet Table 2.1 shows a cash terms fall in the local government settlement of £60m. How can these two things be reconciled? Box 2.1 explains.

Box 2.1: The local government settlement and local service spending

In presenting its Draft Budget, the Scottish Government stated that spending to support local authority services would increase by over £200m between 2016/17 and 2017/18, despite the core local government settlement falling in cash terms.

The key explanation for this is that, in addition to the numbers associated with the local government settlement itself, the Scottish Government also identified other 'sources of support' for local services. These included:

An increase in funding of £107m for Health and Social Care Integration; and

An additional £111m revenue from reform of Council Tax Bands.

The Scottish Government also argued that added to this could be the potential £70m of revenues that could be raised if all Scottish local authorities raised Council Tax by 3% (the maximum they are entitled to in 2017/18).

When this additional £288m is added to the cash terms cut of £60m identified in Table 2.1, the result is a cash terms increase in spending on local services of over £200m. As an aside, the actual number could differ slightly – with the Scottish Government pointing to a slightly higher number – depending upon whether or not comparisons are made between Draft Budgets or Local Government Finance Circulars.

There has subsequently been much debate about the use of such comparisons. We discussed these issues in detail here – www.fraserofallander.org/2016/12/16/local-government-settlement-so-who-is-right-well-both-are

At the heart of this debate are two key issues: 1) the distinction between local services and the funding available for local government and, 2) the discretionary power of local authorities to choose how they allocate funding to priorities within their area.

The local government settlement is inevitably complex, involving a number of funding streams from a variety of different sources – and including discretionary as well as specific grants. Nonetheless, and as noted by the Scottish Parliament's Local Government Committee in its scrutiny of the Draft 2017/18 Budget[6], the way that the settlement is presented does not aid analysis or scrutiny of the figures. This is particularly the case given the way that slightly different information is contained and presented in the budget relative to the finance circulars.

We would support the Local Government Committee's recommendation for greater transparency around the local government settlement. There is a strong case for including the relevant finance information in one document, rather than having to read across a number of circulars and budgets. Allied to this is a case for more transparent and accessible data on local government funding over the longer term.

Stage 1 Budget 'deal'

On 2nd February, and at Stage 1 of the Budget Bill's passage through parliament, the Scottish Government announced a further £160m of resources for local government (made up of £130m revenue and £30m capital)[7]. This was part of a £220m increase in spending beyond the plans laid out in December's Draft Budget.

Of this additional £220m of spending, £30m was funded by tax policy changes (Table 2.2). The majority was from underspends from previous years, combined with a surplus of £60m in the Non-Domestic Rates pool – see Table 2.2.

Table 2.2: Sources of the additional £220m announced at Stage 1

Source	Amount
Budget Exchange (i.e. underspends from previous years)	£125m
Non-Domestic Rates Pool	£60m
Income tax (cash-terms freeze in Higher Rate threshold)	£29m
Reduction in forecast borrowing costs	£6m
Total	**£220m**

Source: FAI Analysis

[6] http://www.parliament.scot/parliamentarybusiness/CurrentCommittees/103259.aspx#j

[7] http://news.gov.scot/news/budget

Table 2.3 updates the Local Government settlement numbers shown in Table 2.1 to take account of this additional funding (of which £70m General Resource Grant, £60m Non-Domestic Rates income and £30m General Capital Grant).

In real terms, the General Revenue Budget is now forecast to fall by around 3.5% in real terms (as opposed to 4.8% at the Draft Budget). Total revenue funding (including the Attainment Fund) will fall by 2.2%. The Scottish Government's grant from Westminster for resource spending increased by 0.14% in real terms between 2016/17 and 2017/18.

Following Stage 1, and adding in capital spending, total local government funding is to increase by £100m in cash terms; a fall of 0.5% in real terms (as opposed to 2% at the Draft Budget).

Finally, if however, one accounts for the £150m re-profiled capital grant set out above, then total capital funding will increase by only 2.4% (rather than 27.7%). Thus total funding is projected to fall by 1.9% (rather than 0.5%) in real terms.

Table 2.3: Local Government Settlement 2017/18 after Stage 1 amendment (£m)

	2016/17	2017/18	Cash change	Real change
General Resource Grant (GRG)	6,845.3	6,749.7	-1.4%	-2.8%
Non-Domestic Rates income	2,768.5	2,665.8	-3.7%	-5.1%
General Revenue Budget (GRG + NDRI)	9,613.8	9,415.5	-2.1%	-3.5%
Specific Revenue Grants	91.0	211.0	131.9%	128.6%
Total revenue	9,704.8	9,626.4	-0.8%	-2.2%
General Capital Grant	480.6	653.1	35.9%	33.9%
Specific Capital Grants	110.2	113.3	2.8%	1.3%
Distributed to SPT	16.0	20.1	25.6%	23.8%
Total capital	606.9	786.5	29.6%	27.7%
Total funding	10,311.7	10,412.9	1.0%	-0.5%

Source: Local Government Finance Circular 9/2016; FAI Analysis

The 2017/18 settlement in longer term context

Having set out the planned 2017/18 settlement, this section aims to provide some context behind this figure.

Chart 2.1 shows the evolution of the local government revenue settlement over the last decade.

Such analysis is complicated by the removal of Police and Fire services from local government in 2013/14. Comparative analysis of Budgets must therefore be adjusted. This is more difficult than might be imagined, as funding for police and fire services came from a number of non-discrete Budget lines. Our draft report outlined two ways to remove police and fire from pre-2013/14 settlements – the 'shares method' and the 'Accounts Commission' method (Box 2.2). These methods allow comparisons to be made over time in lieu of official figures but should be used with caution – the Scottish Government provides no comparative time series like-for-like analysis of local government budget changes, arguing that no single method is appropriate.

Box 2.1: Methods for controlling for the removal of police and fire services from local government budget lines

The 'shares method' calculates the share of local government general revenue funding that was transferred out of the local government settlement in 2013/14 and 2014/15 to account police and fire. According to the Scottish Government's Draft Budget 2013/14, the local government settlement was reduced by £954.7m in 2013/14 and £953.9m in 2014/15 following the transfer of responsibility for policing to the new Scottish Police Authority (SPA); and the settlement was reduced by £274.8m and £273.0m in each year following the transfer of responsibility for the fire service to the new Scottish Fire and Rescue Service[8]. Additionally, a further £315m was removed from the settlement to account for police and fire pensions[9].

This implies that the local government revenue settlement was reduced by 13.7% in 2013/14 and 13.5% in 2014/15 as a result of the transfer. One way to account for the transfer in previous years is therefore to assume that the local government settlement would have been 13.6% lower each year had local authorities not had the responsibility for police and fire services in those years.

The 'Accounts Commission' methodology takes figures on expenditure on relevant police and fire services from the Scottish Government's Draft Budgets for each year prior to 2013/14, and deducts these from the local government general revenue funding settlement in each of those years. It also makes an adjustment to take account of the funding of police and fire pensions that was included in the pre-2013/14 circulars[10].

As will be seen, the two methods give broadly the same result.

At the time of the Draft Budget, the local government settlement was projected to have declined by 10.9% in real terms between 2010/11 and 2017/18 according to the 'shares method', or 10.5% in real terms according to the Accounts Commission method.

Following Stage 1, the real terms decline is now 9.7% and 9.3% respectively. (In cash terms the local government settlement is basically unchanged in 2017/18 relative to 2010/11; in real terms it is around £1bn lower).

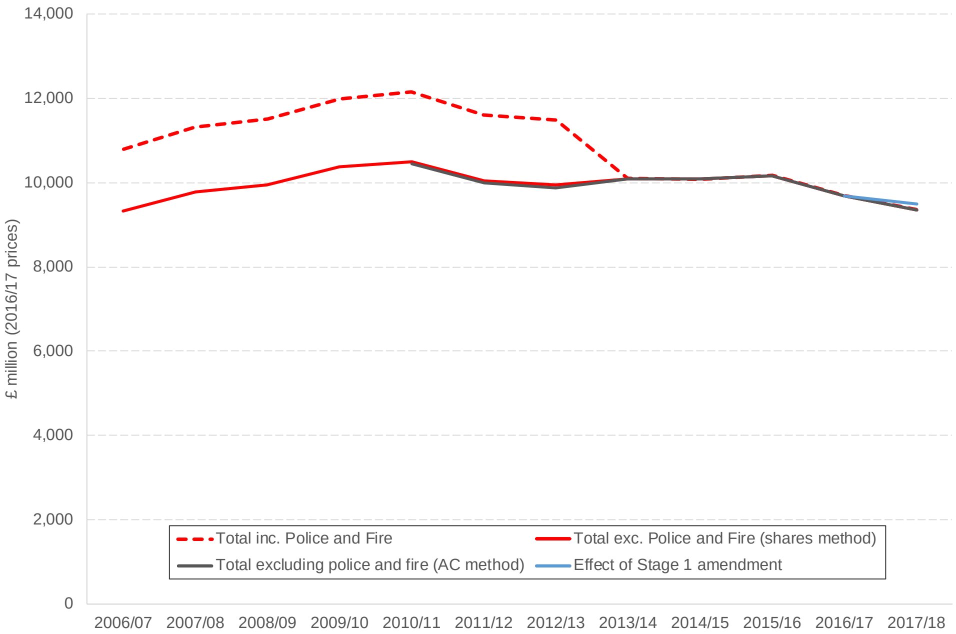
It should be noted that this analysis includes the additional £120m allocated in 2017/18 for the Attainment Fund. If this is excluded – so that we are considering the evolution of funding for existing discretionary spending only – the real terms declines are 10.8% and 10.4% respectively.

[8] Scottish Government Draft Budget 2013/14 http://www.gov.scot/Resource/0040/00402310.pdf

[9] Scottish Government Finance Circular 5/2012 (Annex A) http://www.gov.scot/Resource/0040/00409088.pdf

[10] http://www.audit-scotland.gov.uk/report/local-government-in-scotland-financial-overview-201516

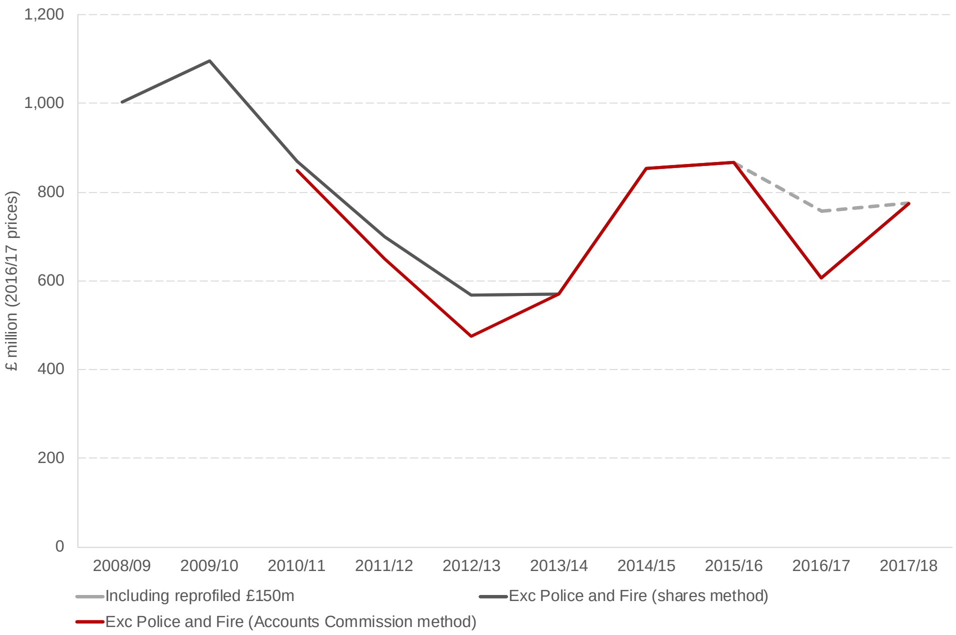
Chart 2.1: Total revenue funding to local government (including Non-Domestic Rates and specific grants), 2006/07 – 2017/18



Source: Local Government Finance Circulars, FAI analysis

Chart 2.2 undertakes a similar analysis for capital spending. It shows that the local government capital settlement is around 30% below its 2009/10 peak. Including the £30m additional Stage 1 funding (and assuming the £150m capital funding not been re-profiled from 2016/17 into future years, as shown by the dashed line), the capital settlement is in line for a very small real terms increase between 2016/17 and 2017/18.

Chart 2.2: Capital funding, 2016/17 prices



Note: Figure shows total local government capital allocation (general capital grant plus specific grants and SPT allocation). The dashed line shows the trajectory had £150m capital funding not been re-profiled from 2016/17 into future years. Source: Local Government Finance Circulars, FAI analysis

Much of the 'new' funding included in the local government settlement in recent years has been added to the settlement to account for 'new burdens', i.e. new spending commitments that local government is expected to deliver.

The funding for these new burdens is included within the settlement figures that we have already presented. Implicitly therefore, on a truly like-for-like basis, the level of resources that local government has to deliver its existing commitments has declined more rapidly than is implied by looking at the value of the total settlement.

Examples of new burdens include the expansion of early years education and childcare services (associated with £58m funding in 2016/17), the Scottish Welfare Fund (associated with £38m in 2016/17), the new Children and Young People Act (associated with around £75m additional funding), and new flood risk management responsibilities (associated with around £8m funding).

A true 'like for like' comparison of the local government settlement would account for each of these new burdens (and in some cases, account for burdens that local government no longer has to deliver). However, developing such a like-for-like measure is problematic given some uncertainty around what counts as a 'new burden' and what is a reconfiguration of existing responsibilities. And, in many cases the amount transferred may be based upon an estimated cost – e.g. for childcare provision – and in reality, may turn out to be too much or too little funding.

The Scottish Government can also make the new burdens argument. For example, its declining real terms resource DEL settlement from Westminster since 2010/11 includes the allocation of around £350m to the Scottish budget in 2013/14 to account for the transfer of Council Tax Benefit from DWP to the Scottish Government.

For these reasons, we do not attempt here to provide an adjusted estimate of the local government settlement that takes explicit account of the new burdens. But suffice to say that there has been some significant change in the balance of public services that local authorities are expected to deliver – and this evolution has come at a time when real terms budgets have been declining.

Local government share of Scottish Government Budget

Another way to look at the long-term trend in local government funding is to examine its share of the total resources being spent by the Scottish Government.

On our calculations, local government's revenue funding (general resource grant, specific grant and Non-Domestic Rates) as a share of the Scottish Government's RDEL grant plus Non-Domestic Rates revenues, has fallen from 35% to 33% (regardless of which method is used to account for the transfer out of police and fire) between 2010/11 and 2017/18.

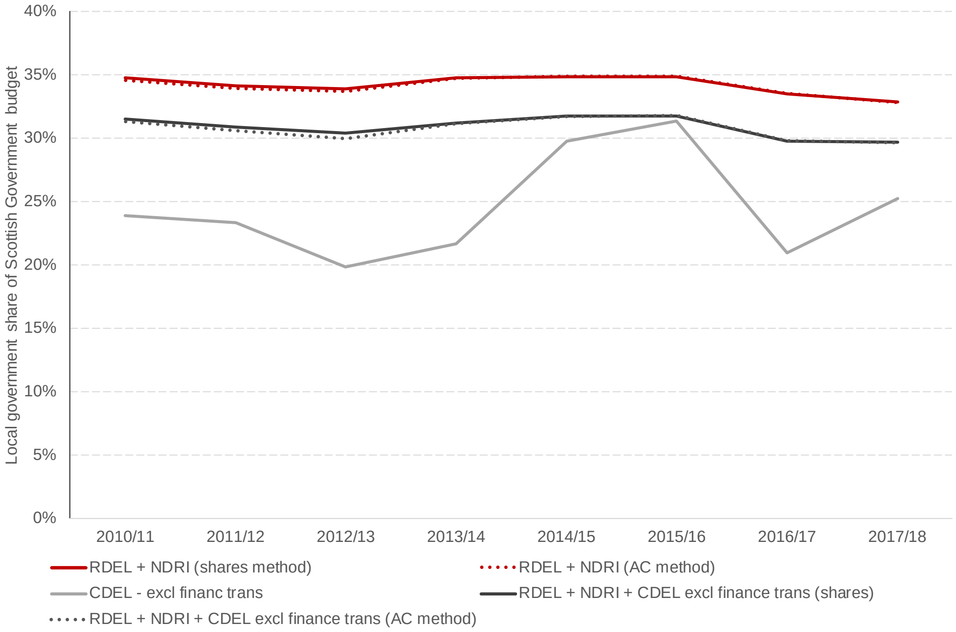
To put this in context, maintaining its share would have boosted local government revenue funding by around £570m in 2017/18– see Chart 2.4. Of course, such increases if they had materialised would have led to reduced spending in other areas of devolved public spending, such as health. Indeed, local government's falling share of Scottish Government spending reflects the choices that the Scottish Government has made to protect health spending at a time when its total budget settlement from Westminster has been falling.

Note that the fall in the local government share largely occurred in the last two years, 2016/17 and 2017/18.

In terms of capital, local government's share of Scottish Government capital Budgets has increased by 1 percentage point between 2010/11 and 2017/18.

Combining resource and capital, the local government share fell from 31% to 30% over the period.

Chart 2.4: Local government share of Scottish Government Budget



Source: Scottish Budgets and Local Government Finance Circulars, various years; FAI analysis

3. Local government spending

Background

In this section we examine how the local government expenditure has changed in recent years.

Local government incurs both revenue and capital expenditure, figures for which are reported by the Scottish Government in their annual Local Government Finance Statistics publication[11]. These do not include accountancy adjustments such as depreciation, pension revaluations, changes in the value of assets, etc[12]. The aim of this section is to look at spending on an annual basis by local government in Scotland on service areas.

Some elements of expenditure (revenue contributions to capital and grants to third parties funded by the general capital grant) have been reported both as revenue and as capital expenditure historically[13]. For this reason, revenue and capital accounts are presented separately and should not be combined, in order to avoid double-counting.

It is important to remember too that spending patterns do not necessarily reflect 'demand' or 'need'. In the face of real terms declines in resources available to them, local authorities have implemented service reforms to mitigate demand for particular services (for example, investment in re-ablement services to reduce care home costs). But reduced expenditure will inevitably have an impact on the quality of service delivery to some degree.

Revenue expenditure

Revenue expenditure can be looked at in two ways:

- Total Gross Revenue Expenditure on services, including income serviced through fees and charges.

- Net Revenue Expenditure on services, which is Total Gross Revenue Expenditure on services minus income from providing services (e.g. through fees, charges, and specific grants). Net Revenue Expenditure is funded through General Funding (which is made up of the General Revenue Grant, Council Tax and Non-Domestic Rates).

[11] http://www.gov.scot/Topics/Statistics/Browse/Local-Government-Finance/PubScottishLGFStats

[12] The Accounts Commission look at spending in statutory accounting terms: http://www.audit-scotland.gov.uk/report/local-government-in-scotland-financial-overview-201516

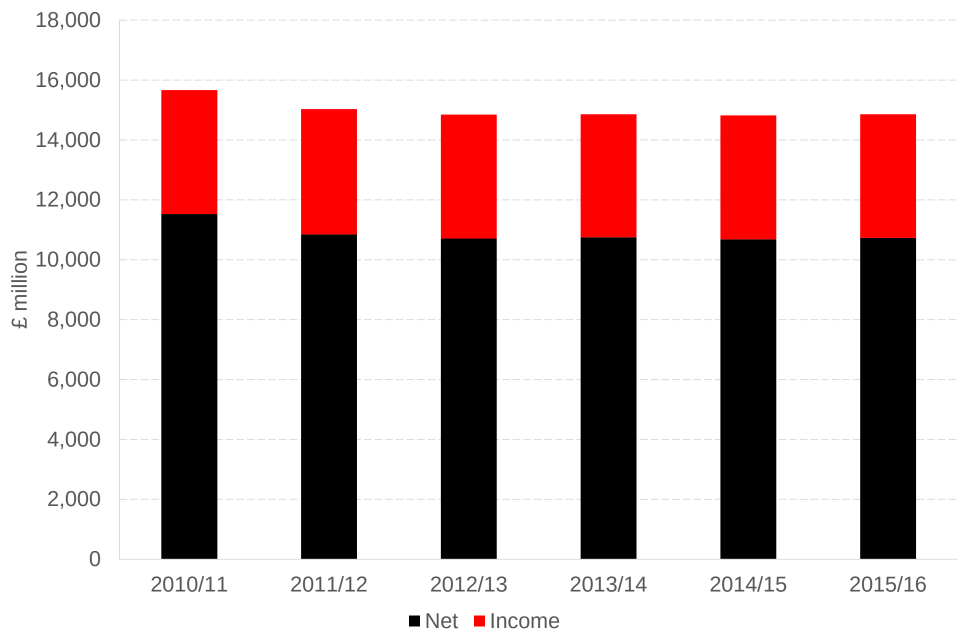
[13] In the 2014/15 finance statistics publication tables, Revenue Contributions to Capital (RCC) are now counted under statutory adjustments while previous publications counted RCCs as revenue service expenditure. In order to produce a consistent time series, RCCs have been removed from the gross and net revenue expenditure series.

Service income can be derived from a variety of different sources – for example parking charges, income from social care, revenues from recreation facilities, and grants from other organisations to deliver particular activities. In some cases, service income helps local authorities deliver wider spending objectives, whilst in other cases, it is attached to the delivery of specific services.

Gross revenue expenditure on all services (including service income) was £15.3bn in cash terms in 2015/16, the last year for which outturn data is available. Taking income generated from providing services into account (£5.2bn), net revenue expenditure on all services was £10.1bn in cash terms. This £10.1bn of net spending on All Services is made up of General Fund revenue expenditure on services and the Housing Revenue Account.

The Housing Revenue Account (HRA) records income and expenditure relating to local authority housing stock separately. Whilst most other local authority services are funded through a combination of Non-Domestic Rates, Council Tax income and Government grants, the HRA is a ring-fenced account, and expenditure is funded mainly by housing rents. In 2014/15 Housing Revenue Account (HRA) net spending was around -£490m, i.e. service income from the HRA (£1.15bn) was greater than gross service expenditure (£660m).

Chart 3.1: General fund gross revenue expenditure, 2016/17 real prices



Source: Local Government Finance Returns; FAI analysis

This chapter will concentrate on General Fund expenditure on services (Education, Culture and related services, Social Work, Roads and Transport, Environmental Services, Planning and Economic Development, Non HRA Housing, Central Services and Trading Services) over time for which a consistent series is available through removing Police and Fire expenditure and District Court expenditure from the General Fund[14].

[14] District Courts were transferred from local government in 2010/11, while Police and Fire were transferred out of Local Government in 2013/14. Spending on these areas have been removed.

Looking at General Fund service spending in real terms (Chart 3.1), gross expenditure on services fell from £15.7bn in 2010/11 to around £14.8bn in 2012/13, where it has remained since. Likewise, net expenditure has been around £10.7bn from 2012/13 compared to £11.5bn in 2010/11. Income from General Fund services has been broadly flat between 2010/11 and 2015/16.

General Fund net revenue expenditure on services

Table 3.1 shows total Net General Fund revenue spending in real terms by service area from 2010/11 to 2015/16 (the latest year available), with gross figures in parentheses[15]. Of course, there may be classification changes or accounting changes[16] over this period affecting the consistency of service expenditure areas.

In this section we present real terms expenditure figures – it is important to adjust spending figures for inflation, as to not do so would imply that expenditure had been relatively protected over time. Nonetheless, in the Annex to this report we present the cash equivalent version of Table 3.1.

[15] These are aggregate figures for all local authorities and different trends will emerge for individual councils.

[16] For example, due to revised accounting arrangements for PPP and PFI, it is not possible to compare net revenue expenditure for 2009-10 with previous years for services (Education, Social Work, Culture & Related Services, Environmental Services and Roads & Transport) in which there are PPP or PFI schemes.

Table 3.1: General fund net (gross) revenue expenditure by service (£m), 2016/17 prices

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Education	5,095 (5,292)	4,853 (5,057)	4,815 (5,013)	4,732 (4,944)	4,689 (4,898)	4,795 (5,008)
Cultural and related services	693 (803)	656 (757)	642 (736)	634 (724)	654 (750)	606 (699)
Social work	3120 (3,936)	3070 (3,917)	3117 (3,984)	3133 (3,980)	3162 (4,011)	3209 (4,095)
Roads and transport	541 (763)	504 (712)	493 (713)	454 (685)	427 (668)	424 (630)
Environmental services	718 (859)	691 (830)	679 (814)	681 (818)	677 (803)	693 (827)
Planning and economic development	339 (556)	310 (503)	293 (505)	289 (473)	283 (469)	246 (430)
Non-HRA Housing	430 (2,576)	346 (2,488)	323 (2,450)	332 (2,465)	348 (2,477)	298 (2,428)
Central Services	602 (816)	432 (714)	354 (576)	500 (702)	446 (668)	474 (694)
Trading Services	-9 (67)	-14 (54)	-4 (57)	-2 (70)	-5 (74)	-17 (47)
General Fund expenditure on Services	11,527 (15,668)	10,848 (15,033)	10,711 (14,849)	10,752 (14,860)	10,681 (14,818)	10,728 (14,859)

Source: Local Government Finance Returns; FAI analysis

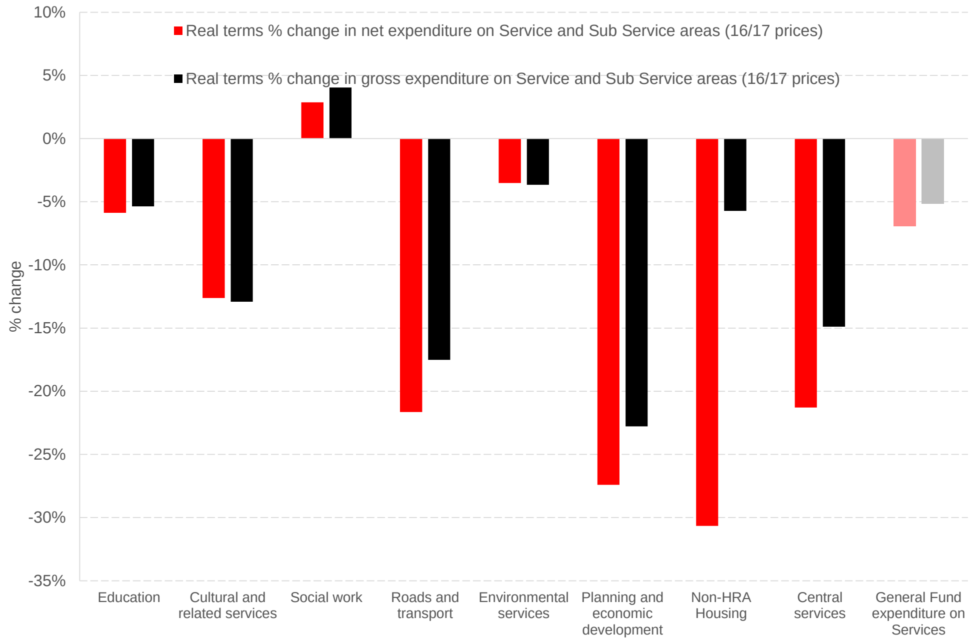
As the table highlights, there are two major areas of service expenditure – Education and Social Work – which in combination account for three quarters of total revenue service spending.

The trend in net expenditure has been quite different across Education and Social work. Net expenditure on education fell in real terms from 2010/11 to 2014/15, picking up in 2015/16, whilst real terms spending on Social Work has increased year on year from 2011/12. Most of the other smaller service areas have experienced real terms declines between 2010/11 and 2015/16 (Chart 3.2).

Service income can be calculated by subtracting net income from gross in Table 3.1. While overall income from the provision of General Fund Services has remained around the same level (Chart 3.1), services vary widely in terms of how much income they generate.

Trading Services (fishery harbours, airports, and other harbours), for example, brings in more income than spending – and is excluded from the chart below. Some subservices, like Parking charges within Roads and Transport, also generate more income than is spent by local authorities. However, the majority of services are not in this position, with more being spent on them than income generated.

Chart 3.2: General Fund service level expenditure change 2010/11 - 2015/16



Source: Local Government Finance Returns; FAI analysis

The share of each service in total General Fund net revenue expenditure is shown in Table 3.3. As might be expected, the share of net spending on Social Work has increased since 2010/11. Education has seen its share of service spending remain relatively constant while other areas, such as Roads and Transport, Planning and Economic Development, Non-HRA Housing and Central Services, have seen their share of General Fund Service net spending fall over time.

Table 3.3: Shares of net revenue expenditure by service

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Education	44.2%	44.7%	45.0%	44.0%	43.9%	44.7%
Cultural and related services	6.0%	6.0%	6.0%	5.9%	6.1%	5.6%
Social work	27.1%	28.3%	29.1%	29.1%	29.6%	29.9%
Roads and transport	4.7%	4.6%	4.6%	4.2%	4.0%	3.9%
Environmental services	6.2%	6.4%	6.3%	6.3%	6.3%	6.5%
Planning and economic development	2.9%	2.9%	2.7%	2.7%	2.6%	2.3%
Non-HRA Housing	3.7%	3.2%	3.0%	3.1%	3.3%	2.8%
Central Services	5.2%	4.0%	3.3%	4.7%	4.2%	4.4%
Trading Services	0%	0%	0%	0%	0%	0%

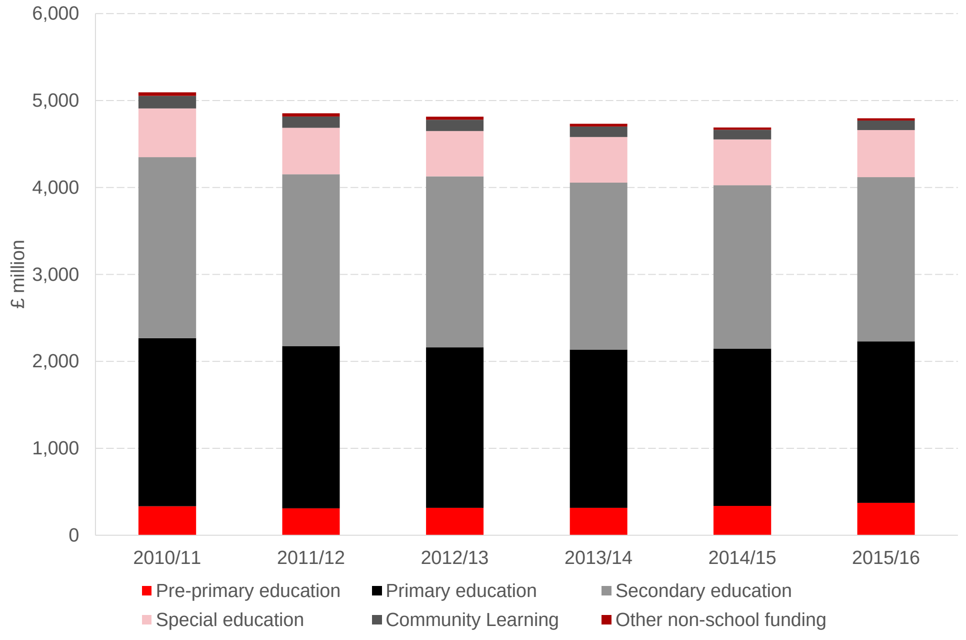
Source: Local Government Finance Returns; FAI analysis

We now turn to consider spending within services, drawing out some of the key trends.

Within Education, the largest areas of expenditure are Primary Education and Secondary Education (Chart 3.3). Net spending on both of these sub-service areas has declined in real terms between 2010/11 and 2015/16 (by 4% for Primary and 9.3% for Secondary education) (Chart 3.4). The fall in real terms spending on primary and secondary education is perhaps surprising, particularly given the Scottish Government's commitment to maintain teacher numbers. Indeed, real terms spending on primary and secondary education did increase between 2014/15 and 2015/16, when this commitment was made explicitly.

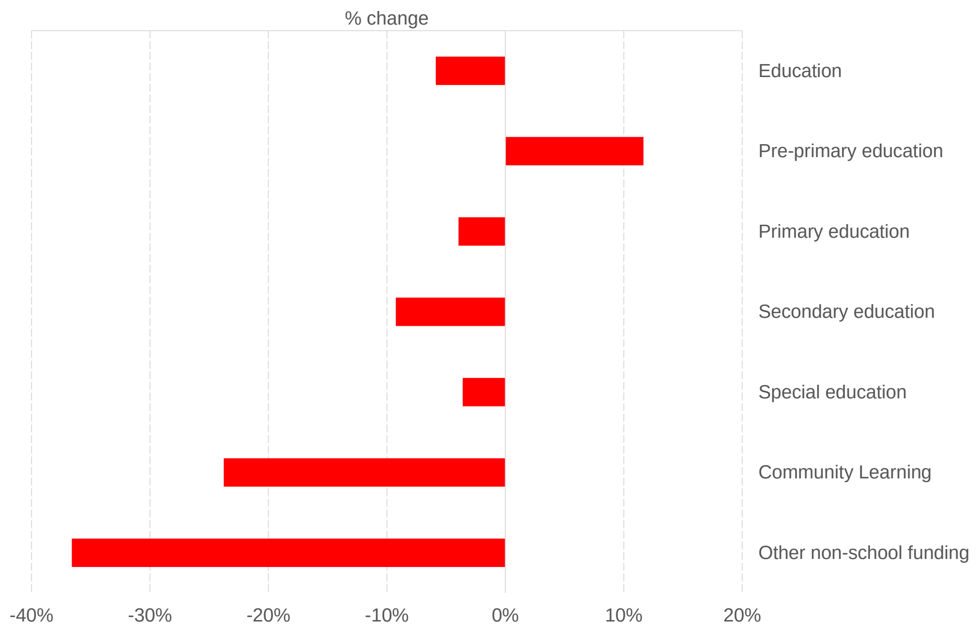
Overall spending on Pre-Primary Education has been increasing in real terms since 2011/12, reflecting government commitments. Net expenditure on Community Learning and 'Other Non-School Funding' have each fallen, but represent a small fraction of overall Education spending.

Chart 3.3: Net revenue expenditure by Education sub-service, £m (16/17 prices)



Source: Local Government Finance Returns; FAI analysis

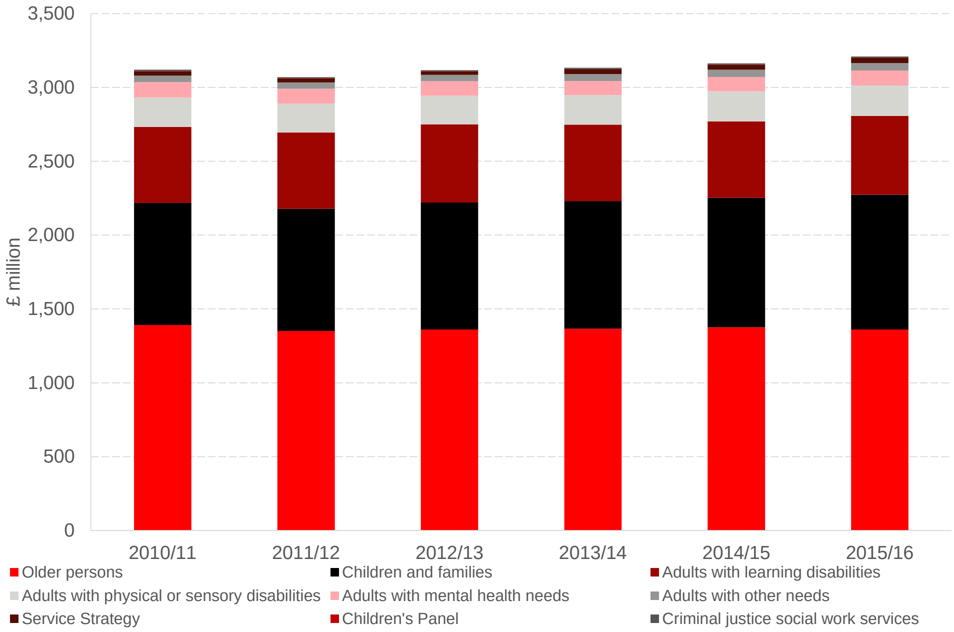
Chart 3.4: Real terms change in net expenditure Education sub-service, 2010/11 – 2015/16



Source: Local Government Finance Returns; FAI analysis

Within Social Work, the two largest areas of revenue expenditure are on ‘Older persons’ and ‘Children and Families’ (Chart 3.5). Net expenditure on Older Persons fell by 2% over this period. Gross expenditure however increased by around 3%, with a rise in service income associated with older persons social care services. On the other hand, net and gross expenditure on Children and Families has increased by around 10% from 2010/11 levels in real terms.

Chart 3.5: Net revenue expenditure by Social Work sub-service, £m (16/17 prices)



Source: Local Government Finance Returns; FAI analysis

Across other service areas, spending patterns similar to the trend in overall net service spending in Chart 3.1 are seen, with spending falling in real terms from 2010/11.

Between 2010/11 and 2015/16, net revenue expenditure on Cultural and Related Services fell by over 12.5% in real terms, from £693m to £606m, with income also falling by almost 15% from 2010/11. Within this area, net expenditure on museums and galleries has fallen by around 7.5%, spending on library services has fallen by 13%, tourism spending by 10%, community parks and open spaces by 20.5%, and countryside recreation and management has fallen by 13%. Net spending on sports facilities has fallen by 12.5% from 2010/11 levels.

Net revenue expenditure on Environmental Services has fallen by 3.5% since 2010/11, from £718m to £693m. The pattern of spending on sub-services varies significantly. Councils have made savings in waste collection and environmental health. Net expenditure on cemetery/ mortuary services has also fallen (thanks largely to increased service income). But net expenditure has increased on flood defence and drainage, coastal protection, and waste disposal. This reflects a series of policy choices by both local and national government.

Spending on Central Services has fallen markedly, as councils reconfigure operations to focus on frontline services. Overall, net revenue expenditure on Central Services has fallen from £602m in 2010/11 to £474m in 2015/16. At sub-service level, the largest component, Corporate and Democratic Core costs, has fallen year on year and by around 23% from 2010/11.

Spending on Planning and Economic Development has also fallen markedly. Net revenue expenditure on Planning and Economic Development has fallen by 27.5% since 2010/11, from £339m to £246m. The largest component of this service area, Economic Development, has fallen by around 21.5% while expenditure falls in Planning Services have fallen more markedly.

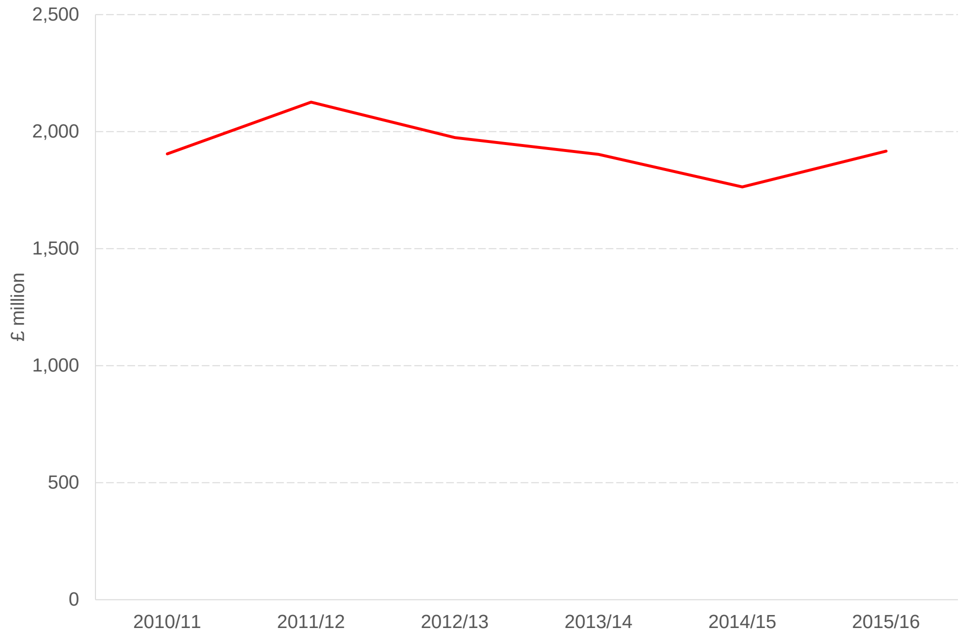
Net expenditure on Roads and Transport has fallen by 21.5% since 2010/11. Gross expenditure has fallen by less (17.5%) reflecting increases in service income from Parking as well as road management services.

Capital expenditure

In 2015-16 total expenditure funded from capital resources was £2.54bn. This was made up of total gross capital expenditure of £2.34bn, in addition to which local authorities funded £0.19bn of revenue expenditure from capital resources. General Fund capital expenditure made up around £1.89bn of total expenditure, with the Housing Revenue Account making up the difference.

Much like General Fund revenue expenditure, General Fund capital expenditure is made up of capital expenditure on Education, Cultural and Related services, Social Work, Roads and transport, Environmental services, Planning and Economic development, Trading Services, Other Services and Non-HRA Housing. Total General Fund capital expenditure is presented in Chart 3.7, with police and fire capital expenditure removed from earlier years.

Chart 3.7: General Fund capital expenditure, £m (16/17 prices)



Source: Local Government Finance Returns; FAI analysis

Capital spending is inevitably more ‘lumpy’ in nature from one-year to the next than revenue expenditure, reflecting the timing of particular investments. To an extent, this is reflected in the analysis of capital expenditure at service level (Table 3.3).

Looking at overall capital expenditure on services, spending remains some way below 2011/12 levels (Chart 3.7). Capital expenditure on General Fund Services in 2015/16 is around 10% less than 2011/12 in real terms (1% more than 2010/11).

Table 3.3: Real terms net capital expenditure by service (£m)

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Education	555	740	545	541	569	661
Cultural and related services	214	262	271	154	124	162
Social work	56	50	78	84	75	63
Roads and transport	435	516	530	474	437	435
Environmental services	112	112	133	195	141	130
Planning and economic development	132	121	125	98	68	92
Trading Services	14	11	19	15	5	7
Other Services	197	154	130	181	177	198
Non-HRA Housing	190	159	144	162	168	169
Total General Fund Services (excluding Police and Fire)	1,905	2,126	1,975	1,903	1,764	1,916

Source: Local Government Finance Returns; FAI analysis

4. The local government allocation formula

How the allocation system works

The Scottish Government allocates grant to local authorities taking into account both the relative spending need of each authority, and the revenues raised from Council Tax and Non-Domestic Rates income.

The grant allocation system first calculates the 'total estimated expenditure' (TEE) that each local authority is likely to need[17] to meet its various commitments. The elements of TEE are:

- An assessment of spending needs, based on the 'Grant Aided Expenditure' (GAE) assessments combined with a 'Special Islands Needs Allowance' (SINA);
- A series of additional revenue grants – such as the funding used in the past to support the Council Tax freeze – the allocation of which is determined on a case-by-case basis;
- A series of further non-specific changes to grant allocations, the allocation of which is based on local authorities' shares of GAE + SINA;
- Local authorities' commitments in respect of certain historic loan charges.

The sum of these elements is then adjusted by a 'floor' to ensure that no local authority experiences particularly large swings in support from one year to the next.

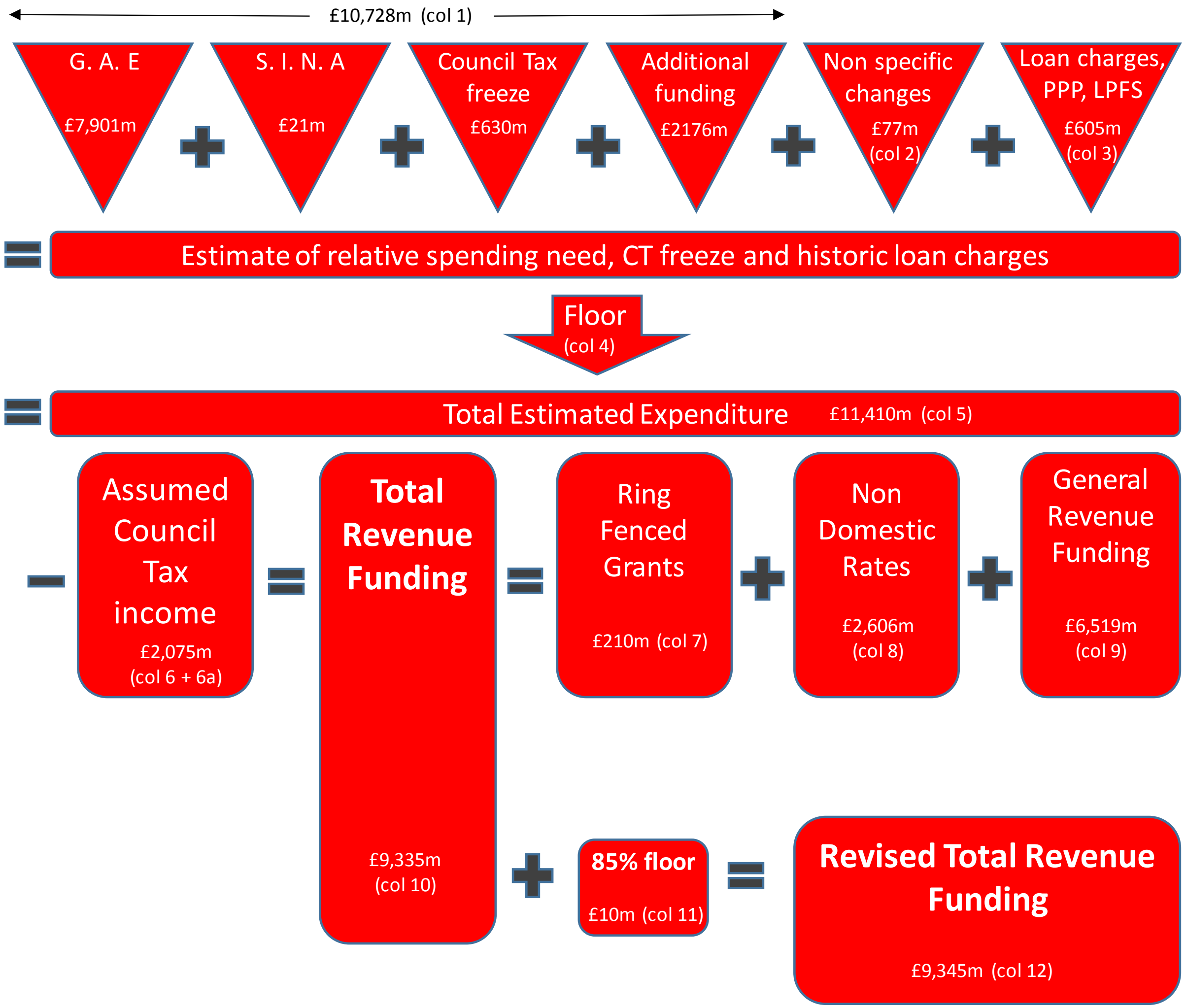
Having calculated TEE, an adjustment is then made based upon an estimate of what each local authority is expected to raise from Council Tax, the revenues that each local authority is forecast to raise from Non-Domestic Rates[18], and their allocation of ring fenced Gaelic funding. A further 'floor' calculation is applied to ensure that no local authority receives less than 85% of the Scottish average on a per capita basis.

An overview, together with the funding associated with each stage, is shown in Figure 4.1.

[17] The notion of spending 'need' in this context is a measure of relative need; TEE does not claim to measure the absolute spending need of local authorities either individually or collectively.

[18] These Non-Domestic Rates revenues are collected by local authorities on behalf of the Scottish Government. The Scottish Government bears the immediate risk of any Non-Domestic Rates revenue shortfall relative to forecast.

Figure 4.1: An overview of the local government settlement[19]



[19] Finance Circular No 9: http://www.gov.scot/Topics/Government/local-government/17999/11203/lgfcircular1718

GAE assessments

The spending needs of local authorities are primarily determined through the 'Grant Aided Expenditure' (GAE) assessments.

The GAE is a systematic means of allocating the pre-determined Spending Review funding totals equitably amongst local authorities. The aim of the GAE is to estimate how to allocate the funding total to local authorities, taking into account 'variations in the demand for services and the costs of providing them to a similar standard and with a similar degree of efficiency'[20]. Note that the GAE assessments are not budgets or targets but are used simply to calculate relative spending needs.

GAE assessments are undertaken for 89 sub-service lines. These 89 assessments are grouped into 7 service blocks (Education, Social work, Roads and Transport, Leisure and Recreation, Cleansing and Environment, Elections and Taxation, and Other Services). Each sub-service line determines how a given proportion of the total funding is distributed. For example, the Education block accounts for £4.3bn of the £7.9bn total that is allocated through GAE; whilst within that, the Primary School Teaching Staff sub-service line accounts for £903m.

For each sub-service line, the relative spending need of a local authority is assessed by reference to one or more indicators. For example, the GAE for Primary Education is allocated to each local authority with reference to its share of primary school aged pupils. It then makes a small adjustment based on a secondary indicator - the percentage of pupils in small schools. So for example, Aberdeenshire is initially allocated £48m for Primary Education (its share of £903m, reflecting its share of all Scotland's primary school aged pupils) which is then increased to £53m on account of the fact that Aberdeenshire has a relatively high proportion of its pupils in small schools.

Since 2008/9, the GAE assessments have remained largely unchanged, in two key ways:

- Firstly, the amount associated with each GAE line (and service block) has been frozen[21].
- Secondly, the indicators used to assess spending need for each GAE have – by and large – remained unchanged[22].

However, although the GAE system itself has not changed, the data that feeds into the assessments is updated each spending review (i.e. to reflect the fact that pupil numbers may have grown more rapidly in some areas than in others).

Since its implementation, assessments within the GAE system have been kept under review by the Settlement and Distribution Group (SDG) and the Data Issues Working Group (DIWG).

- The SDG takes a strategic overview of settlement and distribution issues with the understanding of how decisions impact on the distribution of the overall settlement. The

[20] See 'Green Book' for Grant Aided Expenditure http://www.gov.scot/Resource/0045/00456852.pdf
[21] Prior to this, Minister's determined the funding associated with each GAE line according to their priorities.
[22] Around 95% of the indicators used to assess the GAEs in 2016/17 are similar to those used in 2008/09

SDG is made up of 12 Directors of Finance (or the equivalent Section 95 officer) from COSLA member councils, COSLA officials and Scottish Government officials.

- The DIWG is a technical advisory group which supports the work of the SDG. The DIWG assists the analysis underpinning the GAE calculations and provides technical scrutiny of any changes to methodology. The DIWG is made up of officials from Scottish Government, local authorities, and COSLA itself.

SINA

In addition to the GAE assessments for the seven service blocks, the GAE assessment also includes a 'Special Islands Needs Allowance' (SINA). This allocates around £21m of funding to island authorities including Eilean Siar, Orkney Islands and Shetland Islands as well as Argyll and Bute, Highland and North Ayrshire (Box 4.1).

Box 4.1: The Special Islands Needs Allowance (SINA)

Six local authorities receive Factor A SINA amounts according to how their population is distributed, with smaller islands given more weight.

The average of a sub-section of non-expenditure or budget based GAE per capita in Scotland is calculated. This is then multiplied by the associated island weightings and the total population of each local authority living in each of three island types. This forms the basis for Factor A SINA.

Factor B is given only to those local authorities which are wholly island based, Eilean Siar, Orkney and Shetland. These island local authorities received a 10% uplift on their total non-expenditure GAE less the teacher remoteness and distant islands GAE.

While SINA has not been frozen in the same way as GAE, as the SINA calculations are based on the frozen sub-section lines within GAE and the population of Scotland as a whole has been increasing, this means that SINA has been decreasing in both cash and real terms since 2008/09.

Additions to funding since 2008

How then is 'new funding' since 2008/09 allocated to local authorities? There are essentially two ways in which new funding has been allocated, depending on whether it is associated with a particular policy or programme, or whether it reflects a general uplift in the resources being made available to local government.

Funding tied to particular programmes

If new funding is tied to a particular service programme of policy, it is typically allocated on the basis of an assessment of each local authorities' relative spending need for that new programme. The funding included in this category is diverse, including Business Gateway services, GIRFEC

(Getting it Right for Every Child), Council Tax Reduction Scheme, the expansion of childcare, and Free School Meals.

Also included in this category are a series of grants that were formally ring-fenced, (e.g. the Fairer Scotland Fund and the Supporting People Grant) that have also been rolled-up into the general local government settlement.

Finally, this category has also included the annual grant which offset the costs of the historic Council Tax freeze (£630m in 2016/17).

The allocation methodology for each of these new funding streams is determined by the SDG. It is not always the case that a great deal of information is made available publicly on these allocation methodology decisions. The resulting grant is rolled up into the core local government finance settlement. As with the wider GAE, local authorities are not obliged to spend their nominal allocation on any particular service.

Uplift in general funding

If there is a general uplift in the local government revenue grant – not associated with any specific policy or programme – then it tends to be allocated in line with each local authority's share of GAE+SINA. For example, for an increase of £100m, if Aberdeen's share of GAE+SINA is 3.5%, then it would receive an additional £3.5m.

What about reductions to local authority grants? If those reductions were associated with the cessation of a particular funding stream that had been added since 2008/9, the allocations associated with that funding stream would simply be removed. If however there is a general reduction in the local government grant, this is allocated across local authorities in line with their shares of GAE+SINA (clearly this will imply that those authorities with the largest grant will see the largest cash cut in that grant, although in percentage terms the reductions are equal across different local authorities).

Loan charges/ PPP/ LPFS

The Settlement includes funding to support local authorities meet charges associated with capital borrowing and some historic Public Private Partnership (PPP) projects. Given that these are historic liabilities, the funding associated with this element of the Settlement is declining over time. Funding support associated with more recent PPP and Non-Profit Distributing (NPD) projects is distributed out with the Local Government Finance Settlement.

Assessing local authorities' revenue raising capacity

Having assessed each local authority's spending need, the settlement then takes account of each authority's ability to raise revenue through Council Tax and Non-Domestic Rates[23].

[23] And local authorities' allocation of ring-fenced funding.

The settlement calculates what each authority is expected to raise in Council Tax revenues (the 'assumed Council Tax contribution'), and deducts this amount from TEE[24]. Thus, if an authority expects to see its revenues from Council Tax increase as a result of growth in the number of taxable properties in its area, these additional revenues are simply offset by a larger reduction from TEE.

As highlighted above, Non-Domestic Rates are collected by all 32 authorities on the basis of a national poundage set by the Scottish Government, paid into a central pool and redistributed based on how much each local authority is expected to collect, (plus any adjustments to recognise any prior year surpluses or deficits on the central pool). For example, if a local authority is expected to raise £100m in Non-Domestic Rates, this amount is deducted from that authority's TEE.

General revenue funding thus makes up the balance of total revenue funding each year after estimates of the capacity of the authority to raise income from Council Tax and Non-Domestic Rates have been subtracted from the estimate of each authorities' relative spending need. The Scottish Government guarantees the General Resource Grant as well as the Non-Domestic Rates elements of funding (in other words, the Scottish Government bears the risk that NDRI is lower than expected).

Main floor adjustment

However, so as to ensure that no local authority experiences significantly large falls in its settlement allocation from one year to the next, a 'floor adjustment' is made. In years when general local government funding has been increasing, the floor adjustment ensures that each authority receives a minimum year-on-year increase in its grant. In years when general local government funding has been decreasing, the floor adjustment ensures that no local authority receives more than a maximum decrease in its grant.

In both cases, this is 'paid' for by other local authorities in that their budgets are adjusted accordingly.

In 2016/17 for example, the 'floor' was set at -4.5%. Six authorities had pre-floor funding settlements that would have resulted in their settlement falling by more than 4.5%. Glasgow for example would have seen a cut of 6.4%; through the 'floor' process it was allocated an additional £17m to ensure that its cut was only 4.5%.

The rationale for the floor is to ensure some degree of funding stability for individual local authorities from one year to the next. After application of the floor in 2016/17, the range of settlement changes across local authorities ranged from a cut of 1.3% to a cut of 4.5% (with 19 authorities receiving a cut of between 4 and 4.5%), whereas before the floor the range was an increase of 0.2% to a cut of almost 20%.

[24] The calculation is slightly more complex than is laid out here, but the point remains.

It should be noted that the floor is not calculated on local authorities' total estimated expenditure but on a subset. For instance, it does not take into account the £630m for the Council Tax freeze or the funding relating to any other fully funded policy initiatives.

Although it achieves some stability across local authorities, the floor has less advantageous implications from a resource efficiency point of view. Local authorities end up receiving an allocation different to what the needs assessment exercise suggests it should be, counteracting the needs assessment exercises that inform the initial allocations. In 2016/17, 19 of Scotland's 32 local authorities ended up receiving a reduction of between 4 and 4.5% in their 'Total Estimated Expenditure', despite the pre-floor variation implying much greater variation.

A second floor adjustment, the 85% floor, ensures that no local authority receives less than 85% of the Scottish average allocation per capita. The 85% floor is calculated on the basis of all 32 local authorities revenue allocations plus council tax income. In calculating the average Scottish allocation, a 115% cap is placed on authorities' per capita allocations, which has the effect that the Scottish average allocation per capita is reduced relative to what would be the case if the allocations to the island authorities were included in full. In 2017/18, only Aberdeen received any resources through this floor. The 85% floor raised its allocation by £10m, bringing Aberdeen's allocation per capita to around 84.6% of the (capped) national average.

Distributional implications

Chart 4.1 expresses TEE on a per capita basis[25] by local authority (and for Scotland as a whole), based on the 2017/18 Draft Budget settlement. TEE for each authority is equivalent to funding from grant income, Council Tax revenues, and redistributed Non-Domestic Rates.

Chart 4.1 also breaks down each authorities TEE by component: the proportion due to the GAE+SINA allocation, the element due to subsequent (post-2007/8) changes; the grant received for the Council Tax freeze; ring-fenced funding, and the floor.

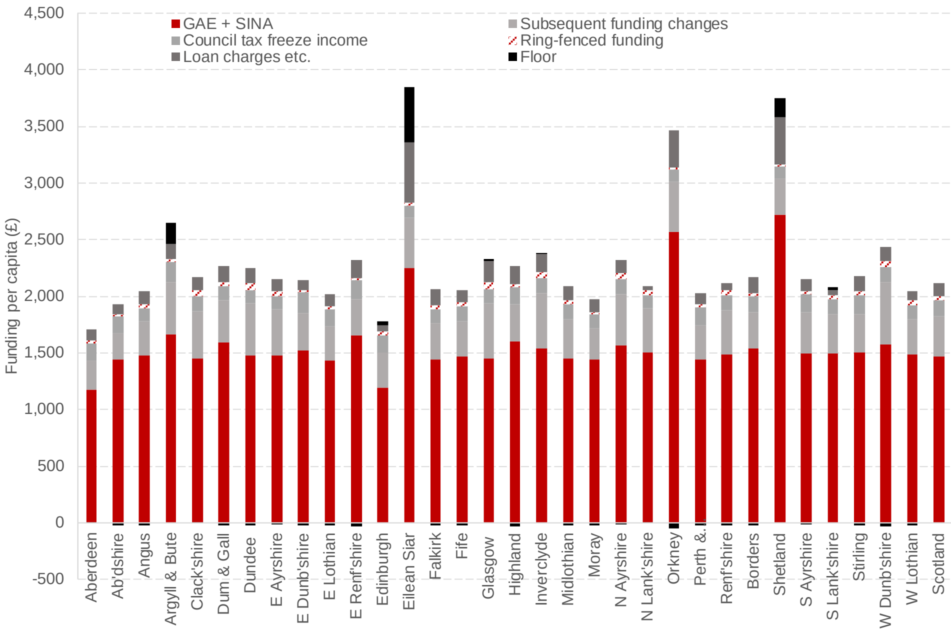
TEE per capita is just over £2,000 for Scotland as a whole. The island authorities have higher TEE per capita, whilst Aberdeen and Edinburgh have the lowest.

The pattern of TEE across authorities is driven largely by the GAE+SINA assessments, and to a lesser extent by the subsequent (post 2007/08) additional funding. Some authorities see their allocation boosted by the floor whilst others see their allocations reduced fractionally by the floor.

Chart 4.2 shows total funding per capita (the same as TEE per capita) in each local authority, and for Scotland as a whole, broken down by funding source.

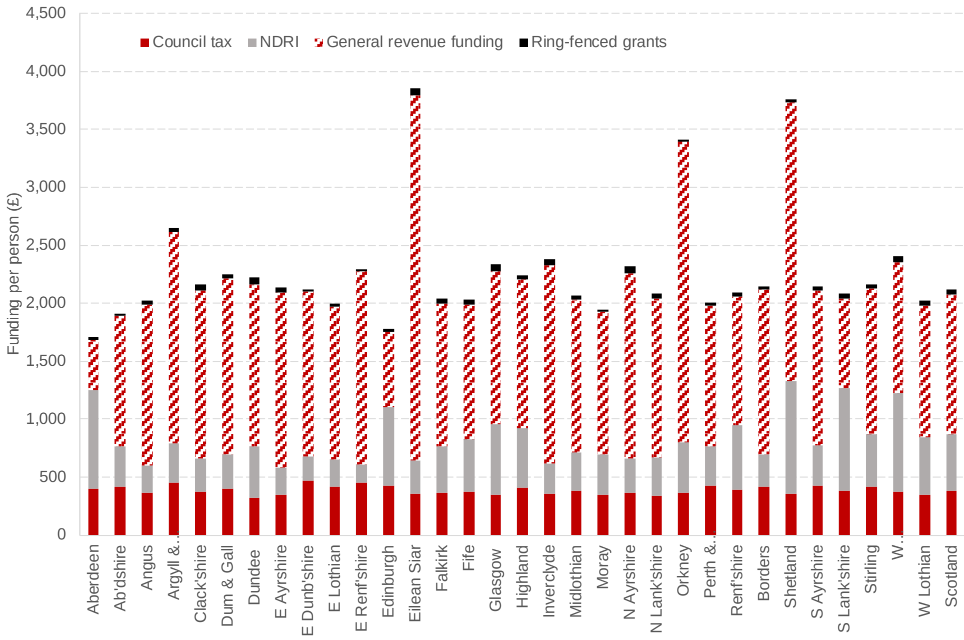
[25] Population projections are from the National Records of Scotland.

Chart 4.1: **Total Estimated Expenditure per capita by local authority and element, 2017/18**



Source: Local Government Draft Finance Circular 2017/18

Chart 4.2: **Total Estimated Expenditure per capita by local authority and source, 2017/18**



Source: Local Government Draft Finance Circular 2017/18

Discussion of the allocation process

Targeting input costs or outcomes

The GAE+SINA allocation system aims to allocate resources across local authorities in a way that compensates them for the fact that they face differences in the costs they must incur to provide a given service at a given standard.

But the allocation system takes less account of the cost of achieving particular outcomes. Ultimately, outcomes are the main objective of a service. They are typically influenced not just by levels of spending and mode of provision but wider social and environmental influences.

In some ways, this is perhaps surprising given the Scottish Government's focus on outcomes in the 'Scotland Performs' National Performance Framework. Indeed it is now almost six years since the Christie Commission report recommended a renewed focus on the targeting of outcomes.

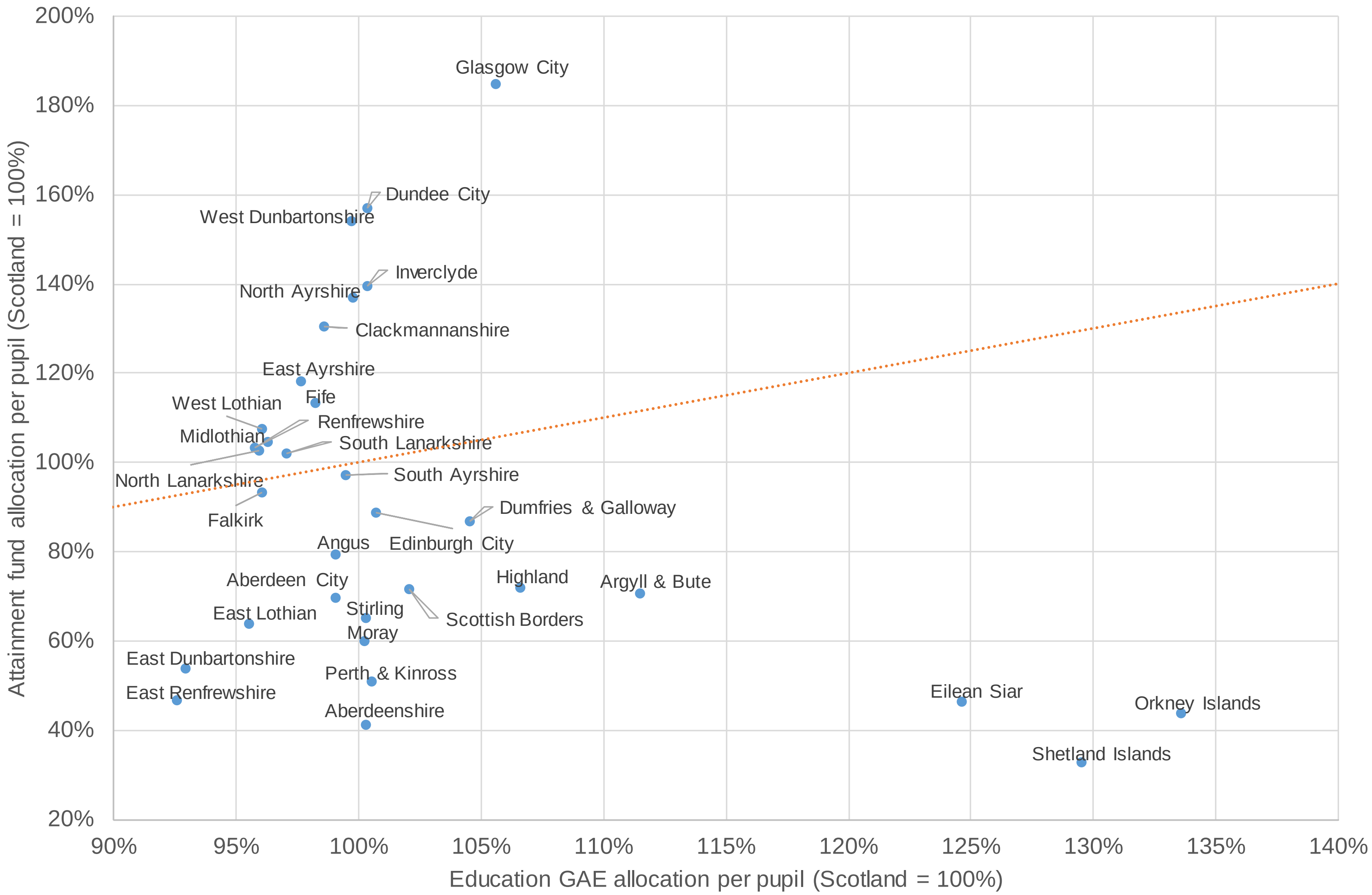
For example, the GAE assessment of relative need for Education spending is essentially based on estimates of the costs incurred in educating a child in different parts of the country, taking into account school running costs. If the assessment were instead based on the costs of educating a particular child to a particular level of attainment, taking into account that child's background, the pattern of allocations may look very different.

As an illustration, Chart 4.3 compares the allocations per pupil made by the Education GAE with the allocations per pupil implied by the allocation of the £120m Attainment Fund in 2017/18. The pattern of allocations could not be more different.

The x-axis of Chart 4.3 shows the allocations made by the Education GAE, expressed relative to the Scottish average per pupil. The island authorities receive 25-35% more than the Scottish average, whilst most mainland authorities receive +/- 5% of the Scottish average.

The Attainment Fund allocations per pupil follow a different pattern. Expressed relative to the Scottish average, the allocations range from 60% below the Scottish average in Aberdeenshire and Shetland, to over 180% in Glasgow (if the pattern of allocations were the same, local authorities would lie along the dashed 45-degree line).

Chart 4.3: Per pupil allocations made by GAE+SINA v. the £120m Attainment Fund



Note: number of pupils in each local authority is assumed to be primary and secondary pupils as identified in the GAE tables for 2016/17

However, allocating resources on the basis of the cost of achieving outcomes is not straightforward.

For a start, what is the outcome we are trying to achieve? Take Education as an example. The way in which resources are allocated across local authorities might look very different depending on whether the outcome we are most interested in is:

- Ensuring some minimum educational standard is achieved across all areas/schools
- Achieving convergence in the spread of attainment between areas/schools
- Ensuring equal attainment for pupils with equivalent initial abilities
- Maximising the percentage of pupils attaining a particular qualification standard.

The first of these targets is likely to imply a very different pattern of resource allocation across areas than the last. Indeed, whilst the first (and second) outcomes would imply redistribution of resources to the poorest or most deprived areas, the final outcome is likely to imply targeting to areas where the 'marginal benefit' is highest – and this may mean targeting resources relatively more heavily at more affluent areas.

Moreover, even if it was agreed which outcome measure should form the focus of the local government funding allocations, there is still likely to be a degree of contentiousness about the relationship between funding and outcomes. For example, the Welsh Government investigated the possibility of an outcome based resource allocation mechanism for school funding[26]. Researchers developed detailed models to predict pupil attainment based on factors associated with the characteristics of individual pupils and their families, the neighbourhoods they lived in and the schools they went to. But policymakers were ultimately reluctant to adopt them given the substantial complexity (and perceived lack of transparency) in how they were derived[27].

There are a number of points that can be taken from this discussion:

- There can never be any single 'right' way to allocate resources. But allocating on the basis of outcomes will probably result in a different pattern of allocations relative to allocating on the basis of input costs.
- However, this can be challenging. Therefore we need to be clearer about what we are trying to achieve by a given allocation system, and how that allocation system meets broader policy objectives.
- In debating how resources are allocated between local authorities, we should not forget that the total amount of funding being allocated remains absolutely crucial. For example, the Welsh research mentioned above (Bramley et al. 2011) found that, whilst changes to

[26] Summarised in Bramley et al. (2011) http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.665.4606&rep=rep1&type=pdf

[27] See for example the Welsh Local Government Association response, in which the work is described as being 'heroic complexity' www.assembly.wales/NAfW%20Documents/wlga.pdf%20-%2012022008/wlga-English.pdf

allocations could have an impact on reducing the attainment gap, it could not be fully eliminated for the current level of resource.

- Similarly, we should not forget that how resources are prioritised within local authorities is also important. In relation to school funding for example, disparities between schools can often be greater than the disparities between local authorities but the way local authorities in turn allocate funding to schools is less redistributive than at national level.

Allocating local government funding on the basis of outcomes will create challenges, but the current approach to allocating funding purely on the basis of input costs is unlikely to represent the most effective way of achieving the government's national outcome objectives. Investigating the way in which the allocation settlement can more explicitly account for outcomes would thus be worthwhile.

Institutional arrangements

As previously noted, the settlement allocation process, including the GAE assessments and the allocation of post 2008/09 funding streams, is overseen by the Settlement and Distribution Group (SDG), supported in a technical capacity by the Data Issues Working Group (DIWG).

Decisions about how new revenue and capital streams are allocated are made by representatives from a sub section of councils, who need to reach an agreement on any proposed changes to the allocation methodology.

This representative approach clearly has merit from the perspectives of accountability, democratic decision making and consensus building.

However, one could argue from an institutional design perspective, this may come at the cost of inertia in the willingness to evolve the settlement in light of changing responsibilities or priorities. This is because a degree of unanimity is required to pursue change, but unanimity will be difficult to achieve in cases where – by definition – any revision to the settlement process will create losers as well as winners.

An alternative institutional set-up might be to establish an independent Allocation Committee. Such a Committee could be tasked to allocate resources across local government in such a way as to achieve specified outcome objectives or need criteria. The Committee could then undertake its own analysis – and take evidence from individual councils – to inform an informed approach to resource allocation.

The model broadly mirrors the approach taken in Australia to allocate grant to States, based on the recommendations of the 'Commonwealth Grants Commission'. An institutional model such as this could (but is not guaranteed to) be more likely to catalyse more substantive change in the resource allocation process, if that is desired, but it would not necessarily reduce the level of contentiousness in any resource allocation approach. The set up might also be seen as undermining the democratic involvement of local authorities in determining the allocation system.

Transparency and complexity

Systems of grant allocation to local government are inherently complex. They are intended to allocate funding across a wide and complex range of service areas. Further complexity is added once account is taken of different revenue raising capacities and various funding floors and damping mechanisms are included.

This complexity can create the impression that the process lacks transparency. In reality there is a fine distinction between complexity and transparency. Just because something is complex does not necessarily mean that it is not transparent.

That said, there are arguably a number of areas where the transparency of the settlement could be improved.

For example, it is not clear that there is any publicly available document that sets out all the elements of the funding settlement in a clear and concise way. Such a document could inform readers how the various specific grants are allocated, how the funding floors are calculated, etc.

Transparency is further complicated by the way settlements are presented by the Scottish Government. For example, the Scottish Government has argued that comparisons be made between Draft Budget allocations in one year with previous years (rather than the Final Budget allocation). But neither of these numbers are the same as those in the local government circular.

In its Scrutiny Report on the Draft Budget, the Scottish Parliament's Local Government and Communities Committee made recommendations including the following:

> *"The Committee believes that the current situation is not transparent, and that the Draft Budget for local government, and the allocations to local authorities are very difficult to follow. It is essential in scrutiny terms that this Committee and the Parliament as a whole is clear on exactly how much money local authorities can be expected to receive and from what sources and with what conditions, if any, on their purpose.*
>
> *"We therefore ask the Scottish Government to consider how the local government Draft Budget, and the allocations to local authorities, could be presented in a more clear and transparent manner."*

We would reiterate these conclusions.

Incentivisation and autonomy for own-source revenues

As we described above, the settlement allocation process allocates grant to local authorities having taken fully into account each authorities' ability to raise income through Non-Domestic Rates and Council Tax.

Any increase in a local authority's tax base (e.g. growth in the number of properties liable to Council Tax) is offset by a larger deduction from that authorities TEE.

It could be argued – similar to the recent debate over more powers for the Scottish Parliament – that authorities have relatively little fiscal incentive to grow their tax bases, with the Scottish Government guaranteeing General Resource Grant and Non Domestic Rates funding.

Despite this, between 2011/12 and 2017/18, Non-Domestic Rates income is expected to have increased by 12% in real terms across Scotland as a whole. Some authorities have seen growth in excess of 20%, whilst Dundee has experienced a real terms decline in Non-Domestic Rates.

The current mechanism provides a degree of predictability and ensures that councils struggling from local economic challenges – and relatively declining revenues – do not suffer. But it limits incentives.

In recent years the Scottish Government has attempted to bring an element of incentivisation into the Non-Domestic Rates system, by allowing local authorities to retain a proportion of business rates growth in their areas (Box 4.2). To date, it appears open to question how effective the BRIS has been. As a result of the 2014/15 BRIS, seven (out of 32) local authorities retained income of just £2.5m (relative to total Non-Domestic Rates revenues in that year of £2.51bn)[28].

The balance between incentivisation and equalisation is difficult.

It may however be possible to design a resource allocation system that provides some scope for authorities to retain the proceeds of tax base growth, whilst maintaining a focus on equalisation. In some countries for example, funding floors are designed to compensate authorities who raise less tax than average by providing grant to those authorities to bring them up to the national average; whilst authorities that raise above the average level of tax are allowed to retain a major proportion of the proceeds.

The extent to which the resource allocation system should balance incentivisation objectives with equalisation objectives is likely to remain a source of debate.

Related to this discussion is a related question about local government tax autonomy. At the current time, local authorities have no scope to vary the structure of business rates, or the ratios between Council Tax bands. Moreover, 2017/18 is the first year since 2008/09 that local authorities have had the option to vary the Council Tax rate by up to 3% (either upwards or downwards).

Given that Council Tax accounts for only around 15% of local government income, the implication is that councils have very little scope to vary their budgets at the margin (a 10% increase in Council Tax revenues would lead to a 1.5% increase in council budgets). This arguably reduces the accountability of local politicians for spending decisions. A separate debate is thus also needed about how much autonomy local authorities should have to vary local taxation rates and structures.

Box 4.2: The Business Rates Incentivisation Scheme (BRIS)
The Business Rates Incentivisation Scheme (BRIS) was first introduced in April 2012. The initial BRIS allowed local authorities to retain 50% of Non-Domestic Rates growth over and above individually set targets.

[28] See Local Government Finance Circular 3/2016 www.gov.scot/Topics/Government/local-government/17999/11203/busratesincenscheme1417

A revised scheme was introduced in 2014/15, focussed on growth in the tax base (rather than receipts). It works as follows. For the forthcoming year, the Scottish Government estimates buoyancy in the Non-Domestic Rates tax base nationally. Individual local authorities are then effectively allocated shares of this national buoyancy, based on historical average growth figures at an individual local authority level. For 2016/17 for example, buoyancy targets range from 0.8% (Glasgow City, among others) to 1.5% (Aberdeenshire).

Each local authority that exceeds its individual local buoyancy target retains a 50 per cent share of the additional income generated, with the Scottish Government retaining the other 50 per cent excess.

The Scottish Government retains the risk that individually or collectively local authorities fail to achieve the overall estimate of income to be collected.

5. The outlook for local government finance

This section considers the outlook for local government revenues and spending over the course of this parliament.

The revenue outlook

What is the outlook for local government general funding? As we highlighted above, we take general funding to consist of the General Revenue Fund from the Scottish Government, revenues from redistributable Non-Domestic Rates, and Council Tax (it thus excludes revenues for specific services).

General Revenue Fund

The outlook for local government's General Revenue Fund from the Scottish Budget depends to a large extent on the outlook for the Scottish Government's Budget – and on how the Scottish Government decides to allocate resources across spending portfolios.

Based upon the current set of information about the trajectory for key public finance and economic indicators, the outlook for the Scottish Government's revenue and capital Budgets over the remainder of this parliament is shown in Table 5.1 and in real terms, in Chart 5.1.

Table 5.1: Outlook for the Scottish Government budget

	2016/17	2017/18	2018/19	2019/20	2020/21
RDEL cash	26,159	26,574	26,658	26,852	27,340
Annual change		*1.59%*	*0.31%*	*0.73%*	*1.82%*
CDEL cash	2,891	3,087	3,303	3,513	3,640
Annual change		*6.78%*	*6.98%*	*6.35%*	*3.62%*
RDEL real (2016/17 prices)	26,159	26,182	25,724	25,453	25,433
Annual change		*0.09%*	*-1.75%*	*-1.05%*	*-0.08%*
CDEL real (2016/17 prices)	2,891	3,033	3,178	3,316	3,369
Annual change		*4.89%*	*4.78%*	*4.36%*	*1.59%*

Notes: The outlook for the Scottish Government's Budget for discretionary resource spending (RDEL) is based on the outlook for the Scottish Government's RDEL block grant from the UK Government (as per the Autumn Statement 2016), plus any revenues from the Scottish Government's plans to set a lower threshold for the Higher Rate of income tax than in the rest of the UK. The outlook for the Scottish Government's Budget for capital spending (CDEL) is based on the outlook for the Scottish Government's CDEL block grant from the UK Government (as per the Autumn Statement 2016), but excluding the possibility of the Scottish Government using its capital borrowing powers to fund higher capital expenditure. Source: FAI analysis

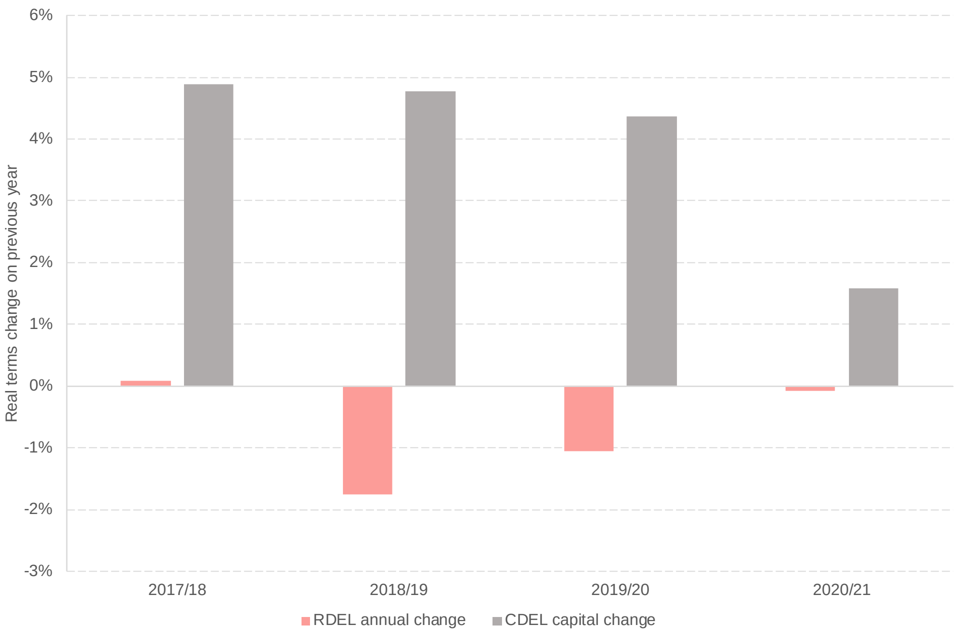
In 2017/18, the Scottish Government's Revenue Budget was essentially unchanged in real terms, whilst its capital Budget grew by almost 5%.

Over the following three years (2018/19 – 2020/21), the outlook for capital spending remains reasonably positive, with real terms increases in the Budget each year (the data in Table 5.1 and Chart 5.1 exclude the scope of the Scottish Government to borrow to fund additional capital expenditure).

The outlook for revenue spending however is less positive. Between 2017/18 and 2018/19, the Scottish Government's Budget is expected to fall by 1.7% in real terms, with a further 1% real terms fall the following year. These figures include the revenue impact of the Scottish Government's income tax policy to set a lower threshold for the Higher Rate (but do not include the effect of any other tax policies, such as the proposal to reduce Air Passenger Duty from 2018/19).

It should be noted of course that from now on the size of the Scottish Budget depends not only on the block grant from the UK Government and devolved tax policy – it depends also on the relative growth of the 'devolved' taxes in Scotland relative to those same taxes in rUK[29]. Thus the Scottish Government's Revenue Budget could feasibly grow somewhat faster or slower than is indicated in Chart 5.1.

Chart 5.1: Outlook for Scottish Government real terms Budget, 2017/18 – 2020/21



See notes to Table 5.1

What does the outlook for the Scottish Government's Budget imply for local government? The answer to this question depends on how the Scottish Government chooses to allocate spending across portfolios.

In the absence of any multi-year Budget plans or spending review documentation, we can only infer what the Scottish Government's plans might involve, based on its stated plans.

[29] For further details, see Scotland's Budget 2016 https://www.sbs.strath.ac.uk/economics/fraser/20160913/ScotlandsBudget-2016.pdf

In its 2016 Manifesto, the SNP made three high-profile spending commitments with clearly set out budgetary implications.

These were: to increase NHS spending by £500m more than inflation by 2021/22; to maintain police spending in real terms; and to expand the provision of free childcare, resulting in an additional £500m spending on childcare by 2020/21.

Assuming that these commitments continue to represent government policy, the implication for remaining 'unprotected' portfolios is likely to be substantial. Spending on the NHS, police and childcare already accounts for over half of the Scottish Government's Resource Budget. These policy commitments will imply that all remaining 'unprotected' portfolios could face real-terms cuts of around 4.6% in 2018/19, 3.6% in 2019/20, and 1.3% in 2020/21; or a total real terms cut between 2017/18 and 2020/21 of 9.2%.

Table 5.2: Outlook for resource spending by the Scottish Government on unprotected portfolios

	2017/18	2018/19	2019/20	2020/21	Change, 2017/18 - 2020/21
Change in RDEL available for 'unprotected' portfolios (cash, £m)	40	-341	-235	68	-508
Percentage change	*0.3%*	*-2.6%*	*-1.8%*	*0.5%*	*-3.9%*
Change in RDEL available for 'unprotected' portfolios (2016/17 prices, £m)	-154	-596	-441	-159	-1196
Percentage change	*-1.2%*	*-4.6%*	*-3.6%*	*-1.3%*	*-9.2%*

Source: FAI analysis.

A cut to the local government settlement of 2.6% in cash terms in 2018/19 would imply the settlement would be around £250m lower in 2018/19 than it was in 2017/18.

Clearly it will be for the Scottish Government to decide how to allocate remaining resources across portfolios. But given that local government revenue funding accounts for just over half of the Scottish Government's unprotected portfolio spending, some degree of real terms cut seems inevitable.

The Scottish Government's Budget may also turn out to be somewhat higher or lower than indicated in Chart 5.1, should the revenues that are 'devolved' to the Scottish Parliament grow relatively more quickly or slowly than those equivalent revenues in rUK. And of course the Scottish Government could, at some future Budget event, choose to implement revenue-raising (or revenue-costing) tax policies. The UK Government may also choose to spend more (or less) on devolved spending areas in England in future years than its current plans indicate, providing additional (or reduced) resources through the Barnett Formula for the Scottish Government to allocate.

It is also possible that the Scottish Government could transfer additional responsibilities or further resources to local government to roll-out existing commitments in areas such as childcare. Indeed, this happened in the 2017/18 Budget with the transfer of £120m to local government to implement the Attainment Fund. Such additional revenues however do not necessarily change the size of the General Revenue Fund, i.e. the level of resource available to fund discretionary spending on existing areas of responsibility.

Overall, the outlook for the General Revenue Fund whilst uncertain, is more likely to decline rather than increase over the course of this parliament.

Redistributable Non-Domestic Rates

Revenues from Non-Domestic Rates have been relatively buoyant in recent years. Redistributable Non-Domestic Rates grew by an average of 3.5% per year in real terms between 2010/11 and 2016/17. This was partly due to 'buoyancy' of the tax base (i.e. growth in the number of premises subject to tax) and also due to inflationary increase in the 'poundage' (effectively the tax rate).

In 2017/18, redistributable Non-Domestic Rates is expected to fall by 5% in real terms. This is largely due to policy changes announced in the 2017/18 Draft Budget, including an expansion to the Small Business Bonus Scheme, and limiting the Large Business Supplement.

Beyond this year, the Scottish Government has forecast that the Non-Domestic Rates tax base will grow by 1.8% in 2018/19, 1.1% in 2019/20 and 0.9% in 2020/21[30]. With the poundage set to increase in line with inflation, these forecasts assume that Non-Domestic Rates revenues will continue to be buoyant, but less so than in the past.

A review of Business Rates in Scotland is underway. The remit is 'to make recommendations that seek to enhance and reform the business rates system in Scotland to better support business growth and long term investment and reflect changing marketplaces'.[31] It is due to report in July 2017. It is as yet unclear what the report's implications will be for the future of Non-Domestic Rates revenues.

Council Tax

Council Tax paid in Scotland depends on the band a property is in (A-H). The amount payable is calculated using a multiplier applied to the Band D level in a local authority area. From 2017/18, the Scottish Government has increased the multipliers applied to bands E-H, with no change to the multipliers applied to band A-D. This means that council tax paid on property in bands E-H in Scotland will increase in all local authorities from 2017/18, with some relief for around 54,000 households in properties in bands E to H on net incomes below the Scottish median for their household type.

On top of this change to the E-H multipliers, the nine-year Council Tax freeze will end in 2017/18 and local authorities have been able to decide whether or not to increase Council Tax rates by up to 3% (i.e. increase Band D, affecting all bands, by up to 3% in addition to the multiplier changes to bands E-H).

[30] Draft Budget 2017/18 Devolved Taxes Forecast Methodology

[31] http://www.gov.scot/businessrates

Table 5.3: **Ranked Band D council tax in 2016/17 versus 2017/18**

	Local authority	Band D (16/17)		Local authority	Band D (17/18)	Inc. (%)
1	Aberdeen	£1,230	1	Glasgow	£1,249	3.0%
2	Glasgow	£1,213	2	Midlothian	£1,246	3.0%
3	Dundee	£1,211	3	Dundee	£1,241	2.5%
4	Midlothian	£1,210	4	Aberdeen	£1,230	0.0%
5	Inverclyde	£1,198	5	East Ayrshire	£1,224	3.0%
6	Stirling	£1,197	6	Argyll and Bute	£1,213	3.0%
7	East Ayrshire	£1,188	7	Edinburgh	£1,204	3.0%
8	Argyll and Bute	£1,178	8	Inverclyde	£1,198	0.0%
9	Edinburgh	£1,169	9	Highland	£1,198	3.0%
10	Renfrewshire	£1,164	10	Stirling	£1,197	0.0%
11	Highland	£1,163	11	South Ayrshire	£1,189	3.0%
12	West Dunbartonshire	£1,163	12	North Ayrshire	£1,187	3.0%
13	Perth and Kinross	£1,158	13	Clackmannanshire	£1,182	3.0%
14	South Ayrshire	£1,154	14	Perth and Kinross	£1,181	2.0%
15	North Ayrshire	£1,152	15	East Dunbartonshire	£1,176	3.0%
16	Clackmannanshire	£1,148	16	Aberdeenshire	£1,169	2.5%
17	East Dunbartonshire	£1,142	17	Moray	£1,169	3.0%
18	Aberdeenshire	£1,140	18	Renfrewshire	£1,164	0.0%
19	Moray	£1,135	19	West Dunbartonshire	£1,163	0.0%
20	West Lothian	£1,128	20	East Renfrewshire	£1,160	3.0%
21	East Renfrewshire	£1,126	21	East Lothian	£1,151	3.0%
22	East Lothian	£1,117	22	Fife	£1,151	3.0%
23	Fife	£1,117	23	West Lothian	£1,128	0.0%
24	South Lanarkshire	£1,101	24	Borders	£1,116	3.0%
25	North Lanarkshire	£1,098	25	Angus	£1,104	3.0%
26	Borders	£1,083	26	Falkirk	£1,102	3.0%
27	Angus	£1,072	27	South Lanarkshire	£1,101	0.0%
28	Falkirk	£1,070	28	North Lanarkshire	£1,098	0.0%
29	Shetland	£1,052	29	Shetland	£1,084	3.0%
30	Dumfries and Galloway	£1,049	30	Dumfries and Galloway	£1,080	3.0%
31	Orkney	£1,037	31	Orkney	£1,068	3.0%
32	Western Isles	£1,024	32	Western Isles	£1,055	3.0%

With a quarter of councils choosing not to increase Council Tax in 2017/18, this does raise a question about quite how challenged local budgets are (Table 5.3).

But bear in mind that across all local authorities, a rise in Council Tax rates of 3% is equivalent to around £70m, a relatively small amount in the context of net revenue expenditure of around £11.7bn. As Council Tax only accounts for 15% of total revenue, a percentage increase in tax rate (which is very visible to local residents) results in a proportionately much smaller increase in council budget.

In addition, all local authorities will see council tax increases in bands E-H whether council tax rates are increased from 2008/09 levels or not. At the same time, local authorities vary widely in the proportion of properties which fall within the E-H bands. According to the Scottish Assessors Association database, Edinburgh has around 13% of all E-H properties in Scotland and has implemented an additional increase of 3% across all bands. On the other hand, Inverclyde and West Dunbartonshire councils each contain around 1% of all E-H properties in Scotland but have chosen to continue to freeze council tax at 2008/09 levels.

It remains to be seen to what extent Council Tax revenues will be allowed to increase in future years, and if so, the choices that local authorities will make both individually and collectively.

Reserves

A recent report by the Accounts Commission indicates that Scottish local authorities had around £2.5bn in 'useable reserves' in 2015/16. However, stripping out the reserves of Orkney and Shetland relating to oil, gas and harbour activities, useable reserves in the 'General Fund' are closer to £1.2bn.

Whilst this may sound significant, (and whilst the majority of councils have increased their reserves in recent years despite challenging financial settlements), this represents around 10% of councils' income from general revenue grants, Non-Domestic Rates and Council Tax. More importantly, as noted by the Accounts Commission, 'use of reserves to support services in the short term is not sustainable unless they are used to support service transformation and generate future savings'.

Furthermore, a large proportion of councils' 'useable reserves' have already been allocated for specific future liabilities. These include for example known commitments and new responsibilities in relation to waste management and recycling, and known future costs, including for example making changes to parking meters due to the introduction of the new pound coin in March 2017. In general, unallocated reserves amount to only around 1-2% of councils' running costs. The point of reserves is to provide contingency against future uncertainties and risks.

The scope for local authorities to supplement reductions in general revenue grant or tax revenues through draw-down of reserves is therefore relatively limited.

Brexit

Brexit is likely to have implications for local government revenue but also delivery challenges. Scotland has been allocated over €900m of European Structural and Investment Funds (comprising ERDF and ESF funds) over the 2014-20 programming period[32]. Around 45% of these funds had been committed by summer 2016.

Local Authorities are 'lead partners' in the ERDF and ESF programmes, responsible for administering and delivering interventions in areas including business competitiveness, employability, social inclusion, and Smart Cities.

The UK and Scottish Governments have guaranteed to pass on, in full, all funding that is committed to specific projects before the UK leaves the EU, even if the payments extend beyond the date of Brexit. However, no guarantee has been made in relation to projects or proposals that come forward after the UK has left the EU.

These EU funding streams provide local government with an important income source to enhance local service provision. The funding streams are also particularly important to local authorities given the fact that the funding streams operate over a medium term planning period at a time when the Scottish Government has moved away from multi-year budgeting at least in the last two years. The funds are also particularly important in that they tend to relate to regeneration and economic development activities – areas which are of critical importance to the Scottish economy at the present time but for which only limited core funding is available.

[32] http://www.gov.scot/Topics/Business-Industry/support/17404/EuropeanStructuralFunds

Spending risks and constraints

In the context of the constrained revenue outlook, local government will endeavour to maintain the quality of public service delivery as far as possible. This objective is however, likely to be challenging given various pressures on spending.

One area where cost pressures is likely to increase is in relation to employee costs. Data from the Scottish Local Government Finance Statistics 2014/15 indicate that employee costs represent 41% of local government's £15bn gross expenditure.

The impact of future pay settlements on local government finances is thus likely to be significant. No national pay settlements for 2017/18 or beyond have yet been agreed. Increases in inflation as a result of Brexit are likely to place significantly greater pressure on pay settlements than has been observed in recent years. A pay award of just 1% would cost some £61m.

The rising age profile of council workforces may also result in wage costs increasing through incremental drift, regardless of pay settlements. The requirement of Scottish councils to pay the Scottish Living Wage – not only to direct employees but also to care home providers (the costs of which are passed back to councils) will provide an additional pay constraint.

In addition to this, councils are likely to face higher pension costs as a result of auto-enrolment. Auto-enrolment is being phased in, but for most councils all eligible staff are likely to be enrolled in pension schemes by 2017 (unless those employees specifically opt-out). Renfrewshire Council has estimated that auto-enrolment will cost it an additional £3m per annum. If this is representative of all Scottish Councils, the cost implication nationally would be around £94m.

Higher inflationary pressures may also have cost implications via increases in the unitary charge associated with PPP-funded schools.

Local government faces a number of demand-led cost pressures as a result of demographic and socio-economic change. This is particularly the case in relation to Adult Social Care. Between 2016 and 2020, Scotland's over-65 population is forecast to grow by 7%, whilst it is forecast to grow by 19% between 2016 and 2025.

Given that spending on social care accounts for 30% of councils' net revenue expenditure, each 1% increase in social care spending implies a 0.4% fall in spending on all other services, on average. Services for those of school age also face demographic pressures. Scotland's population aged 5-16 is forecast to grow by 2.5% between 2016-2020 (the working age population in contrast is forecast to fall by 0.5%).

Local authorities are also likely to face new delivery responsibilities in some areas. For example, the government may want to involve local government in its vision for expanded provision for childcare services. The devolution of employability programmes from 2017 to Scotland (following the recommendations of the Smith Commission) may also have delivery implications for local government. The way in which any such new responsibilities might be funded is critical – will 'new burdens' be associated with additional resources (and if so will these be ring-fenced or included within general revenue grant), or will local government be expected to deliver new services alongside current responsibilities?

In addition to the funding challenges previously identified, Brexit may also create challenges for delivery of services in certain areas, given its likely impacts on the curtailing of free movement and/or EU citizenship rights. A recent Spice briefing[33] indicates that 12,000 EU nationals are employed in health and social care in Scotland, accounting for 3% of total employment in this sector.

It is not clear that the potential cited opportunities from Brexit (which in theory might include scope for reform of procurement legislation, or of state aid rules – although this is subject to significant debate) will necessarily outweigh its costs.

City Deals

One area of opportunity for some local authorities could be through the growth in bespoke deals for cities or regions. The Glasgow City Region City Deal was signed in 2014, with two further deals signed for Aberdeen City Region and Inverness in 2016. Further Deals are planned for the remaining cities in Scotland, whilst other arrangements are being discussed for the islands and other regions. These arrangements aim to offer new collaborative regional partnerships between central and local government, with a key focus on boosting the levels of investment in the economy (including unlocking private sector investment). Whilst many will see these not as a replacement for local government funding, they do offer a source of opportunity for delivering new outcomes in a way that might not always have been possible in the past.

[33] www.parliament.scot/ResearchBriefingsAndFactsheets/S5/SB_16-86_EU_nationals_living_in_Scotland.pdf

6. Conclusions

Following years of real terms spending increases, the core local government resource settlement has declined in real terms since 2010/11. The settlement (including general resource grant, redistributable Non-Domestic Rates, and specific grants) has declined by around 10% since 2010/11. These cuts have been concentrated in particular years with 2011/12, 2016/17 and 2017/18 seeing relatively larger falls – whilst some years have seen real terms increases (2013/14 and 2015/16).

Of course, as successive UK Governments have attempted to restore the public finances to a profile of sustainability, local government has not been the only public service experiencing financial constraint. Indeed, as a share of Scottish Government resource spending, the local government allocation has only declined by two percentage points. This reflects political choices about which public services (notably health) should be protected at a time when the Scottish Government's real terms resource budget has been falling. Nonetheless, as a delivery organisation funding reductions of this scale have been very challenging for local government to achieve.

Local government has responded by making changes to back office functions, implementing pay restraint, evolving their use of assets, and raising more income from services. In the meantime, the balance of local government expenditure has been shifting. Local authorities no longer have responsibility for delivering some services (including for example police and fire services, functions of District Courts). But local authorities have also gained 'new burdens' for example in areas relating to early years education and childcare services, the new Children and Young People Bill, and new flood risk management responsibilities. New funding has been associated with some of these new responsibilities, but that of course implies that local government's core settlement on a like-for-like basis has declined by more than the headline numbers quoted above imply.

Perhaps more significantly, there has been some evidence of a change in the distribution of spending across broad service areas – with spending on health and social care increasing in real terms whilst other service areas have experienced falls – reflecting demographic pressures and also policy preferences.

So the last few years have seen changes in both the overall funding available for local government, the responsibilities of local government, and the way in which local government has distributed its expenditure across different service areas. Yet partly because these changes are happening relatively gradually, there has been little public debate around the changing nature of local government service delivery, or how these services are funded.

The way in which funding is allocated between local authorities, while kept under review, has remained relatively unchanged in recent years. Funding is allocated primarily through the Grant Aided Expenditure (GAE). The GAE system takes account of how the costs of delivering particular public services varies across the country. But the GAE is not designed to take account of the how the cost of achieving particular public service outcomes might vary (nor indeed does it state explicitly what outcomes the allocations are designed to achieve). There would be significant challenges in moving towards a more outcome based allocation system, but the scope for doing so – particularly in the context of the National Performance Framework and the widely agreed principles set out by the Christie Commission – would be worth investigating in further detail.

Overall the future funding outlook for local government remains uncertain. The Scottish Government has only set a one year Budget for 2017/18. But the outlook for the Scottish Government's block grant from Westminster, together with the Scottish Government's stated spending commitments and tax plans, implies that local government should expect further real terms falls in its Budget over the next two years.

It is as yet unclear what might be the outcome of the ongoing review of Business Rates. Equally it is unclear what scope there might be to raise revenue from Council Tax in future years.

Local government is facing a number of spending pressures. Some of these reflect demand pressures (particularly in relation to social care and children's services), whilst others reflect cost pressures (higher inflation and the implication for pay awards, higher pension costs through auto-enrolment, the requirement to pay the Apprenticeship Levy, and ironically the NDR revaluation). Both will combine to create a challenging environment to maintain the quality of public services within existing resources. Improvements in technology – which have traditionally supported cost-saving by enabling hardware to be purchased through capital budgets – is now increasingly being offered as a service via 'the cloud' – mitigating the extent to which it supports cost saving.

It remains to be seen what further spending or delivery responsibilities might be devolved to a local level. Local government may play a role in delivering elements of the employability programmes that are being devolved to Scotland following the recommendations of the Smith Commission, and it may play a role in meeting the government's commitments in relation to an expansion of childcare provision. It is also unclear to what extent the joint delivery of health and social care services will help to alleviate future pressures on the social care budget.

The spectre of Brexit raises further uncertainty on both revenue and delivery fronts. Local Authorities are 'lead partners' in Scotland's Structural Fund programmes, responsible for administering and delivering interventions. These EU funding streams provide local government with an important income source to enhance local service provision, in areas including employability and business support. The Scottish Government has guaranteed to pass on, in full, all funding that is committed to specific projects before the UK leaves the EU, even if the payments extend beyond the date of Brexit. However, understandably no guarantee has been made in relation to projects or proposals that come forward after the UK has left the EU.

Brexit may also create recruitment challenges in sectors such as social care. The extent to which these risks and costs of Brexit might be mitigated by the opportunities (which potentially include the scope for some reform of procurement, state aid, and other regulation) is open to question.

These challenges in combination highlight why many are now calling for a debate about local government's role in service delivery, and how these services are funded in the future. This is likely to be a key source of political debate during the upcoming local elections.

One area of potential reform, irrespective of wider discussions around local government, is to improve the way in which local government funding information is presented within the Scottish

Government's Budget and related documents. This year has seen confusion between Draft versus final Budget numbers, discretionary versus specific funding, and which elements of public spending should be included under the auspices of 'local'.

But overall, there is no escaping that a debate about much broader questions, such as which services should be delivered by local government, how much autonomy local government should have, and how much responsibility it should have for raising its own revenues, is needed now more than ever.

Annex: Expenditure data in cash terms

Table A3.1: General fund net (gross) revenue expenditure by service (£m)

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Education	4670 (4850)	4538 (4729)	4571 (4760)	4578 (4783)	4612 (4817)	4736 (4946)
Cultural and related services	635 (736)	613 (708)	609 (699)	614 (701)	643 (737)	598 (691)
Social work	2860 (3608)	2871 (3663)	2959 (3783)	3031 (3851)	3110 (3944)	3169 (4044)
Roads and transport	495 (700)	472 (666)	468 (677)	439 (663)	420 (657)	418 (622)
Environmental services	658 (787)	646 (776)	644 (773)	659 (791)	666 (790)	684 (817)
Planning and economic development	311 (510)	289 (470)	279 (480)	279 (458)	278 (462)	243 (424)
Non-HRA Housing	394 (2361)	323 (2326)	306 (2326)	321 (2385)	342 (2436)	294 (2398)
Central Services	552 (748)	404 (668)	336 (547)	484 (679)	439 (657)	468 (686)
Trading Services	-8 (62)	-13 (50)	-4 (54)	-2 (68)	-5 (73)	-17 (47)
General Fund expenditure on Services	10567 (14362)	10144 (14057)	10170 (14099)	10403 (14378)	10504 (14573)	10594 (14674)

Source: Local Government Finance Returns; FAI analysis.

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