Scottish Government Draft Budget 2015/16: Scrutiny of the Draft Local Government Circular by the Local Government and Regeneration Committee

The City of Edinburgh Council welcomes the opportunity to comment on a number of aspects of existing funding distribution arrangements for local government in Scotland. In addition to making a number of specific observations on the questions raised by the Committee, the Council’s submission highlights the importance of the overall quantum of funding being made available to local government if it is to deliver an increasingly complex and wide-ranging change agenda.

Current funding formula and distribution methodology

1. At the heart of the current system is the use of a client group approach, with the relative number, characteristics and location of those in potential or actual receipt of the service guiding the distribution of available funding. This principle of basing distribution on the best-available assessment of underlying need, uninfluenced by policy decisions or actual spend on the service at individual council level, is considered to be the main strength of existing arrangements.

2. In the majority of cases, funding distribution is calculated with reference to authorities’ respective shares of the primary indicator, the factor considered to be the main determinant of the overall need to spend on a service. In most school-based assessments, for example, this factor is pupil numbers. In recognising that there may be other factors influencing the unit costs of delivery, however, where the strength of this relationship can be substantiated through statistical analysis, other factors (termed secondary indicators) are also used. In the case of primary school teaching staff, use of a secondary indicator therefore captures the financial impact of smaller class sizes (and consequent pupil:teacher ratios) in more rural authorities. The continuing validity and redistributive effect of these secondary indicators is assessed annually in light of the most recent year’s audited expenditure data. While such adjustments can only ever be indicative of the impact of these factors on an individual council’s need to spend, that their continuing relevance can be demonstrated by means of statistical analysis lends additional credence to the resulting distribution.

Role of Settlement and Distribution Group (SDG)

3. In cases where new funding streams are introduced, or legislative or other changes mean that updating of existing allocation data is not feasible, recommendations on the distribution methodologies to be adopted are made to Council Leaders by the Settlement and Distribution Group (SDG), a strategic body comprising a combination of senior Scottish Government officials and council Chief Financial Officers. It is
important to emphasise that local government officials serving on the SDG do so in an impartial capacity, guided by the underlying principles of objectivity, transparency and, more recently, stability. Their work is informed by the similarly-impartial Data Issues Working Group (DIWG), charged with undertaking more detailed technical analysis and providing advice and guidance as appropriate on specific areas. All reports considered by the SDG are circulated to non-member Directors of Finance in advance of the Group’s meetings, providing an opportunity both to comment on the recommendations being made and highlight any other relevant factors that may have been overlooked.

4. Whilst any consideration of funding distribution within a finite sum inevitably leads to “winners” and “losers”, the underlying methodology and discussion forums for considering these issues are felt to work well. These arrangements complement a number of other more general, helpful developments for local government in recent years, including:

(i) **a substantial reduction in the extent of ring-fencing**, reflected in the very low level of specific revenue and capital grants now contained within the Local Government Finance Settlement. This echoes the non-prescriptive nature of the underlying GAE assessments and has increased councils’ ability to target resources to where they can make the biggest difference in contributing to priority outcomes;

(ii) subject to the timing and periods covered by UK Spending Reviews, **three-year funding settlements, along with clearer identification of national priorities**. In recent years, this has been accompanied by consistent financial support in targeted areas, particularly in addressing the impact upon councils and individuals of aspects of welfare reform;

(iii) **a general move towards focusing on outputs and outcomes** as opposed to inputs (although there remain some inherent contradictions in this area, both at national and local level – receipt of an authority’s full funding allocation through the Local Government Finance Settlement in 2014/15, for example, involved a commitment to maintaining existing teacher numbers. The Scottish Government has, however, acknowledged this anomaly and is working with councils to identify more outcome-focused measures for future years’ financial settlements) and

(iv) a willingness to consider, and implement, **a number of new funding mechanisms underpinned by the principle of incentivisation** including the Business Rates Incentivisation Scheme (BRIS), Tax Increment Financing (TIF) and, within Edinburgh, the Regeneration Accelerator Model (RAM) for taking forward investment in the St. James Quarter in the city. Most recently, the signing of the Glasgow and Clyde
Valley City Deal is anticipated to unlock a further £3.3 billion of private sector investment over the next twenty years.

5. At a more operational level, a number of improvements have also been introduced over the past two to three years. In advance of the announcement of recent Finance Settlements, checking sessions bringing together relevant senior Scottish Government officials and council officers have been arranged, increasing transparency and ultimately reducing the likelihood of errors. On-going consultation between the Scottish Government and councils on the content and presentation of the Finance Circular has also been welcomed. In addition, specific queries raised by councils on the Circular’s contents continue to be dealt with promptly and, on the rare occasion when errors are discovered, are generally corrected in a timely fashion.

6. Given the inherent limitations of data availability and the extent of change affecting the wider public sector, in acknowledging that the funding distribution can never achieve absolute accuracy, current arrangements are felt to be effective. Distributions based on a robust assessment of need remain the cornerstone of the Settlement. It was within this broad context that the Council successfully argued for the provision of supplementary funding to recognise the additional costs arising from being the local authority to Scotland’s capital city.

Areas for potential improvement

7. While existing arrangements are felt to work well, in a small number of cases there can be a considerable delay between the announcement of Scotland-wide funding for a new policy initiative and its subsequent distribution amongst authorities, hampering budget planning and opening up the potential for unexpected adverse variances late in the year. Although this has often been due to wider discussions concerning the adequacy of the funding quantum made available to support policy implementation, as an example, councils have still not been advised as to the distribution of some £70m of funding for the Council Tax Reduction Scheme (CTRS) in 2014/15, despite the publication of the relevant data underpinning the calculation some time ago. The Council’s final CTRS allocation in 2013/14 was around £0.5m lower than anticipated which, while ultimately contained within a balanced overall budget position, represented a significant variance from earlier projections. Perhaps with this in mind, the SDG has subsequently agreed for the equivalent 2015/16 allocation to be determined wholly in advance.

8. More recently, a number of funding streams relating to new Scottish Government policy initiatives (notably extended provisions for free early learning and childcare and free school meals for all P1 to P3 pupils) have been considered by the SDG.
Particularly in the case of capital-based distributions, in the absence of sufficiently robust and independent property capacity and condition information, relevant funding has required to be distributed on alternative proxy bases.

9. The recommended distribution basis to COSLA Leaders for allocating additional capital funding to support the free school meals policy is the estimated cost of modifications required within each authority’s estate. As a general rule, funding allocations should not be guided by actual expenditure. While this arrangement should not be seen as setting a wider precedent in moving away from needs-based assessments, in light of the degree of scrutiny applied by COSLA and the Scottish Government to these cost estimates, on this occasion it is felt to represent the most appropriate basis in translating the Scottish Government’s commitment to full funding to a local authority setting.

**Balance between Central Government funding and locally-generated funding**

10. In contrast to a number of other developments empowering local authorities, the general direction over the past twenty-five years has been for discretion over the scope and level of local taxation to be taken away from councils. The Non-Domestic Rates poundage has been set nationally since 1990 and the advent of the Council Tax freeze policy, whereby local authorities receive additional funding equivalent to a three per cent increase on current levels on condition that they not then increase its level, could be seen to have left councils as a collection agent for central government. Given that the level of General Revenue Grant funding is also determined centrally, councils are realistically only currently able to retain an element of discretion over fees and charges income which accounts for just seven per cent of total funding. As noted by the Commission on Strengthening Local Democracy in Scotland, this contrasts starkly with the position in many other European countries where more than half of total council income is determined locally.

11. In overall resource availability terms, the relative certainty these arrangements bring could be seen as advantageous in the current period of austerity. As a more general point of principle, however, they may alternatively be viewed as eroding councils’ accountability to their citizens by removing the link between expenditure decisions and the funding of that expenditure. The continuing freeze in Council Tax also reduces substantially councils’ ability to supplement their overall level of expenditure to invest in service priorities, where these are not able to be funded through revenue savings and/or additional income. The fact that those elements of additional funding that are provided are almost exclusively to support the delivery of national commitments could furthermore be seen to constrain the ability of councils
to optimise the targeting of available resources in addressing and responding to local needs.

12. It is important to emphasise that, even were the Council Tax freeze policy not in place, the ability to supplement grant and non-domestic rates funding through additional Council Tax revenues varies widely. In Edinburgh, Council Tax currently funds about 24% of the Council’s net revenue expenditure but in some other authorities where the profile of properties is weighed towards the lower bands, this figure is considerably lower. Following creation of national Police and Fire and Rescue services and the consequent removal of corresponding funding from the Local Government Settlement, this proportion has increased slightly but remains low in comparative international terms.

13. Despite the relatively high levels of Council Tax income raised in the city, due to the “gearing” effect, at least a 4% increase in Council Tax would still be required to increase overall expenditure by 1%. Were the level of non-domestic rates also determined locally, however, a majority of income would then be controlled by the Council.

**Grant funding allocations**

14. The accurate projection of future council-specific grant funding allocations remains difficult for three main reasons:

(i) **the absence of Local Government-specific funding allocations (i.e. the overall quantum) beyond 2015/16**, with the level of funding allocated within the Scottish budget dependent on forthcoming UK-wide spending reviews;

(ii) **the importance of relative movement in expenditure allocation shares in determining a given council’s updated overall needs assessment** (i.e. its share of that overall quantum) and

(iii) **changes in the assumed level of income available locally through Council Tax**.

15. The second point above is of particular relevance to the Council in 2015/16. While the city’s population continues to grow, the 2011 census results pointed to a significant previous overestimate of the extent of this growth, particularly in the 25-34 year-old age group. Full correction of this historical overstatement in 2015/16 has resulted in a substantial year-on-year loss of revenue grant of £13m (almost 2% of the Council’s combined general revenue funding and non-domestic rates income),
adding significantly to the challenge of balancing the budget despite the previous approval of over £15m of savings for delivery next year.

16. Expressed in gross terms, in total the Council therefore needs to identify savings of at least £37m (around 4% of its net budget) in 2015/16. While this likely loss of income was anticipated following publication of the census results, it serves to highlight the inherent volatility of some aspects of the grant distribution system.

17. The Scottish Government’s funding allocations also take account of anticipated changes in a local authority’s tax base in determining the level of general revenue grant support made available. Other things being equal, an increase in the projected size of the local tax base results in a corresponding deduction in respect of assumed Council Tax income. While capital expenditure-related aspects of additional infrastructure may be met through developers’ contributions, the net revenue impact is less clear-cut, with additional funding provided only if an authority’s relative growth exceeds that of other authorities. While it is vital for the city’s wider development, in the case of Edinburgh where 16,000 affordable homes are required over the next ten years, this growth may, in net terms, therefore serve to hasten additional cost pressures on the Council.

Level of Non-Domestic Rates collected and how this influences overall funding

18. Prior to 2011/12, Edinburgh was a substantial net contributor to the national non-domestic rates pool, passing over around £100m per year more than it then received on a pro-rated population basis as part of the Local Government Settlement. Since April 2011, however, in common with the rest of Scotland’s thirty-two authorities, all rates income raised in the city has been retained. While this change has arguably resulted in greater transparency as to how the council is funded, its effect is largely presentational. As neither the Council’s assessed need to spend, nor the income it can raise locally through Council Tax, has changed, an offsetting reduction to general revenue grant funding has been made such that the combined level of grant funding and rates income is unaffected. There is therefore no net direct impact on the Council’s overall level of external funding.

Business Rates Incentivisation Scheme

19. In absolute terms, based on the most recent year for which audited figures are available, Edinburgh was the largest single contributor to the national pool, collecting almost 14% of the total business rates income across Scotland as a whole. In view of its role as Scotland’s economic driver, the Council was therefore a keen advocate of the introduction of improved incentivisation arrangements, culminating in the launch of the Business Rates Incentivisation Scheme (BRIS) in 2012/13. Under
this scheme, councils are able to retain 50% of any income in excess of their agreed
target for a period of up to five years, with any shortfall relative to target
underwritten by the Scottish Government.

20. The scheme guidelines make provision for either the Scottish Government or
individual councils to request the triggering of a “significant event” clause, under
which the appropriateness of existing targets is reviewed in the event of a material
expected change in income, either up or down. Following lengthy discussions but in
the absence of formal agreement, interim payments in respect of 2012/13 totalling
around £9m were made to twelve councils, although Edinburgh was not amongst
them. That these payments were only confirmed in the summer of 2014, with
targets for 2014/15 (as of the time of writing) still to be confirmed, has however
undoubtedly served to undermine the scheme’s credibility and incentivising effects.

21. In view of the above difficulties and more fundamental concerns as to the
effectiveness of the scheme in its (then) current form, a joint COSLA and Scottish
Government working group was tasked with developing the key features of a revised
scheme. Pivotal to its success will be providing sufficient incentive to councils to
commit to additional or refocused investment in the knowledge that this investment
may then be repaid by means of corresponding additional income, thereby creating
a virtuous cycle. While expressing some disappointment that the longer-term
incentivising aspects of the scheme are diluted by not allowing income in excess of
target to be retained across (five-yearly) revaluation periods, the Council supports
the revised emphasis on those aspects of the tax base most readily influenced by
local authorities as an important step towards re-establishing the scheme’s role as
part of a wider set of potential measures to promote sustainable economic growth.

22. More fundamentally, the Commission on Strengthening Local Democracy
recommended the returning to local control of the setting of the Non-Domestic
Rates poundage. While this will ultimately be informed by political decision, the
proposal is certainly felt worthy of consideration as part of moves towards wider
fiscal empowerment of local government.

Ways in which current system for collection and distribution of Non-Domestic
Rates might be improved

23. Collection rates for Non-Domestic Rates in Scotland are generally very high, with
around 97% of sums collected in the year in which they are due and over 99%
collected within five years. The Council contributed to, and supported the main
recommendations of, the 2013 Scottish Government business rates consultation,
including simplification of the current rates relief application and appeals processes,
alongside strengthening the powers of debt recovery. The maintenance of current levels of funding for mandatory and discretionary reliefs was also welcomed, in Edinburgh’s case recognising the much wider economic and social benefits of the city’s vibrant cultural and social enterprise sectors.

24. While noting the provisions within the Community Empowerment (Scotland) Bill to enable local authorities to reduce or remit non-domestic rates, given that the full amount of any reduction would fall to be met by the Council, any such use would need to be clearly targeted to the delivery of wider Council or community planning objectives.

Anticipated impact of 2015/16 Settlement on Council’s services

25. As with all other local authorities in Scotland, the Council is seeking to reconcile increasing service demand (particularly as a result of demographic change) with an overall level of resources that is reducing in real terms. Being the local authority for the capital city, however, the Council faces a number of further challenges and additional expectations as Scotland emerges from the economic downturn.

26. The extent of this challenge is most clearly illustrated by comparing expenditure demands expected to increase by around 15% between 2013/14 and 2017/18 to a level of income that is forecast, at best, to remain static over the same period. There is therefore a need to go beyond incremental, efficiency-driven measures (although these are clearly still important) and consider more transformational options for service delivery, aligned to the Council’s priority outcomes.

27. As noted earlier in the submission, when combined with the £13m headline year-on-year reduction in grant funding, increased expenditure demands resulting from demographic change, inflation and other pressures mean that the Council needs to identify total savings of £37m in 2015/16, of which £15m have previously been approved. Over the three years to 2017/18, a further £67m of savings, in addition to the £34m previously approved, are estimated to be required. In total, these £101m of savings represent 10.7% of the Council’s net budget. While attention is always focused first and foremost on better ways of doing things, having delivered over £200m of efficiencies since 2007/08, further incremental opportunities are correspondingly more difficult.

28. Although the focus in such circumstances inevitably falls on the specific expenditure reductions necessary to deliver a balanced budget, subject to approval, the Council will continue its strategy of making explicit incremental annual provision for the impacts of demographic and wider societal change. Almost £10m of additional
Annual funding has been identified within the Council’s Long-Term Financial Plan in each of the next three years to reflect on-going growth in the number of older people, those with physical and/or learning disabilities, school pupils and at-risk children. In order for this level of additional investment to be affordable, however, sustainable savings require to be identified.

29. The Council was one of the first in Scotland to adopt an explicit priority-based approach to its budget, doing so as part of setting its 2013/18 budget framework. This approach has been developed in subsequent years, with the emphasis placed on how best to invest over £800m of funding that remains available for the delivery of frontline services. In recognising that incremental change will not be sufficient to address the Council’s financial challenges, however, the Council has launched the BOLD (Better Outcomes through Leaner Delivery) programme to examine innovative potential ways of delivering services. The programme has informed the detailed proposals that currently form the basis of public engagement, with five overarching themes also identified to drive the identification of required savings in future years.

30. In contrast to previous years when the focus has been firmly upon detailed proposals, this year’s budget engagement adopts a longer-term, strategic approach by using an interactive budget planner to gain additional insight into citizens’ priorities. The response to this has thus far been very encouraging, with over 1,000 completed plans submitted, capturing a snapshot of the views of a far wider and more representative cross-section of residents than has been possible in previous years. The insight obtained will be used by the Council’s ruling Capital Coalition both to inform consideration of the proposals currently the subject of public engagement and, more particularly, where the Council invests and saves in the coming years.