

**BACKGROUND – FORMULA GRANT DISTRIBUTION CONSULTATION**

**COVERAGE**

1. This consultation covers all local authorities in England who currently receive grant via the Formula Spending Share system. Police authorities in both England and Wales who receive grant via this system are also covered.

2. Background

Approximately 25% of public spending in England takes the form of spending by local authorities on services they provide. Most of this money is distributed as grant from central government, with the balance being raised locally via council tax. The Formula Grant Distribution System is concerned with the distribution of a large part of this grant from central government to local authorities, known as Formula Grant.

3. The Formula Grant Distribution System was last reviewed for the 2003/04 local government finance settlement. Since then, the distribution formula has remained frozen for a period of three years, in order to provide local authorities with some stability in their funding. This three year formula freeze came to an end with the 2005/06 settlement.
4. During the formula freeze period, we have been working with local government and other interested parties to consider possible changes to the formulae which could be introduced once the freeze had ended. This paper provides the basis for a full consultation on options for formula changes that could be introduced from the 2006/07 settlement onwards.
5. The system divides up the finite pot of available grant (which is determined in the biennial spending reviews) by reference to authorities' relative circumstances and their ability to raise council tax. At present the system is based on a number of mathematical formulae covering seven service 'blocks'. These blocks are:

Education  
Personal Social Services (PSS)  
Police  
Fire  
Environmental, Protective and Cultural Services (EPCS)  
Highways Maintenance; and  
Capital Finance

6. However, since the last formula review, it has been decided that funding for schools should be taken out of the Formula Grant System and be paid as Dedicated Schools Grant direct from the Department for Education and Skills. This will come into effect in 2006/07. Therefore, references to the education block throughout this document refer only to that portion remaining once the schools funding has been removed – currently known as the LEA Block.
7. There is a separate chapter in this consultation paper about the transfer of schools funding, which explains how the transfer has been exemplified for the purposes of this consultation.
8. History of technical work

Following the last review of grant distribution formulae, the Settlement Working Group was formed to consider how the formulae might be updated and modernised once the formula freeze was lifted. The Settlement Working Group consists of representatives from all types of local authority in England along with interested parties from central Government.

9. Separate technical groups were also set up to look at the formulae for the Police and Fire funding blocks. Discussions within the Police and Fire formula groups were fed back into the Settlement Working Group for consideration within overall discussions.
10. Papers and minutes from these groups are available on the websites of the Office of the Deputy Prime Minister (<http://www.odpm.gov.uk/>), and the Home Office (<http://www.homeoffice.gov.uk/>).

## **AIMS**

11. The aim of this review is to produce a robust and fair system for the distribution of formula grant that will be fit for use in the context of three year settlements. That will include, among other things, adaptations to make the system more forward looking. The Government recognises that any system based on formulae cannot reflect all possible circumstances, so there will inevitably be an element of rough justice: and that the technical nature of the issues means that there is frequently no clear cut optimum solution, so pragmatic decisions will be needed to produce a workable system.

## **OPTIONS**

12. This consultation document contains options for each of the components of the grant distribution system. These are the seven blocks listed above, other formulae included in the present method of grant calculation, plus matters of overall context affecting the arrangements for distribution of Formula Grant.

13. There are sections containing options on each of these issues, together with details of how each option would affect individual authorities. The Government believes that the options in this paper could be used to update the Formula Grant Distribution System. However, the options here may be further refined following consultation. Respondents may also propose new options. Therefore, the components of the new formulae may not necessarily be drawn from the list contained within the consultation document.

**PROPOSED RESPONSE TO FORMULA GRANT DISTRIBUTION CONSULTATION**

The following sections detail the options/questions raised as part of the Formula Grant Distribution Consultation Process, focusing only on the service blocks and other formulae within the distribution system which affect Gedling Borough Council.

Gedling's proposed responses are included at each section in bold.

1. **ENVIRONMENTAL, PROTECTIVE AND CULTURAL SERVICES**

**The Current System**

The District - Level EPCS and County-Level EPCS formulae are judgmental. Given the wide range of services that these blocks cover the weights given to the various indicators were not derived using statistical methods. It is proposed to retain the main elements of these judgement-based formulae but to update them using the latest census data available. The view is taken that it would be highly undesirable to split this block up into sub-blocks representing single services as that would be a major increase in the complexity of the system with little gain in the accuracy of distribution of grant.

**Census Data**

The population density, population sparsity, net in-commuters and country of birth of residents variables are currently derived from the 1991 Census. We propose to update these variables to their equivalents from the 2001 Census by ensuring that the proportions of the control total given out using these data remain unchanged.

**Question 39/41: Do you agree that an adjustment to the 2001 Census based country of birth indicator and output area density indicator used in the EPCS block should be used?**

**Gedling Response: Generally, it is accepted that the most accurate up to date information should be used, therefore the use of the 2001 Census data is supported.**

**Concessionary Fares**

Since the original judgements on weightings were reached for 2003/04, there has been one further substantial policy change in the area of this sub-block. The Budget 2005 announced a free concessionary bus fare scheme for people aged over 60 and disabled people, which is funded by an extra £350 million added to this sub-block.

Take-up is likely to be higher in urban areas where there is a higher density of bus services and among those people who do not own a car. Not owning a car is likely to be a measure of deprivation in rural areas but may simply be a lifestyle choice in inner-city urban areas. For this reason the variable on “no car ownership” is not used in the FSS formulae. It is proposed, however, an option for re-weighting the district level formula that would increase weighting on population density, pensioners on income support and incapacity benefit/severe disablement allowance.

**Question 21: Do you think we should adjust the coefficients for concessionary fares?**

**Gedling Response: This is not desirable. Take up is currently linked to service provision which is in turn higher in urban areas, this change would continue to increase pressure on urban service areas and not stimulate demand in rural areas.**

### **Waste**

The existing lower tier EPCS formula was agreed by Ministers for the 2003/04 Settlement. Some work has been done to show that the main explanatory factor in the distribution of waste collection expenditure between authorities is resident population.

**Question 22: Do you think we should make any further changes to coefficients; for example, it has been argued that we should do so to take into account the increasing expenditure on waste?**

**Gedling Response: Yes, as this is a known area where costs will rise and therefore will demand more national and local resources to fund, then the allocation of these funds should be on the basis that best reflects the actual cost of service provision.**

### **Fixed Costs**

In 2003/04 a survey was carried out to help determine the amount of money required by an authority for “being in business”. As a result every upper- and lower-tier authority received £300,000 in FSS.

This amount has not been updated since 2003/04 and there has been no new evidence gathered for the size of this block during the current review. We propose to update this block in line with inflation to £325,000 per authority.

**Question 23: Do you think we should update the fixed cost element?**

**Gedling Response: Local authority members are well aware that the basic business costs of running a Council are well in excess of the amounts stated. (Even for a small district council the costs of democracy and meeting statutory officer roles would exceed an amount of £750,000. Ministers should be encouraged to raise this value further than the amount of £325,000 suggested as this would be a more realistic view of the fixed costs elements.**

## **2. CAPITAL FINANCING**

### **The Current System**

There are currently three sub-blocks within the capital financing block. These are:

- i debt charges;
- ii interest on reserved receipts; and
- iii other interest receipts

No changes are proposed for the debt charges formula. The two elements on interest receipts, which are deducted from the debt charges element to give the overall Capital Financing FSS, have arguably outlived their usefulness, giving an opportunity to focus this FSS element solely on the financing of capital.

The Government no longer prescribes that certain capital receipts have to be set aside to meet credit liabilities ('reserved receipts'). The element on other interest receipts is distributed within classes of authorities pro rata to the totals of their FSS; the only potential distributional value added by this element is in the way in which it is split among the classes of authorities. Some kinds of authorities have greater balances in proportion to their size or budget, than others. If we give those classes of authorities a proportionately larger share of this (negative) FSS element, then their formula grant will be reduced compared to other classes in a way that can be argued to reflect their greater ability to earn interest. But, now that we have moved to a prudential regime for capital management, such micro management by the formula grant system seems unwarranted; it could also act over time as a disincentive to retain prudent balances.

Given that these FSS elements are negative, however, any reduction or abolition would need to be accompanied by a proposal on handling the consequences of that. Within a formula whose purpose is to distribute grant (and where, therefore, the totals are not related to spending), the simplest option is to abolish the negative elements without any corresponding reduction in FSS elsewhere. But other options are possible.

### **Summary of options:**

#### *Option CF1*

Abolish both interest receipts elements from the capital finance FSS

#### *Option CF2*

Abolish both interest receipt elements and reduce the capital finance FSS total by the equivalent amount

#### *Option CF3*

Abolish both interest receipt elements and reduce the non-capital FSS totals by the equivalent amount

**Question 25:** Do you think we should remove the Interest Receipt elements?

**Gedling Response:** Yes, It is agreed that the interest receipt elements of this service block have outlived their usefulness due to the introduction of the Prudential Regime and that they should be removed and of the options presented CF1 is preferred.

**Question 27:** If so, should we reduce other FSS totals to compensate, or not? If we reduce other FSS elements, where should we make the reductions?

**Gedling Response:** It is felt that there is no requirement to do this as compensation will negate the benefit of the change, the grant is more transparent if distribution is not complicated by technical adjustments.

### 3. **AREA COST ADJUSTMENT**

#### **The Current System**

The current system contains an adjustment to reflect varying costs of service delivery around the country - the area cost adjustment (ACA). It has two separate components. By far the largest is the component for the variation in pay costs (the labour cost adjustment), which is based on data that reflect the local labour market. There is also a much smaller component for variation in business rates (the rates cost adjustment).

The current ACA, introduced in 2003/04, is generally regarded as a considerable improvement on its predecessor. In particular, instead of being restricted to London and the South East, it reflects pay variation around the country at the scale of former county area. It is subject to a lower limit, below which all authorities receive the same ACA factor of 1.0. This reflects the fact that in areas of relatively low pay, local authorities still pay many staff according to national pay scales.

Two distinct sets of options for reforming the area cost adjustment are presented below. Options ACA1-ACA3 represent minor changes which can be seen as small technical improvements or simplifications. During the formula freeze, some authorities have expressed concerns about the way in which we group councils together to calculate the ACA. In particular they believe that the current ACA groupings do not adequately reflect the wage pressures they face. As a result we present options ACA4 and ACA5. These represent a radical change to the geography of the ACA, and create quite stark differences in the ACA that neighbouring authorities would receive.

### **Option ACA1**

The labour cost adjustment uses data from the Annual Survey of Hours and Earnings (ASHE), the largest survey of earnings conducted by the Office of National Statistics. An expanded ASHE data set has recently become available which includes more earnings from part time jobs and weights which ensure that the wage data we use to calculate the ACA are representative of the national labour market. We propose to use this extended data set in future.

### **Rates Cost Adjustment**

The rates cost adjustment is the element of the ACA that takes account of differences in the cost of business rates on council premises between areas. Overall, business rates accounts for between 0.3% and 2.1% of the current ACA.

### **Option ACA2**

We have two options for updating the rates cost adjustment. The first is to abolish this very small part of the ACA. For almost every type of council service, the proportion of expenditure spent on business rates costs has fallen over time. In 2003/4, total council spending on business rates was 0.8% of their expenditure. Removing the rates cost adjustment would simplify the ACA and focus it on labour costs, which is its main purpose and its main driver.



### **Option ACA3**

However, abolishing the rates cost adjustment would have a moderate effect on the funding of some authorities in areas where rates costs are at their highest. The alternative is to update the weightings on the rates costs adjustment using recent data.

Using information from the 2003/4 Subjective Analysis Return option ACA3 updates the weight given to the rates cost adjustment to 1% of the ACA for all services except social services. Rates costs accounted for 0.2% of expenditure on social services in 2003/4. We propose to abolish the rates cost adjustment in the ACA for social services under either option.

If ACA options 1-3 above are adopted, we propose to continue setting the lower limit in the ACA so that it applies to the local authorities contained in the 25 ACA areas with the lowest labour costs. However, there is an argument that we should take the opportunity of this review to revisit the judgement used to set the lower limit threshold, so that the ACA better reflects the differences in local wage costs between areas. This could be achieved by setting the threshold of the lower limit at a lower level. Such a lower limit would contain less local authorities.

**Question 28: Do you have any comments on our intention to use the full ASHE data set to calculate the ACA?**

**Gedling Response:** Generally, it is accepted that the most useful up to date information should be used, therefore the use of ASHE data is supported.

**Question 29: Do you think that we should remove the very small rates cost adjustment, or do you think that we should update the weighting of the RCA in line with 2003/4 expenditure data?**

**Gedling Response:** It is agreed that the small rates cost adjustment has limited impact and could be removed.

**Question 30: Do you agree with the Governments proposal to retain the current method of setting the lower limit for options ACA1-3?**

**Gedling Response:** It is considered that this area could be reviewed but with further consultation on the proposed detail and impact.

#### 4. **ADDITIONAL RESOURCE EQUALISATION**

##### **The Current System**

The grant distribution system takes account of the relative ability of different councils to raise council tax (known in the jargon as "resource equalisation"). We currently do this by setting, for grant distribution purposes only, an assumed average national level of council tax (ANCT). In 2005/06 the average band-D council tax in England was £1,214. ANCT was assumed to be £1,102. Therefore the average council tax was 10% above the assumed level of council tax.

Greater resource equalisation would distribute more grant towards high needs, low council tax base authorities. So there is an equity, rather than a strictly technical argument for increasing resource equalisation. Under the current system, we would give effect to greater resource equalisation by increasing the assumed national council tax and, because we are not actually distributing any more grant, the total of Formula Spending Shares.

##### ***Summary of Options***

###### *Option RE1*

Full additional resource equalisation.

###### *Option RE2*

Half additional resource equalisation.

###### *Option RE3*

Full additional resource equalisation with abolishing interest receipts.

##### ***Questions***

**Question 33: Do you think we should increase resource equalisation?**

**Gedling Response:** It is considered that resource equalisation should be increased as this produces more equitable results, distributing grant toward high need low tax base authorities.

**Question 34: Which of the options do you prefer?**

**Gedling Response:** Option RE3 is preferred as full equalisation produces the most equitable solution and interest receipts have outlived their usefulness as described in the Capital Financing Service Block.

## 5. **FLOOR DAMPING**

### **The Current System**

The floor amount i.e. minimum increase of Formula Grant available to each authority is calculated. Every authority is guaranteed at least its floor amount. In order to pay for this, authorities above the floor have their percentage grant increase above the floor scaled back by a constant scaling factor. There is a separate scaling factor for each of the four floor groups i.e.

- Education/PSS authorities;
- Single-service police authorities;
- Single-service fire authorities;
- and Shire Districts

### **Abolition of the capital adjustment**

Floors and ceilings were first introduced for education/PSS authorities in 2001/02. Authorities at both the floor and the ceiling complained that they received no increase in grant if they increased their borrowing. Ministers accepted this argument and in 2002/03, when floors and ceilings were introduced for all authorities, the first capital adjustment was introduced. This compared the Debt Charges SSA in 2002/03 to the Debt Charges SSA in 2001/02.

Some authorities argued that this form of capital adjustment penalized those authorities with large outstanding debt as at 1 April 1990. The debt charges adjustment was changed to its present form in 2003/04. In 2005/06 Ministers abolished the ceiling. Authorities therefore now fall into two groups: floor authorities or scaled authorities i.e. those above the floor that help to pay for the floor.

### **Floor authorities**

Formula grant before floors ensures that if all authorities spent at FSS, then council tax payers in all areas of the country would pay the same level of council tax depending on their council tax band i.e. it is said to equalise for needs and resources. Support for capital expenditure is covered by the Debt Charges FSS and authorities therefore receive support for additional capital expenditure within their formula grant before floors.

Floor authorities receive additional grant above this level to ensure that they receive a year-on-year increase in grant equal to the floor. They would therefore be able to set council tax below the national average if all authorities spent at FSS.

Given this is it reasonable to argue that such authorities should receive additional grant to support capital expenditure?

### **Authorities above the floor**

Authorities above the floor only have their grant above the floor scaled back and therefore to this extent they benefit from the capital adjustment. However the scaling factor for such authorities would be less if the floor was less costly i.e. if the capital adjustment was removed for floor authorities.

### **Alternative approaches to paying for the floor**

Since damping must be cost neutral it follows that authorities that are above the floor must pay for this. In the current system we scale back authorities grant above the floor in order to achieve this. However this is not the only option.

### **Damping based on taxbase**

Another way of raising money to pay for the floor is to raise the Assumed National Council Tax (ANCT). In this system damping is paid for by all authorities; it is not split into separate floor groups.

### **Damping based on the basic amount per head**

In order to pay for the floor increases, the basic amount per head is decreased evenly across all authorities. The four separate floor groups are retained under this system and each works independently with respect to damping.

### **Summary of options**

#### *Option DMP1*

Abolishing the capital adjustment.

#### *Option DMP2*

Damping based on taxbase

#### *Option DMP3*

Damping based on basic amount per head

### ***Questions***

**Question 35: Do you consider that the capital adjustment should be abolished?**

**Gedling Response: No comment as this has significant impact on upper tier authorities**

**Question 36: Which approach for paying for damping you prefer (i.e. the existing method, DMP2 or DMP3)?**

**Gedling Response: Damping based on the tax base is preferred i.e. DMP2. It is considered that the current system significantly disadvantages 'gaining' district councils. District Council share of total funding, via EPCS and Capital Financing Blocks is relatively modest. Restricting damping costs within groups has resulted in many district councils not recovering monies above the ceiling within the three year spending review as originally intended.**