



LGA annual conference,
Bournemouth

5 July 2023

@TheIFS

Forward look on finance

David Phillips
Kate Ogden

Today's presentation



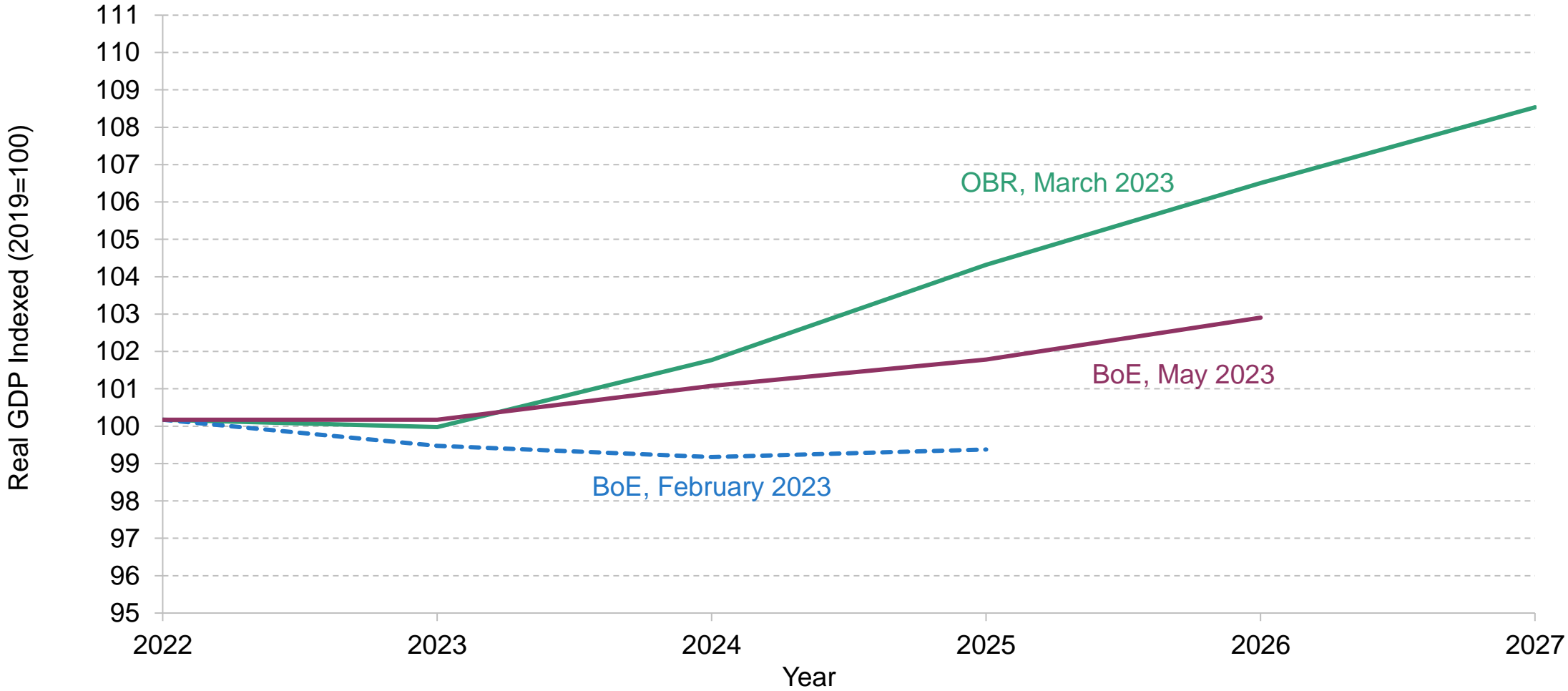
- Economic outlook
- Fiscal and public spending outlook
- Local government funding outlook
- Potential reforms post-election

Economic outlook



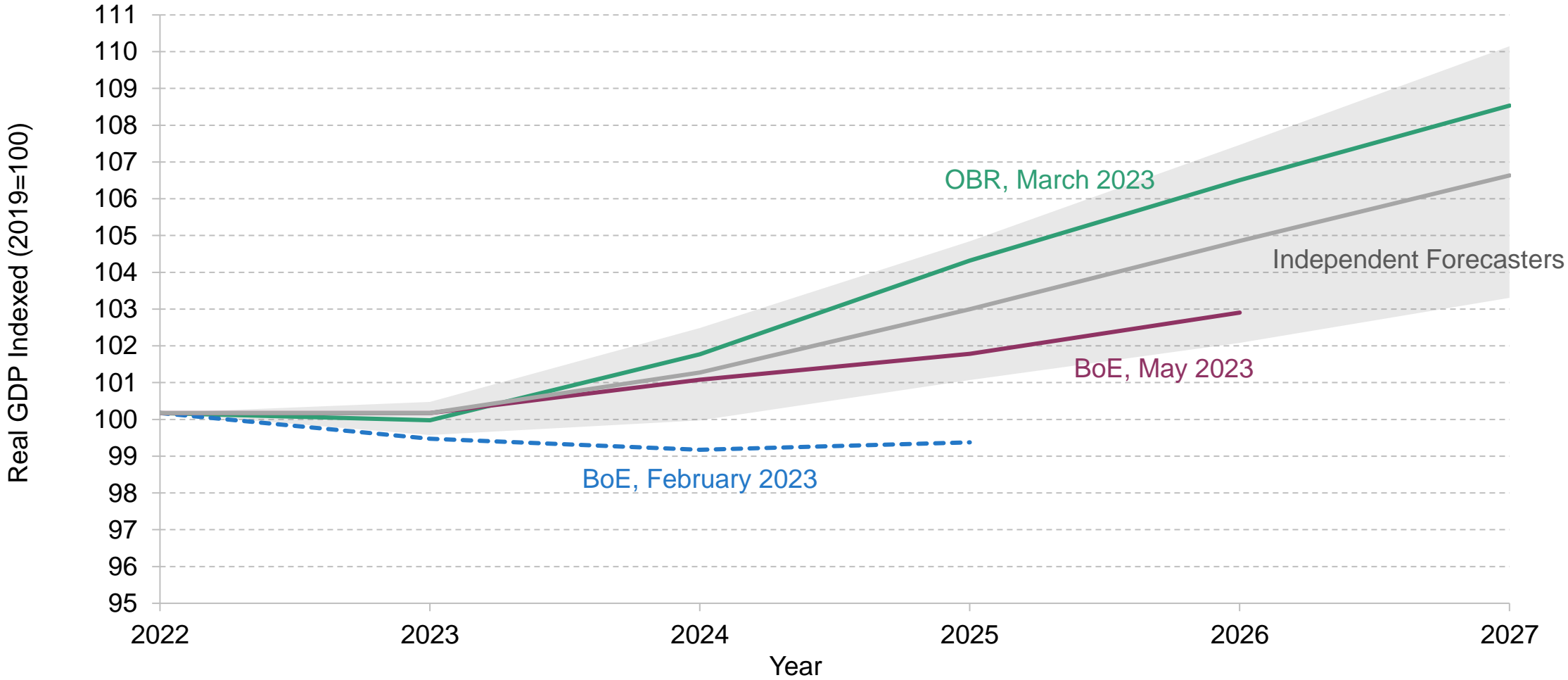
- Uncertain outlook for economic growth

Comparison of economic forecasts



Source: Emmerson (2023) IFS analysis of Spring Budget 2023, <https://ifs.org.uk/spring-budget-2023>. BoE Monetary Policy Report - May 2023, projections based on market interest rate expectations. HM Treasury summary of independent forecasters.

Comparison of economic forecasts

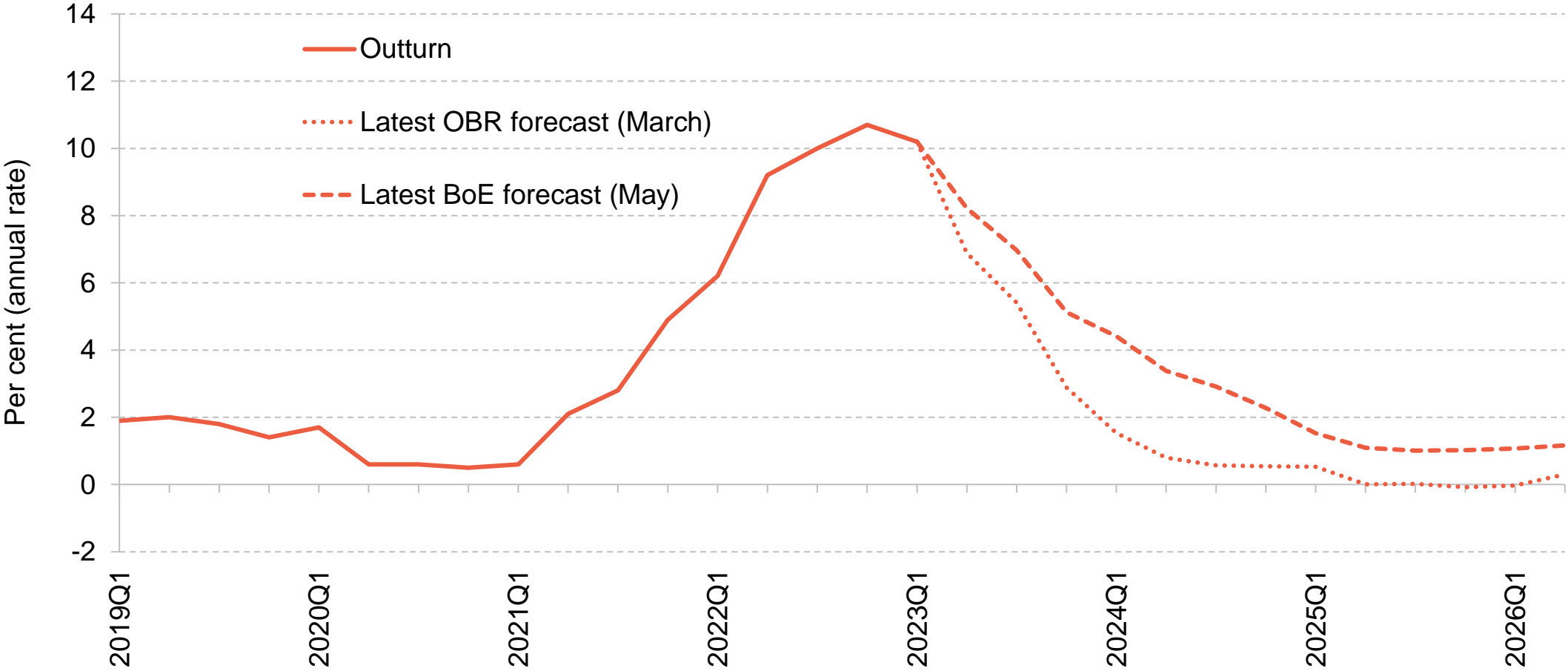


Source: Emmerson (2023) IFS analysis of Spring Budget 2023, <https://ifs.org.uk/spring-budget-2023>. BoE Monetary Policy Report - May 2023, projections based on market interest rate expectations. HM Treasury summary of independent forecasters.

Economic outlook

- Uncertain outlook for economic growth
 - OBR forecasts are more optimistic than most, and particularly than the BoE
 - Over £100 billion difference in forecast size of economy in 2026
- Inflation high and proving more persistent than expected

Inflation forecast and outturns

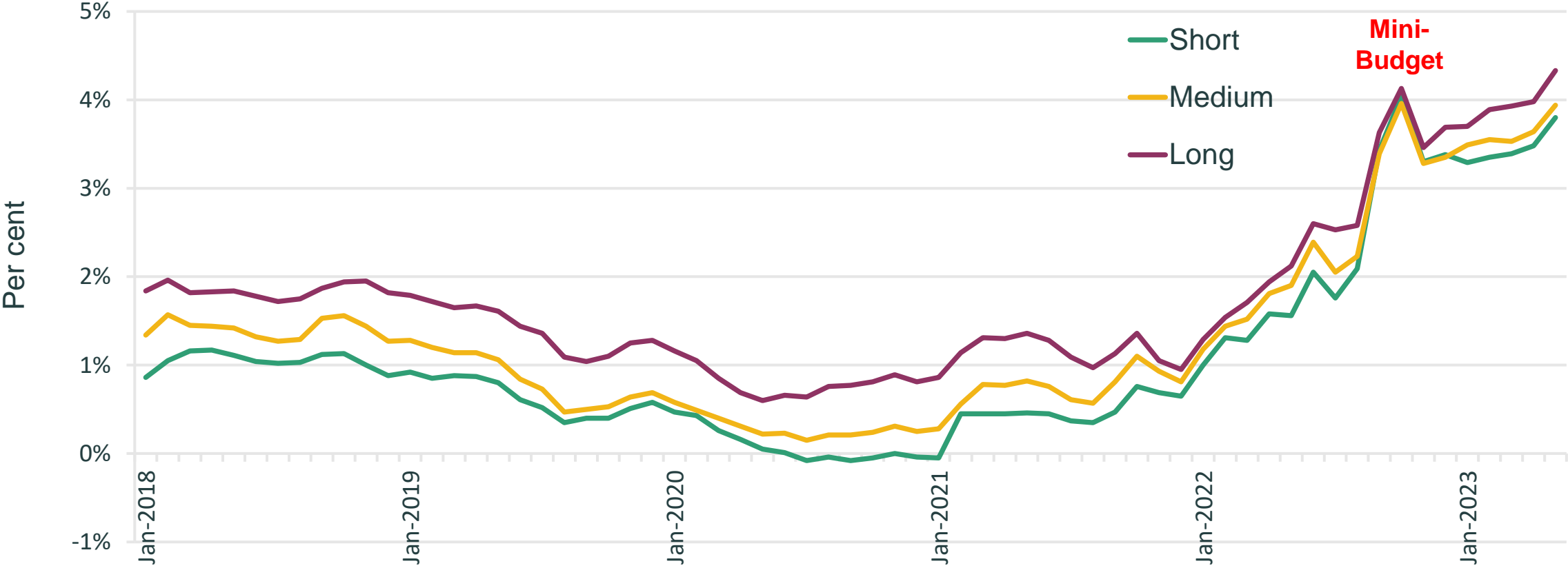


Source: ONS series D7G7, BoE May 2023 Monetary Policy Report, OBR Economic Forecast March 2023.

- Uncertain outlook for economic growth
 - OBR forecasts are more optimistic than most, and particularly than the BoE
 - Over £100 billion difference in forecast size of economy in 2026
- Inflation high and proving more persistent than expected
 - Upwards pressure on nominal wages – private sector up 7.6% in year to March, compared to 5.6% in public sector
 - Increase in interest rates for government, businesses and households

Interest rates on government bonds

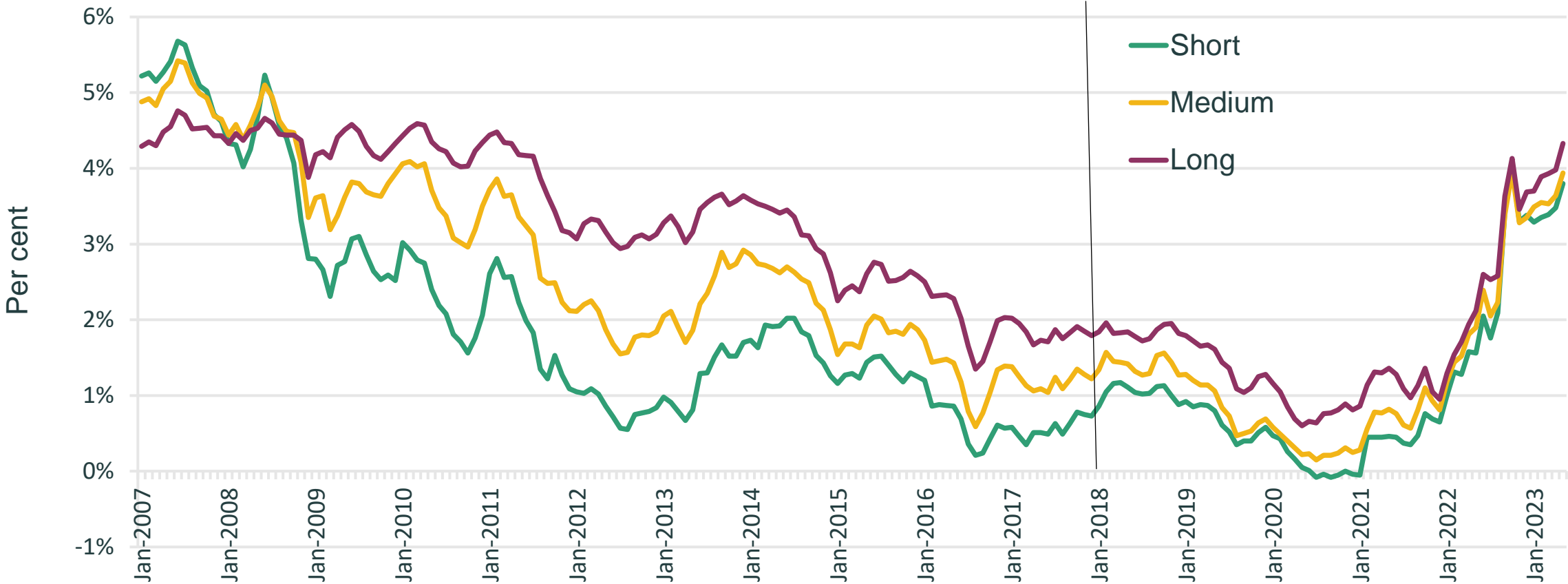
Average monthly government bond yields



Source: Debt Management Office, Historical Monthly Gilt Yields, <https://dmo.gov.uk/data/>

Interest rates on government bonds

Average monthly government bond yields

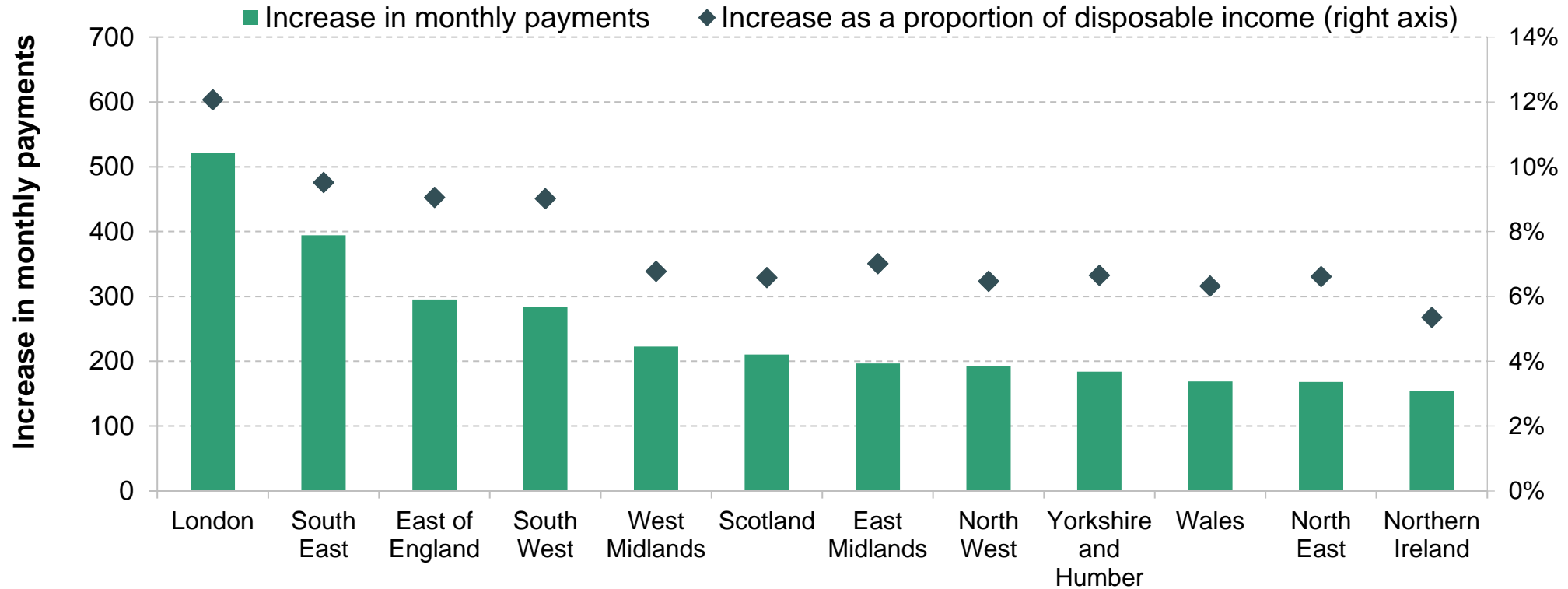


Source: Debt Management Office, Historical Monthly Gilt Yields, <https://dmo.gov.uk/data/>

- Uncertain outlook for economic growth
 - OBR forecasts are more optimistic than most, and particularly than the BoE
 - Over £100 billion difference in forecast size of economy in 2026
- Inflation high and proving more persistent than expected
 - Upwards pressure on nominal wages – private sector up 7.6% in year to March, compared to 5.6% in public sector
 - Increase in interest rates for government, businesses and households
- Household incomes are falling in real-terms
 - OBR forecast a nearly 4% fall in 2022-23 and 2% fall in 2023-24
 - Energy & food costs affect poor most; mortgage costs 30-50 year olds on mid-high incomes, especially in London & South

Rising mortgage costs, esp in South

Average increase in mortgage payments in mortgage-paying households



Note: Impact of an increase in mortgage rates of 3.74 percentage points, compared to March 2022. Sample is comprised only of heads of households and their spouses.

Source: Waters and Wernham (2023).

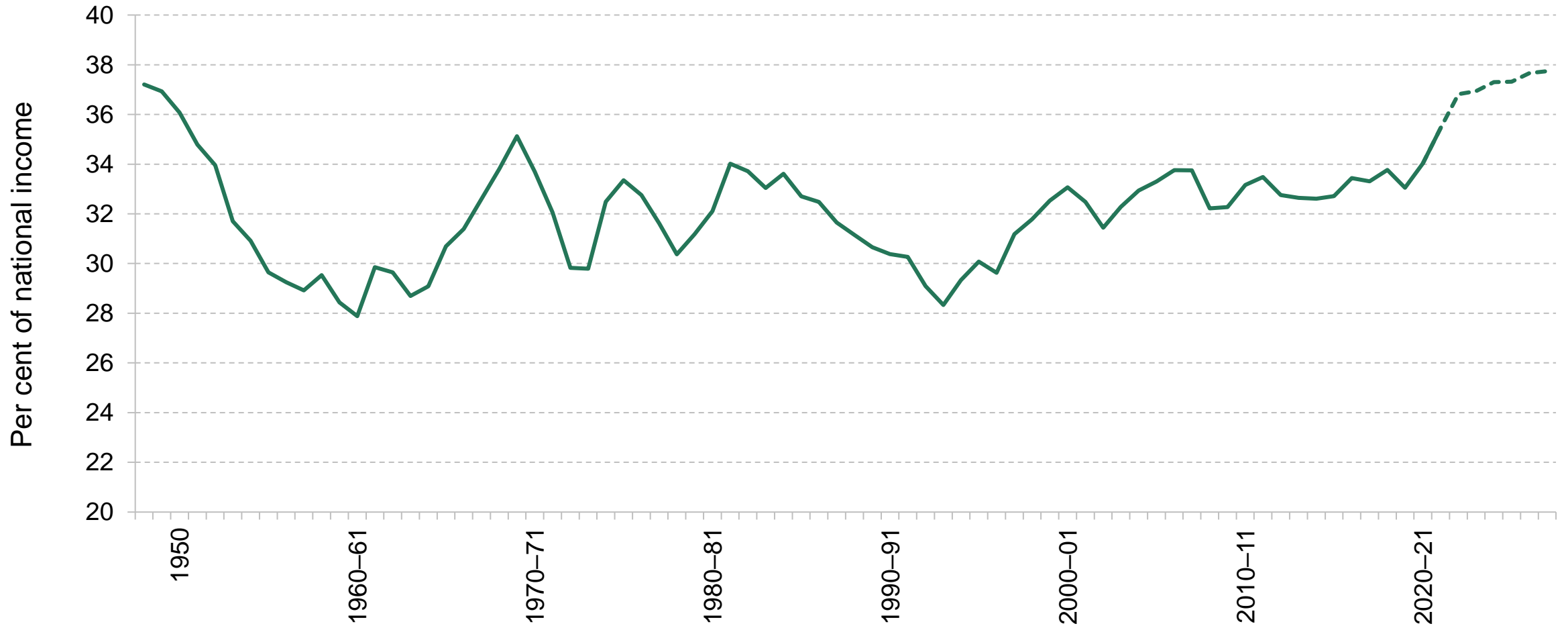
Fiscal outlook



- Slow growth and higher interest rates have negatively impacted the public finances
- To address this, a programme of fiscal consolidation
 - Taxes set to rise to nearly 38% of GDP

Historically high tax burden

National accounts taxes as a % of national income



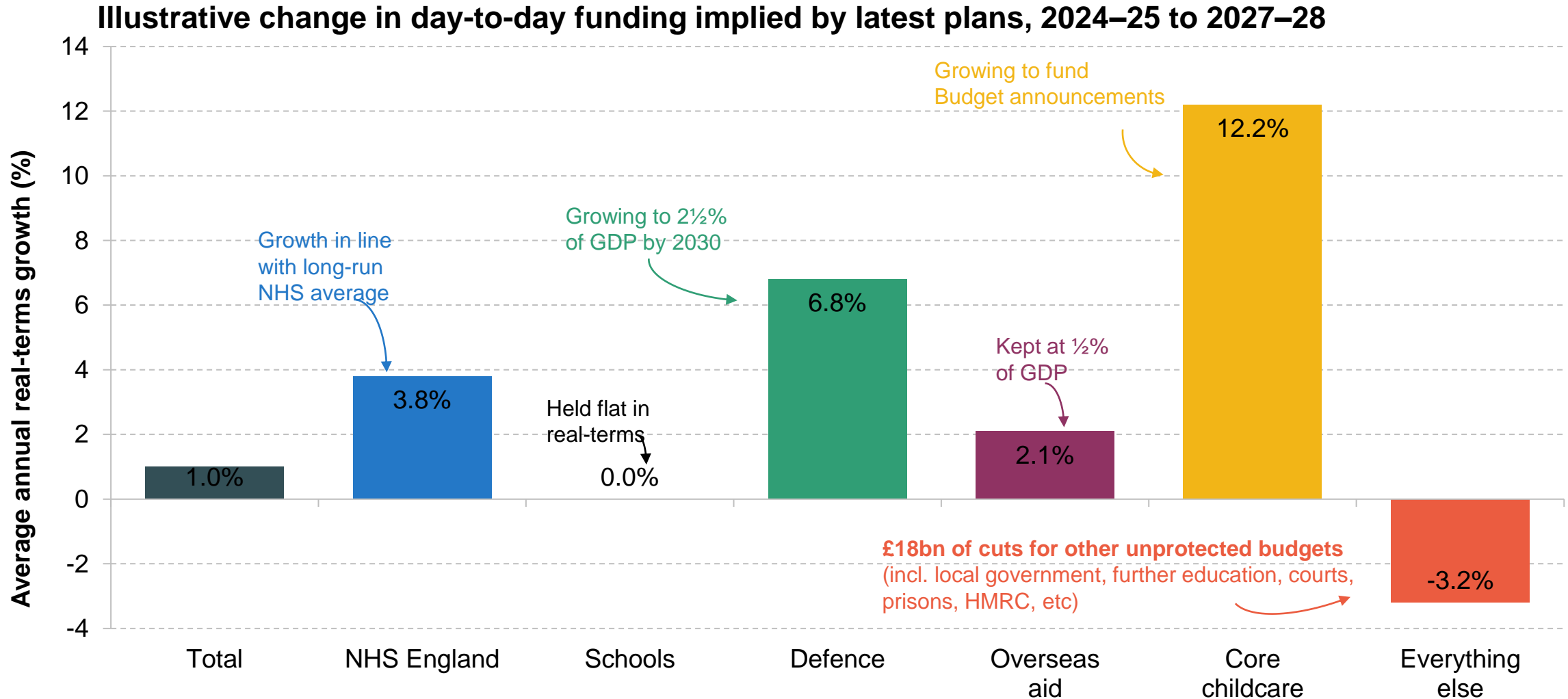
Source: Emmerson (2023) IFS analysis of Spring Budget 2023, <https://ifs.org.uk/spring-budget-2023>.

Fiscal outlook



- Slow growth and higher interest rates have negatively impacted the public finances
- To address this, a programme of fiscal consolidation
 - Taxes set to rise to nearly 38% of GDP
 - Constrain increases in public service spending to 1% a year in real-terms

Tough choices on spending prioritisation



- Slow growth and higher interest rates have negatively impacted the public finances
- To address this, a programme of fiscal consolidation
 - Taxes set to rise to nearly 38% of GDP
 - Constrain increases in public service spending to 1% a year in real-terms
- Even with these actions and OBR's relatively optimistic forecast, government barely set to meet its fiscal rules
 - Debt still growing and OBR forecast only tiny fall in 2027-28 (the year rule applies)
 - Recent increases in interest rate expectations would wipe out this fall
- Whoever is in government post-election will face very tough choices on tax and spending and will be vital to boost both private and public-sector's dismal recent productivity performance

Core spending power rose significantly this year

- Substantial year-on-year cash increase in core spending of £5.1bn (9.4%)
 - Compares to +6.5% for core schools budget, +5.1% for NHS England
- 6.7% in real-terms based on GDP deflator – but this may underestimate cost rises
 - 3.1% real-terms using CPI (BoE May) – may overstate cost rises but also expect demand growth
- Cash spending on services budgeted to rise £6.2bn (11.7%) year-on-year
 - £2.5bn from ASC and £1.5bn from CSC (£90m for asylum seeker support)
 - £160m more for street lighting
 - £174m (20%) rise in spend on homelessness

Source: Final local government finance settlement 2023-24; OBR EFO March 2023; DLUHC (2023) [Local authority revenue expenditure and financing: 2023-24 budget](#), Table 1. Change in spending compares 2022-23 and 2023-24 budgets and excluded spend on education, police, fire and the GLA element of highways and transport spending.

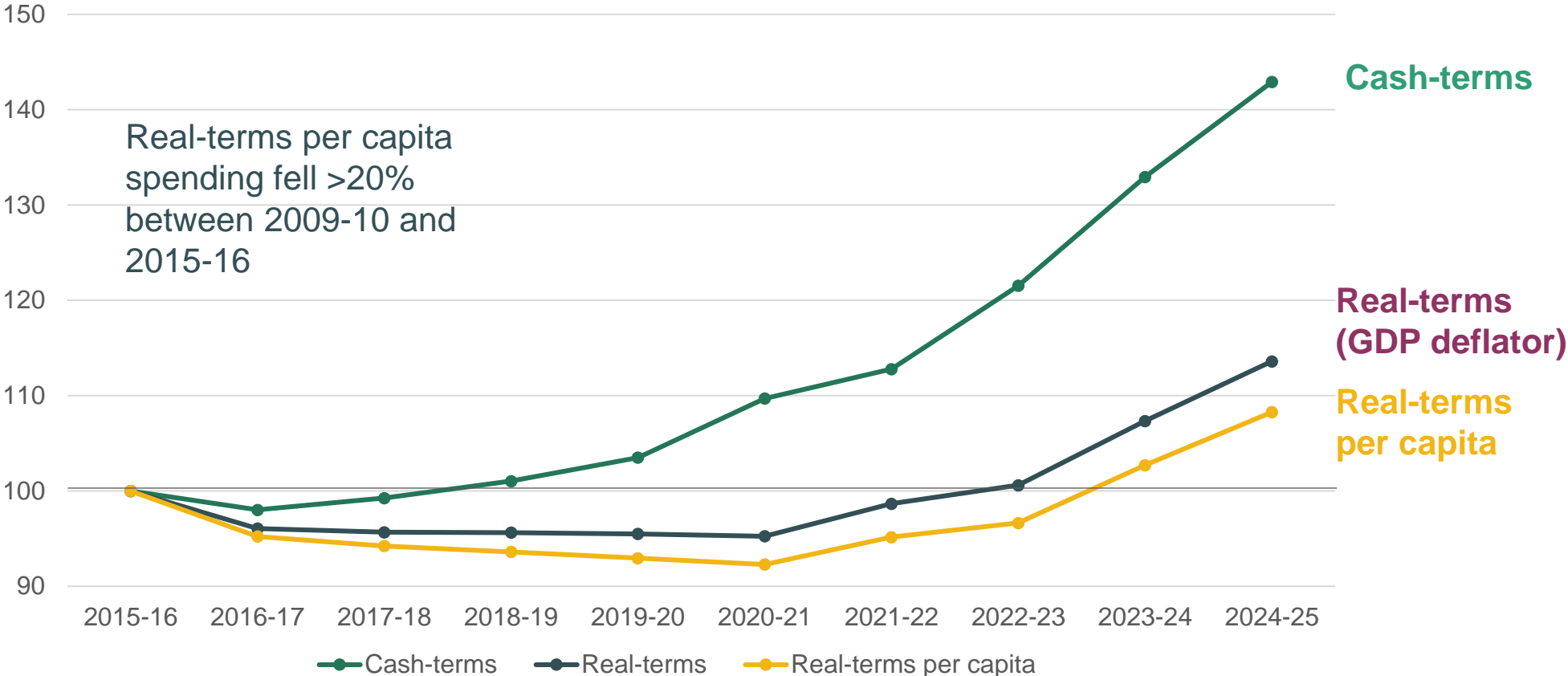
Further significant rise expected next year



- December [policy statement](#) set outlines of funding in 2024-25:
 - Same CT referendum limits (3% plus 2% ASC precept)
 - Business rate revenues indexed to CPI (BoE forecast 7.0%)
 - Further planned increases in SC grants (£1.1bn)
- If nothing else changes, expect a further £4.5bn (7.5%) increase in CSP in 2024-25
 - Inflation expected to fall, so 5.8% real-terms using GDP deflator (4.9% using CPI)

Sector-wide funding projections

Core spending power since 2015



Note: Real-terms figures reflect the forecast GDP deflator. Changes exclude the impact of rolling in grants, and additional CT flexibilities granted to Croydon, Thurrock and Slough. 2024-25 figures are estimates based on assuming only changes to total grant funding are those already announced, maximum use of allowed CT rises and taxbase growth of 1% each year.

Source: Final local government finance settlement 2023-24; Local government finance policy statement 2023-24 to 2024-25; OBR EFO March 2023; ONS 2020-based population projections.

Further significant rise expected next year



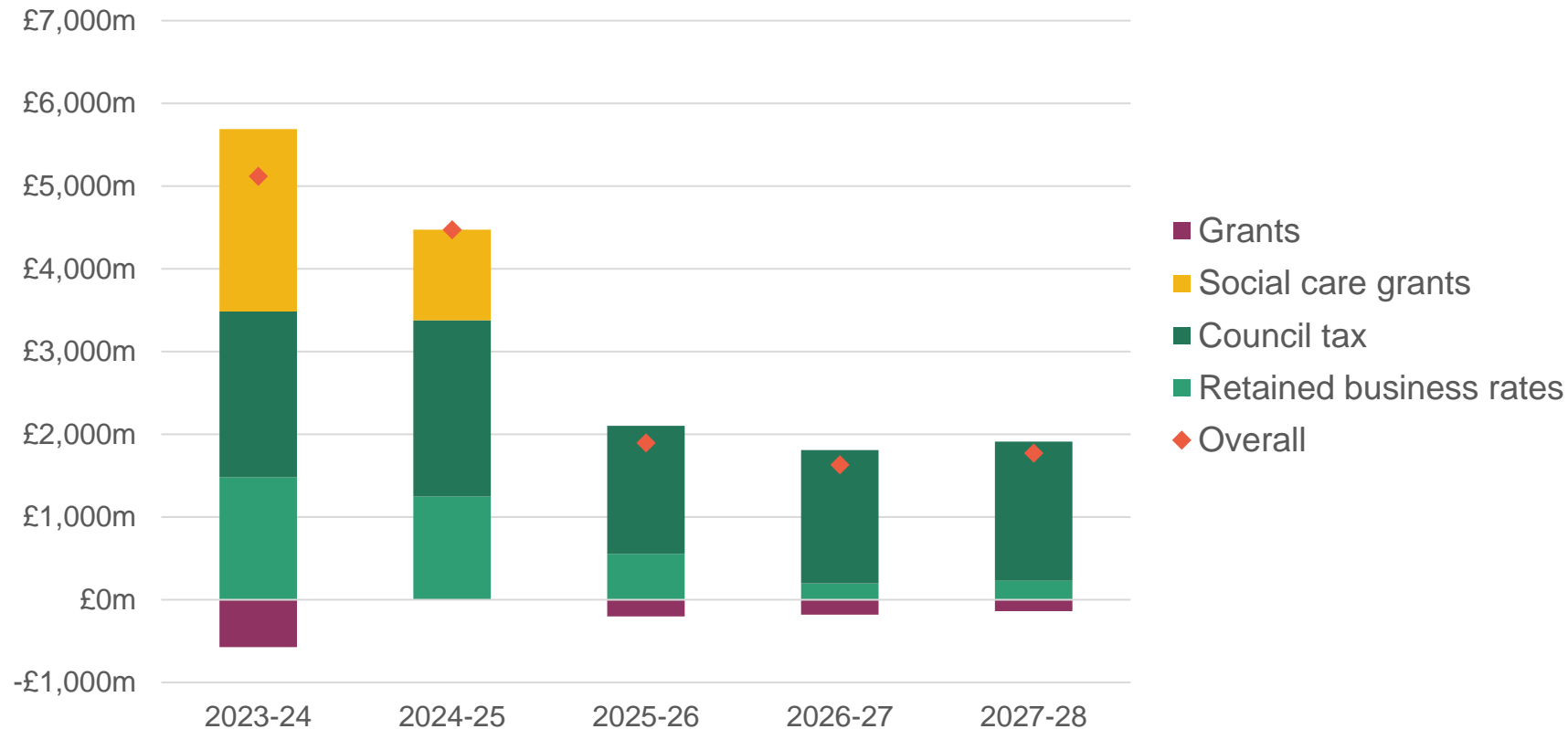
- December policy statement set outlines of funding in 2024-25:
 - Same CT referendum limits (3% plus 2% ASC precept)
 - Business rate revenues indexed to CPI (BoE forecast 7.0%)
 - Further planned increases in SC grants (£1.1bn)
- If nothing else changes, expect a further £4.5bn (7.5%) increase in CSP in 2024-25
 - Inflation expected to fall, so 5.8% real-terms using GDP deflator (4.9% using CPI)
- Extended Producer Responsibility (pEPR) to be phased in next year
 - DLUHC estimate £780 million for councils in 2024-25 (not full year), paid to reflect costs of an “efficient” service
 - DLUHC will assess impact on relative needs and resources of individual LAs

After 2024-25, funding could get tighter and rises ever more reliant on council tax

- Social care charging reforms delayed until 2025
 - Funding has been repurposed to prop up existing services – presume extra would be found
- If assume CT referendum limits return to 2% + 1% precept, BRs indexed to CPI (and no base growth) and other grants cut by 3.2% real-terms
 - £1.9bn (3.0%) cash rise in CSP in 2025-26 – vast majority from CT rises
 - Similar in subsequent years, especially as BoE forecast CPI to fall to 1%

After 2024-25, funding could get tighter and rises ever more reliant on council tax

Cash changes in CSP year-on-year



Note: 2024-25 figures are estimates based on assuming only changes to total grant funding are those already announced, maximum use of allowed council tax rises and council tax base growth of 1%. In subsequent years, council tax revenues are assumed to rise by 4.3% each year, retained business rates revenues in line with BoEs May 2023 forecast for CPI in the relevant quarter and all other parts of CSP are assumed to decline by 3.2% real-terms each year (using the GDP deflator),

After 2024-25, funding could get tighter and rises ever more reliant on council tax

- Social care charging reforms delayed until 2025
 - Funding has been repurposed to prop up existing services – presume extra would be found
- If assume same CT referendum limits, BRs indexed to CPI (and no base growth) and other grants cut by 3.2% real-term
 - £1.9bn (3.0%) cash rise in CSP in 2025-26 – vast majority from CT rises
- Similar in subsequent years, especially as BoE forecast CPI to fall to 1%
- Reliance on council tax for rises in spending power has distributional consequences
 - This year, business rates and social care grants offset so more deprived areas saw bigger % rises in CSP
 - Will be much harder to offset CT rises in this way in future years

Changes to local govt finance system are overdue

- Policy Statement confirmed business rates reset and 'Fair Funding Review' will be delayed (again!) until 2025-26 at the earliest
- Will inevitably create some big losers as need to:
 - redistribute substantial retained BR revenues
 - adjust for years of popn growth and changes in local socio-economic circumstances
 - reflect big changes in councils' activities
- Constraints on overall funding make it harder to implement (mean cuts for 'losers') but also make it even more important that funding is well-aligned to needs
- Ideally revalue and reform council tax itself
 - Welsh Government is reforming CT (more progressive bands, regular revaluations) and Scottish Govt is considering

Devolution and structural reforms

- Current government is focusing on deeper and new devolution deals
 - Deeper deals and single funding pots for city-regions (starting with GM and WM)
 - More ambitious county devolution deals if move to elected mayor/leader model
 - Potential ↑ in business rates retention, but little appetite for wider revenue devolution
- Labour's [Commission on the UK'S Future](#) suggests powers similar to the 'trailblazer deals' across the country, if there is local capacity and desire
 - Also suggests existing LAs and CAs form local and regional partnerships to pool powers, budgets and better plan for economic development
 - Supportive of fiscal devolution (with checks and equalisation) – but indications party leadership are less sure
- Local government looks set to continue to rely on council tax, business rates and central government grants for vast bulk of its funding

A 'National Care Service' for England?

- Under Corbyn, comprehensive free personal care and greater public provision (in-house)
 - Inspired by Scottish NCS – top-down, and risks making services less consistent (if flaws in needs assessments and no local flexibility)
- Labour still committed to a NCS, but Fabian Society report likely a better guide:
 - council flexibility over models of care but national brand, national pay-bands to achieve parity with similar NHS roles, and a 'national care guarantee'
 - 10-year commitment to significantly raise expenditure in real terms every year
 - phasing in a national need-based funding formula with a specific grant that tops up or replaces locally-raised revenue (to include transitional arrangements)
- ASC accounts for 40% (£22bn) of councils' budgeted non-education spend in 2023-24 → separating out from rest of LG finance would likely mean re-nationalising BR revenues

Summary

- Economic outlook is uncertain
 - Key risks are is productivity growth remains low, inflation and interest rates high
- Public finance situation is precarious
 - Despite tax rises and spending restraint, debt is barely set to fall as share of GDP
 - Upwards pressures on spending and pressure to pull a rabbit out of the hat on taxes
- Hefty rises in core spending power this year and next, even in real-terms
 - Likely to be tighter from 2025 onwards and relying on council tax brings risks
- Reforms to finance system are overdue
 - And even more necessary if social care funding is to be separated out

Some plugs

- IFS local government finance model - <https://ifs.org.uk/local-finance-model>
 - Medium-term funding and spending projections for each council to support financial planning
 - Will soon be updated to reflect published 2023-24 budgets
- Program of IFS work funded by the Health Foundation on geographic allocation of funding vs needs across a range of public services
 - Phase 1 found local govt funding in 2019 poorly aligned with needs
 - Next report will compare funding for upper-tier LA areas in 2022 with updated assessed spending needs, including interactive online maps
- IFS will be publishing analysis of party manifestos ahead of the general election

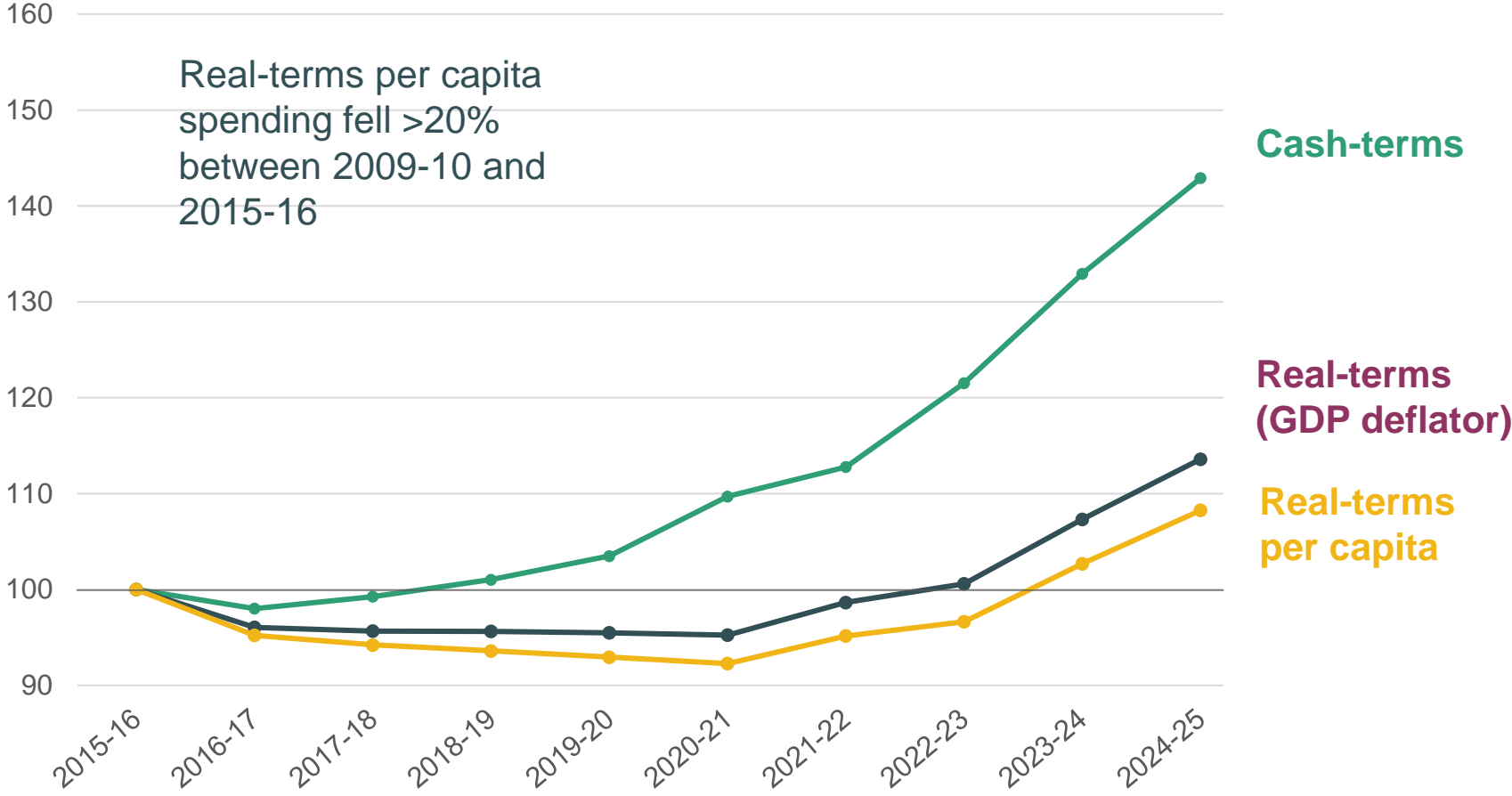
The Institute for Fiscal Studies
7 Ridgmount Street
London
WC1E 7AE

www.ifs.org.uk



Sector-wide funding projections

Core spending power since 2015



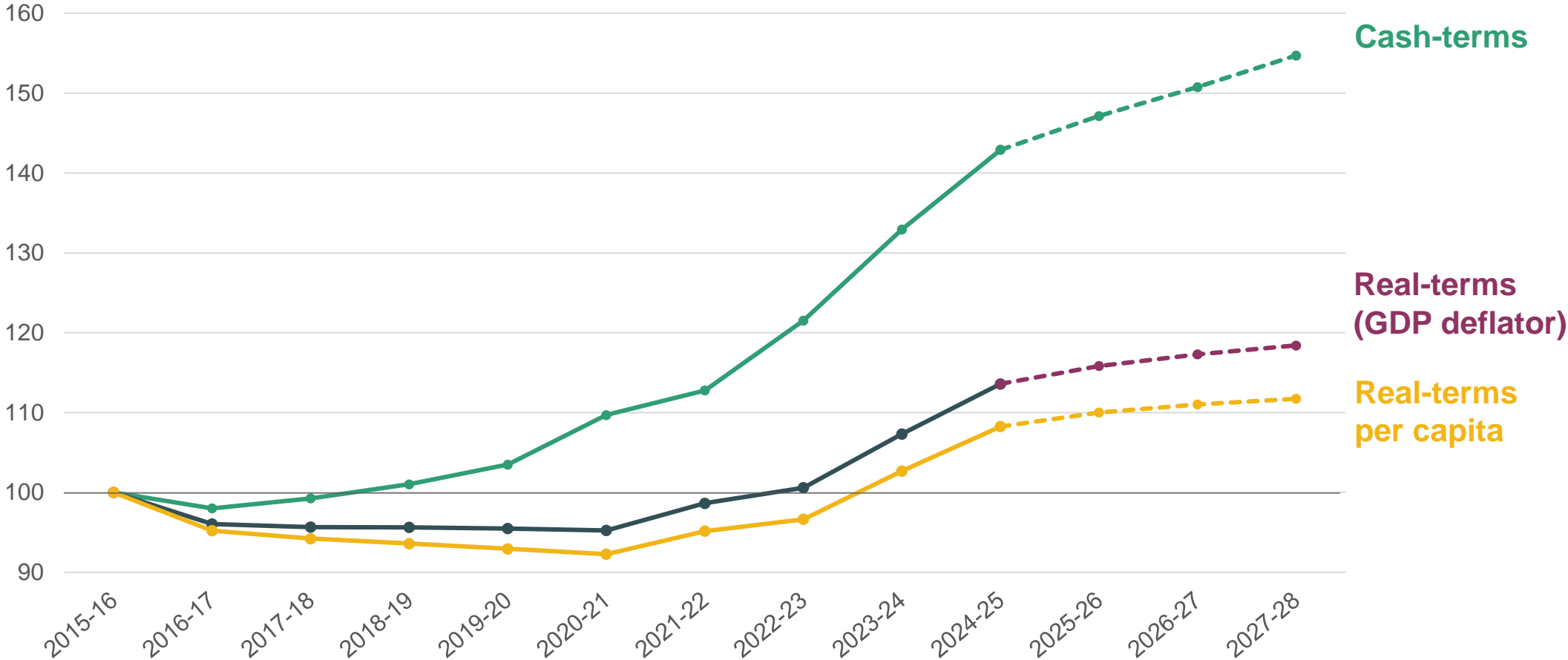
Note: Real-terms figures reflect the forecast GDP deflator. Excludes the impact of rolling in grants, and additional CT flexibilities granted to Croydon, Thurrock and Slough. 2024-25 figures are estimates based on assuming only changes to total grant funding are those already announced, maximum use of allowed CT rises and taxbase growth of 1% each year.

Source: Final local government finance settlement 2023-24; Local government finance policy statement 2023-24 to 2024-25; OBR EFO March 2023; ONS 2020-based population projections.

Sector-wide funding projections



Core spending power since 2015



Note: Real-terms figures reflect the forecast GDP deflator. Changes exclude the impact of rolling in grants, and additional CT flexibilities granted to Croydon, Thurrock and Slough. 2024-25 figures are estimates based on assuming only changes to total grant funding are those already announced, maximum use of allowed CT rises and taxbase growth of 1% each year.

Source: Final local government finance settlement 2023-24; Local government finance policy statement 2023-24 to 2024-25; OBR EFO March 2023; ONS 2020-based population projections.

Extended Producer Responsibility may mean extra funding from 2024

- Extended Producer Responsibility (pEPR) expected to be phased in from 2024-25
 - Aims to shift the cost of managing HH packaging waste onto producers, encouraging them to make packaging more easily recyclable (and to use less)
- Producers will pay a ‘Scheme Administrator’ which will make payments to councils
 - DLUHC estimate £780 million for councils in 2024-25 (not full year)
- Payments will be based on costs of running an “efficient” service and will “consider rurality and level of deprivation and performance expectations”
 - “Payments will be made directly to the LA that incurs costs associated with their waste management functions” – will matter how this is split between tiers in two-tier areas
- DLUHC will assess impact on relative needs and resources of individual LAs
 - If successful, payments could reduce over time – will costs fall at the same rate?)

Source: DLUHC annual [report and accounts 2021 to 2022](#); DLUHC Packaging and packaging waste: introducing Extended Producer Responsibility [consultation outcome](#)