



Title: **Needs & Redistribution Technical Working Group**

Paper: **NR TWG 17/05 Discussion paper regarding the approach to Deprivation in the Fair Funding Review by the Department for Communities and Local Government**

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POLICY DEVELOPMENT: NOT A STATEMENT OF GOVERNMENT POLICY

Introduction

- 1) As part of the Fair Funding Review (the Review), we need to consider how best to measure and account for the main cost drivers affecting local authorities with respect to delivering public services. Deprivation is widely considered to be a key cost driver for local authorities, and was specifically raised by several respondents to the Call for Evidence published last year where we asked what factors we should consider when measuring the relative need of authorities.
- 2) This paper sets out how the current relative needs assessments account for deprivation and what options there are for accounting for it in a future needs assessment.
- 3) Relative levels of deprivation are a crucial determinant of ‘need’ for several services that local authorities provide. There are strong, well-established relationships between the degree of deprivation within an authority (measured through various deprivation-related indicators) and the amount an authority spends in order to maintain the same level of services. For example, there is a strong link between the proportion of income-deprived children within a local authority, and the amount that a local authority spends on Children’s Social Care.
- 4) An important underlying reason for why deprivation is so strongly linked to spend relates to eligibility for key means-tested services, such as Adult Social Care. This also explains why, for example, income deprivation indicators are more useful than merely using average incomes: it is deprivation which is the key cost driver; e.g. the proportion that are below a given income threshold, which affects need, rather than

the extent to which individuals within a local authority boundary are above this threshold. The degree of affluence is therefore less important.

- 5) At present, deprivation is generally included as a ‘top-up’ within Relative Needs Formulas (RNFs), whereby additional funding is allocated according to how ‘deprived’ the local authority is relative to other local authorities. The following table shows the indicators used to calculate deprivation top-ups in current RNFs:

Figure 1: Deprivation-related indicators presently used within RNFs.

Service area	RNF	Indicator(s)
Children’s Services	Youth and Community	1. Children in out-of-work families receiving child tax credit.
Children’s Services	Local Authority Central Education functions	1. Children in out-of-work families receiving child tax credit.
Children’s Services	Children’s Social Care	<ol style="list-style-type: none"> 1. Children without good health; 2. Income support/income based Jobseeker’s Allowance claimants aged 18 to 64 years; 3. Children in out-of-work families receiving child tax credit; 4. Children in black ethnic groups.
Adults’ Personal social Services	Social Services for Older People	<ol style="list-style-type: none"> 1. Older people receiving Attendance Allowance; 2. Older people living in rented accommodation; 3. Older people living in one person households; 4. Older people on income support / income based Jobseeker’s Allowance / guarantee element of Pension Credit.
Adults’ Personal social Services	Social Services for Younger Adults	<ol style="list-style-type: none"> 1. People aged 18 to 64 receiving Disability Living Allowance; 2. People aged 18 to 64 who are long term unemployed or have never worked; 3. People aged 18 to 64 who work in routine or semi-routine occupations; 4. Households with no family.
Fire and Rescue Services	Fire and Rescue	<ol style="list-style-type: none"> 1. Risk index – which is the sum of: <ul style="list-style-type: none"> - The proportion of working age adults with no qualifications; - The proportion of working age population not in employment; - The proportion of working age adults on income support; - The authority’s standardised mortality ratio.

Environmental, protective and cultural services	Environmental, protective and cultural services	<ol style="list-style-type: none"> 1. Incapacity benefit and severe disablement allowance; 2. Income support / income based Jobseeker's Allowance / guarantee element of Pension Credit claimants; 3. Older people on income support / income based Jobseeker's Allowance / guarantee element of Pension Credit; 4. Unemployment related benefit claimants.
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Key: Red deprivation indicators relate to income deprivation amongst the working aged (18-64 years); blue deprivation indicators relate to employment deprivation amongst the working aged (18-64 years); orange deprivation indicators relate to economic deprivation amongst children (0-18 years); green deprivation indicators relate to economic deprivation amongst older people (65+ years).

There are multiple reasons why there is a need to review how deprivation is approached across service areas:

- 6) Firstly, deprivation is a key cost driver in the current local government RNFs and significantly affects the distribution of funding. It is therefore necessary to critically appraise the way in which deprivation is taken into account, particularly with respect to which, and how many, deprivation-related indicators are used. Furthermore, it is important to re-examine the statistical robustness of the current deprivation-related indicators (and any others that are considered), especially given the time which has passed since these indicators were originally chosen.
- 7) Secondly, as simplicity and transparency are key principles for the Review, it is worth investigating the extent to which we can simplify or standardise how deprivation is taken into account across different service areas. For example, one option is to use the same indicator(s) for income or employment deprivation where these are identified as cost drivers. Table 1 shows that there are multiple indicators used to explain similar aspects of deprivation (see colour coding), which may provide scope for simplification. This would allow new RNFs to become more easily understood and communicated.
- 8) Thirdly, many of the deprivation-related indicators which have been used in previous local government finance settlements may need to be updated in 2020. To ensure that new RNFs are contemporary, in line with the principles of the Review, more recent data is likely to be required. However, due to changes and discontinuation of various income and employment benefits, and the phased geographical nature of the introduction of Universal Credit (UC), many past indicators are not suitable and consistent England-wide data from UC will not be available until 2022 at the earliest. Therefore, a new data solution for these indicators as proxies for deprivation must be identified.

Options

9) A number of options could be considered to address the points above and factor deprivation into a new relative needs assessment for local government.

1. Use the Indices of Multiple Deprivation

10) One approach is to review the current set of deprivation-related indicators and replace these indicators with the scores for Indices of Multiple Deprivation (IMD) domains where beneficial. The Indices of Multiple Deprivation are a series of indicators (known as 'domains') which measure levels of deprivation at various geographical scales. These domains include deprivation related to income; employment; health; education; crime; living environment; and barriers to housing and services; there is also an overall IMD, which is a weighted average of these seven domains.

11) Specifically, we would expect to use the income and employment domain scores, and perhaps the supplementary indices relating to income deprivation affecting older people ('IDAOP') and children ('IDACI'). Where the use of IMD indices to account for deprivation are not sufficient alone, we could decide which non-IMD deprivation-related indicators should be used and or / maintained, and update the data for these maintained indicators. This would enable us to take a new approach to deprivation using contemporary data, in a robust manner. This would also enable us to assess new indicators and / or remove others currently present in the RNFs, in order to simplify and update the new RNFs. Using IMD domains as indicators within RNFs has multiple advantages.

Advantages of using IMD scores

12) Using the IMD may provide a way of solving data issues presented by the lack of nation-wide UC data. The next release of the IMD intends to combine present UC data and income and unemployment benefit data in different parts of the country in order to establish estimates for income and employment deprivation at various geographical scales, including at the Lower Super Output Area (LSOA) level as well as the Local Authority level. Using this data in place of indicators for income and unemployment benefits will enable RNFs to be more contemporary, as the data for the next release of the IMD will be dated to 2017. The new release is currently scheduled to be published in summer 2019.

13) The IMD provides a degree of simplification and standardisation of the RNFs as the same indicator could be used in multiple service areas. At the same time, the 'supplementary' indicators relating to income deprivation affecting older people ('IDAOP') and children ('IDACI') may provide more accurate measures of 'need to

spend' for Adult Social Care and Children's Social Care compared to the general income deprivation indices alone. The IMD could aid the transparency of RNFs as well, since the purpose of the domains is straightforward and easily communicable. Whereas the current approach uses a series of indicators (see Table 1 above) broadly linked to different types of deprivation, IMD domains consolidate these and many other indicators into a single variable.

14) The particular indices that are suggested to be used (income and employment domains, and IDAOPI and IDACI supplementary indices) are also the only ones for which the scores for the indices are in the form of continuous, ratio data (at least in the 2015 release). That is, an authority scoring 40 on the income deprivation domain, for example, is correctly interpreted as being twice as income deprived as one with a score of 20 on this measure. However, for the other domains, such as crime deprivation, the scores are less meaningful; a score of 40 would not mean there was twice as much crime deprivation as one with a score of 20: all that could be said with certainty is that based on the data, crime deprivation is higher in the authority with the higher score. It is a core assumption of the main analytical statistical techniques that the IMD scores are in the form of continuous, ratio data. This option is therefore made more robust by the fact that the particular IMD indices that are suggested to be used obey this crucial condition.

Disadvantages of using IMD scores

15) A potential criticism of using IMD scores to account for deprivation in an RNF is that the IMD scores are made up of composites, which comprise many individual indicators that are combined to create one domain (e.g. different types of income-related benefits are used to create the income deprivation domain). This could potentially reduce transparency, especially if some of the underlying indicators used seem less relevant. Furthermore, the weighting for the variables within the domains are pre-determined, and some may see this as potentially inflexible for our purposes, and also lacking in transparency. However, these issues are negated by the fact that for the income and employment indices which would most likely be used, the underlying indicators are very similar to those used at present. Preliminary analysis suggests that there is a very strong statistical relationship between presently-used income benefit indicators and the income domain within the IMD; this also applies with respect to the unemployment-related indicators. This means that analytically, the IMD should make a suitable replacement for these indicators.

16) One possible drawback of using the IMD is timing. The present release (2015) is based primarily on data from 2012/13. The new IMD indices will be available only from summer 2019, which means that whilst they could be used for a 2020/21 implementation date, we would be unable to consult on a revised set of baseline funding levels using this data until late 2019.

Deprivation as a cost-driver

- 17) This option presumes deprivation is treated as a *cost-driver* within one or more RNFs. As a cost driver, deprivation-related indicators, which act as proxies, will be 'additive' variables which we assume influence the *quantity* of services that a local authority needs to provide. Alternatively were we to view deprivation as being a *multiplicative* variable, which increases the cost of providing individual services, we could factor it in an overall Area Cost Adjustment (ACA). Currently, ACAs are used to make separate adjustments to the allocations to local authorities determined by RNFs, and based on factors like local labour costs. We do not believe that deprivation increases the cost of providing any given service, but instead increases the number of such services that need to be provided. For example, a high IDACI score is linked to local authorities needing to provide more Children's Social Care services, but it does not necessarily mean that each individual case in which care is required will be more expensive in authorities with higher IDACI scores than in authorities with lower IDACI scores. In practice, in terms of how deprivation will work within RNFs, this means that IMD indices and other deprivation-related indicators will be individual variables within a funding formula calculation, rather than as an external adjustment.
- 18) Furthermore, by including deprivation-related indicators as cost drivers alongside others, its relative importance compared to the other cost drivers can be analytically determined. On the other hand, it may be harder to explain the influence that deprivation has on resultant allocations, and indeed the influence is likely to vary significantly across service areas.
2. 'Do minimum' option: maintain all present deprivation-related indicators, updating these with new data where possible.
- 19) Another option would be to update the current set of deprivation-related indicators with newer data. This would enable the deprivation indicators to be more contemporary. It would also be in line with any updates to the rest of the indicators within RNFs (assuming these were updated) and be available for implementation of the Review. As in the previous option, deprivation would also be treated here as a cost-driver.
- 20) However, this option would not address the data problem presented by income support and unemployment benefits indicators, whereby the introduction of Universal Credit means that at present there is not a newer dataset available for these indicators. This would mean that some deprivation-related indicators were updated, but not others. Indeed, the majority of the indicators in Table 1 are affected by this issue, and so maintaining these indicators necessarily means out-of-date data would need to be used. Furthermore, as with the 'do nothing' option, it would not be

possible to consider the use of new deprivation-related indicators which may be better drivers of spend than those which are used at present.

3. 'Do nothing' option

- 21) Another option for accounting for deprivation is a 'do nothing' option. This would effectively mean not changing any deprivation indicators, nor updating the data, within any service areas or RNFs.
- 22) While this method would be straightforward to implement, it would not account for any changes in relative deprivation between local authorities, with the newest data for deprivation-related indicators being from 2012. Since relative deprivation affects relative needs, a 'do-nothing' option would represent an analytically inferior approach compared to other options with more recent data.
- 23) In addition, since deprivation-related indicators are embedded within RNFs in different service areas, a 'do nothing' option is necessarily dependent on decisions made within each service area for which deprivation is relevant. It would make little sense to update other indicators within RNFs, for example, whilst ignoring deprivation-related indicators.

Some other options to consider:

Eliminating deprivation indicators entirely from RNFs

- 24) If we were not to take deprivation into account at all, funding allocations would likely be drastically altered. It is well established that authorities with higher levels of deprivation have greater need to deliver a variety of different services. Therefore, since the object of the Review is to ensure that resource is allocated in a fair way according to relative need, this option is not feasible given that it would ignore vast quantities of need in those areas which do experience high levels of deprivation.

Adjusting for deprivation in aggregate rather than within RNFs, e.g. within a single 'foundation' formula

- 25) This option would mean that deprivation is taken into account in a general sense across all service areas, rather than for individual services. This would require the use of an indicator which could take into account all relevant kinds of deprivation, and applied to all service areas. Using the overall IMD score could act as such an indicator, however ultimately spend is not affected by deprivation in all service areas. As an example, 'need to spend' on highways and transport is not affected by levels of deprivation but, generally, by relative length of road and HGV traffic. Furthermore, the overall IMD score includes many domains which may not be relevant, such as education and crime. Therefore, it is not statistically valid to apply an overall

deprivation adjustment outside of individual RNFs, and whilst doing so could be seen as a trade-off for simplicity or transparency purposes, the implications of such an adjustment for allocations are unlikely to be acceptable. These issues are less evident if we employ, in addition to a foundation formula, a series of service specific formulae.

Questions:

Q1: Irrespective of the specific way in which it is done, do you agree that deprivation must be taken into account within needs assessments?

Q2: Should we use the IMD for assessing local authority need? If so, should we use the income and employment domains specifically?

Q3: Do you agree that deprivation should be considered an additive cost-driver (i.e. a variable that determines the *number* of services provided), as opposed to a multiplicative cost-adjustment (whereby we assume deprivation increases the cost of delivering individual services)?

Q4: Are there any alternative indicators which could be used instead of (or in addition to) the IMD or legacy benefits data that could better meet our requirements?

Next steps

- Our immediate priority is to better understand the sector's views on this issue and ascertain whether there are any important factors that have not been considered. In the first instance we would welcome reactions from the group on this paper and the questions presented. We would also welcome any further comments after the meeting, which members may wish to provide in writing.
- We wish to consult more widely on this matter and intend to work towards a planned consultation on relative needs in due course.
- We will also consider publishing a further technical paper on this issue at a later stage, once our thinking has developed and depending on the responses received from earlier engagement and consultation with the sector.
- Finally, before we are able to determine our approach to deprivation within the Review, further analysis and consideration will be required to understand the implications of the options set out in this paper on either a foundation formula or more service specific approach, both of which are currently being explored by the Review. In either case, it will be necessary to determine which deprivation-related indicators are most appropriate to use.