

Adult social care funding: a local or national responsibility?

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Preface

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Executive summary

Adult social care policy is devolved to the nations of the UK. This report considers the organisation of public funding for adult social care services in England. While the NHS provides some social care services to those with significant health-related care needs, most publicly funded care in England is organised and paid for by local councils.

Local government finance and adult social care policies are changing

- Adult social care spending accounts for more than one-third of councils' overall spending on local services (excluding education). To fund this spending, councils rely on a combination of council tax and business rates revenues and grant funding from central government. Historically, these grants were allocated in a way designed to compensate councils for the negative correlation between local tax bases and local spending needs.
- Recent years have seen big cuts to these general-purpose grants, resulting in a 21% reduction in councils' overall revenues between 2009–10 and 2016–17. Furthermore, grant allocations have not been updated to reflect changes in the assessed spending needs of different councils since 2013–14.
- This reflects a more general trend with government policy on local government finance pointing towards each council having more responsibility for raising its own revenues, and less equalisation of resources between councils with different tax bases and spending needs. The business rates retention scheme (BRRS), for instance, means councils' budgets will depend to an increasing extent on local business rates revenue performance. And general grant funding is set to be abolished from 2020.
- The aim of these changes is to provide councils with stronger financial incentives to grow their local economies and tackle underlying spending needs. However, if tax bases and spending needs evolve in different ways, the ability of councils to fund services – including adult social care services – could diverge over time.
- At the same time, government policy towards adult social care is pointing in the opposite direction. Central government appears to want a more consistent quality of service across the country. Social care needs assessment processes have been standardised and national minimum eligibility criteria introduced, where previously councils had more flexibility to determine who was in need of social care services.
- Westminster is also increasing its influence over the level of social care spending through a growing pot of ring-fenced grant funding and council tax (the 'Social Care Precept') specifically for adult social care services. Broadly speaking, this pot is allocated according to central government's assessment of councils' adult social care spending needs. Including this ring-fenced pot, adult social care spending fell 6% between 2009–10 and 2016–17, a much smaller cut than for local government as a whole.

There are tensions between these changes, with a risk of divergences in funding availability at a local level ...

- Current policy is therefore pulling in different directions. On the one hand, the government is trying to create a more consistent quality of adult social care services across the country, thereby limiting councils' flexibility over what they provide. On the other hand, it now tries less to ensure that councils each have the money the government thinks they need to deliver services of an equivalent quality, because it wants to give them stronger incentives for revenue growth and the control of spending needs. How problematic this will be will depend both on the specific design of the local government finance system in future – which is not yet clear – and on how local tax revenues, other revenues and spending needs evolve over time.
- We do not know how local tax revenues and spending needs will evolve in future, but to see how things might change, we can look at how they evolved in the past.
- Key determinants of adult social care spending need can and do evolve differently around the country. Take disability rates: whilst patterns of disability benefit receipt by residents of different councils are highly persistent over time, they are not static. For example, between 2006 and 2016, one in ten councils saw the share of the population getting disability benefits increase by 1.5 percentage points or more, while another one in ten saw an increase of 0.1 percentage points or less.
- What really matters, though, is whether the spending needs and revenues of councils move in tandem or in opposite directions. In fact, between 2006–07 and 2013–14, there was a slight positive correlation between increases in the relative need for adult social care spending and growth in local tax-raising capacity (from council tax and business rates) at a council level.
- This weak positive correlation implies less risk of funding divergence across councils than if these variables were negatively correlated. But for individual councils, assessed needs and revenue-raising capacity still evolved in quite different ways. For example, 33 out of 151 councils saw their assessed relative spending need for adult social care spending *increase* and their relative tax-raising capacity *fall*, while 35 councils saw the opposite.
- With councils bearing more of the change in local tax revenues and spending needs in future than in the past, if these trends continued, it could be hard to deliver a consistent standard of adult social care services across the country.
- We do not have council-level projections for revenue-raising capacity and spending needs. But one factor driving spending needs, at least, is likely to evolve quite differently in different council areas in coming years: the ageing of the population. In one in ten council areas, the fraction of the population aged 75 or over is set to increase by 6.0 percentage points or more by 2035; in another one in ten areas, it is set to increase by 1.7 percentage points or less. This pattern is repeated when focusing on the very oldest people aged 85 or older, who are most likely to require care services.

... and an overall shortfall in funding at a national level

- Changes in councils' *relative* spending needs and *relative* tax-raising capacity are informative about the scope for divergences between councils in their ability to fund services. But even if these variables moved together one-for-one, that does not mean all councils would be able to fund the quality of services expected of them. It also matters how *absolute* spending needs and revenues evolve. It could be the case that all councils struggle to meet their spending needs if the growth in absolute spending needs outpaces the growth in absolute revenues.
- Previous projections suggest the absolute need for adult social care spending could rise substantially over the next two decades: perhaps 4.4% a year in real terms. It is highly unlikely that revenues from business rates and council tax will keep pace with this. Increases in average business rates bills are capped at inflation and recently there has been little growth in the underlying tax base (0.3% a year). Councils have more discretion over council tax, but increases of the scale required may be unpopular and politically unsustainable.
- If, for instance, business rates and council tax revenues were to grow by 0.3% and 2.5% a year, respectively, in real terms over the next 20 years, delivering 4.4% real-terms annual increases to adult social care spending would see spending on it rise to half of overall revenues from these taxes by 2035–36. This would be up from less than one-third in 2016–17. It would also imply that the rates and council tax revenues available for other services would have to *fall* by an average of 0.3% a year in real terms over the same period.
- Even if ongoing large increases in council tax were possible, the resulting revenues would be distributed unevenly across councils. This is because council tax bases vary substantially across councils and there is a negative correlation between tax revenue capacity and relative spending needs for social care and other services. Thus a reliance on large increases in council tax could increase divergences in funding availability between councils even if, at the national level, it allowed sufficient revenues to be raised to meet rising spending needs.

Topping up local tax funding with ring-fenced grants would not guarantee all the extra money goes to adult social care

- Thus, while the government plans to abolish the existing general grant given to councils in 2020, it is highly likely that it will need to provide a growing top-up to the revenues that councils can obtain from council tax and business rates over the coming decades.
- It could continue to provide these in the form of ring-fenced grants to partially fund adult social care services. Such grants would also, in principle, reduce the risk to adult social care spending from changes in local tax bases and needs for other services: this component of funding would not be directly exposed to such risks.
- However, if ring-fenced grants only partially fund adult social care services, councils can implicitly divert part of the funding from these grants to other purposes. This is because they could reduce the amount of their own revenues they allocate to adult social care. This means that, despite the formal ring fence, councils keep a degree of flexibility over

how to allocate their budgets – which can be advantageous. But it does mean the extent to which central government can actually target this money at adult social care is more limited than it may initially seem.

Fully ring-fenced funding would significantly reduce local discretion ...

- If the government wanted to ensure ring-fenced funding was used in full for adult social care services, such funding would need to cover all spending on adult social care services. This would be akin to the funding of schools, which since 2006–07 has been provided in the form of a ring-fenced grant from the Department for Education.
- Such fully ring-fenced funding would also insulate social care spending from changes in local tax bases. But it would have drawbacks. In particular, it would reduce councils' discretion to vary spending on the basis of local preferences and their view of the need for spending (which could be more accurate than a centralised needs assessment).
- If the government wanted to allocate these grants on the basis of assessed needs, it would run into the fact that there are big differences between councils' assessed needs and what they actually spend on adult social care. In 2015–16, for instance, the latest needs assessment only explained 13% of the variation in actual spending per adult resident. 44 councils had adult social care spending that was at least 10% higher than implied by the relative needs formula. Of these, in 13 councils it was at least 20% higher. Conversely, in 35 it was at least 10% lower and in 19 at least 20% lower than implied by the relative needs formula.
- Moving to needs-based ring-fenced grant funding would therefore imply a big redistribution of spending around the country. It would be impractical to do this overnight; transitional arrangements would have to be made, with grants initially based on current spending levels.

... and could have knock-on effects for other local services

- A ring-fenced grant covering the whole of social care spending would take around £15 billion of spending out of local government control. If central government wanted the introduction of such a ring-fenced grant to be revenue neutral, it would have two options: it could devolve additional responsibilities for councils to fund out of their council tax and business rates revenues; and/or it could extract a proportion of councils' tax revenues and use these to (part-)fund the ring-fenced grant.
- Finding responsibilities of this scale to devolve could be difficult. For instance, the total spending on police and fire services is forecast to amount to around £13 billion in the current financial year. Councils might also face challenges in taking on the role of funding such significant new responsibilities. And it would be important for the government to consider whether it was willing to subject these newly devolved services to the potential funding risk associated with changes in councils' tax bases.
- The government could extract revenues from local taxes by imposing a 'tariff' on councils' tax revenues. This 'tariff' would then pay for (part of) the ring-fenced adult social care grants. Councils' remaining revenues from council tax and business rates would pay for their other service responsibilities.

- If this were the case, local government would be left with a much smaller portfolio of funding responsibilities, of which children's social care and public health would account for around 40%. The remaining 60% would be a wide range of services which each have much smaller annual budgets, from highway maintenance to bin collection.
- Such a system could increase the risk of funding diverging from needs for these other services. This is because spending on them would have to bear the risk associated with changes in local tax systems. In contrast, if adult social care remains at least partly funded from a council's own tax revenues, there is the possibility of sharing that risk with adult social care services.
- However, if councils do not feel able to make adult social care services share in these risks, centralising funding for these services could actually reduce financial risks for other services. This is because the other services would already be bearing the full risk associated with changes in local tax revenues. And centralised funding of adult social care via 'tariffs' could insulate funding for other services from risks associated with changes in adult social care spending needs (e.g. because the local population becomes poorer and/or sicker): councils would just pay their fixed 'adult social care tariffs', whatever happens to these needs.
- So would fully centralising responsibility for funding adult social care increase or reduce funding risks for other services? It depends on whether we think councils would otherwise be able to allow spending on adult social care to share in the adjustments required when local tax revenues fall. And it depends on the scale of revenue and spending needs risks for different services and how these are correlated.

So the upshot is ...

- Government therefore faces tricky choices. It could keep adult social care at least part-funded by councils' general (business rates and council tax) revenues and accept that this means (a) it cannot guarantee that ring-fenced additional funding actually gets spent on adult social care and (b) councils could use their discretion to offer different levels of service provision. Adult social care spending would therefore be at least partially exposed to changes in local tax revenues and spending needs and to differences in councils' spending priorities. This could make it difficult to achieve a consistent standard of care across the country.
- Instead, fully centralising the funding of adult social care would allow the government to (eventually) allocate spending across the country according to assessed needs. And it would fully insulate adult social care from changes in local tax revenues. If the government could accurately assess spending needs, it would also be easier to achieve a consistent standard of care across England. But such a policy would imply a significant reduction in local discretion, could involve significant redistributions of spending across the country and would have knock-on effects for the funding risks faced by other services.

1. Introduction

Many people are born with or develop a physical or mental illness or disability. As a result, they may require help carrying out day-to-day activities such as washing or cooking, or need monitoring and support to ensure their safety. We call this help and support ‘social care’.

The majority of this care is informal: provided by friends and relatives outside of either the state or private care systems, often on an unpaid basis.¹ And unlike NHS-provided healthcare services, formal social care services are not provided free of charge on a universal basis by the state. However, the state still plays a major role in the funding of adult social care services: the National Audit Office (2014) estimated that around £19 billion of the £35 billion spent on formal adult social care services was from the state.

While the NHS provides some social care services to those with significant health-related care needs, most state-funded care is organised and paid for by local councils, who have overarching responsibility for ensuring that people in their area are able to access and afford the care services that they need. This includes both help provided in people’s homes and help provided in residential care homes.² Individuals’ eligibility for financial support from their council for this care is based on two sets of criteria: one based on the severity of their social care needs and the other on their financial situation.

To fund this means-tested support, councils rely on both their own tax revenues and grant funding from central government. Traditionally, these grants were allocated in a way designed to compensate for differences in councils’ tax bases and spending needs, with the aim of allowing the provision of comparable levels of services nationally if councils charged the same level of council tax. However, ongoing reforms to the local government finance system are reducing the degree of financial equalisation between councils, with the aim of providing councils with stronger fiscal incentives to grow their tax bases and reduce local spending needs.

At the same time, central government has been placing additional controls on the adult social care offering of local authorities. First, social care needs assessment processes have been standardised and national minimum eligibility criteria introduced, where previously councils had more flexibility to determine who was in need of social care services. Second, a growing share of central government funding for local authorities has been specifically ring-fenced for adult social care. Although such ring fences are difficult to enforce, they do in principle place a restriction on how councils allocate funding across service areas.

These two shifts in government policy are not normally discussed in conjunction. This is a problem because, in combination, they reflect a trade-off inherent in devolution: on the one hand, a desire for consistency across the country in terms of access to adult social care services, which underlies the introduction of national eligibility criteria and ring-fenced funding; and on the other, the hope that stronger fiscal incentives will increase efficiency and encourage councils to support local property development and foster

¹ Although low-income individuals providing care for 35 hours a week or more can claim a benefit called carer’s allowance.

² For further details, see the ‘General responsibilities of local authorities’ section of the Care Act 2014, available at <http://www.legislation.gov.uk/ukpga/2014/23/contents/enacted>.

economic growth. Current policy is therefore pulling in different directions: trying to create a consistent set of social care services across the country, but at the same time risking growing divergences in funding levels between councils whose budgets will become more dependent on their own revenue performance. The government's long-awaited Green Paper on social care will therefore need to consider how social care funding sits within the broader local government finance system – and, indeed, whether social care funding should be the responsibility of local government at all.

This report complements recent work by the Health Foundation and the King's Fund on the pros and cons of various social care funding models (Wenzel et al., 2018), by focusing specifically on the role of local government in funding social care. It proceeds as follows. Chapter 2 contains a brief overview of England's systems of social care funding and local government funding, focusing on those points which are essential context for the following analysis. Readers interested to know more will find an in-depth explanation of the same topics in Appendix A. Chapter 3 demonstrates the tension between local funding and national standards by examining the correlation between assessed needs for social care and other service spending on the one hand and local tax-raising capacity on the other. It then illustrates the likely discrepancy between growth in demand for social care and growth in funding available from council tax and business rates over the next two decades. Chapter 4 discusses the options for funding social care outside the general system of local government finance, including both continued partial funding and possible full funding via ring-fenced grants. It shows that the introduction of completely ring-fenced funding for adult social care could have knock-on effects for the funding risks facing other council services, such as children and families social services, housing and libraries. Chapter 5 concludes.

2. Summary of ongoing reforms to adult social care and local government finance in England

Chapter summary

- State-funded adult social care is largely the responsibility of local government. Across England as a whole, adult social care services accounted for 34% of councils' spending on local services (excluding education) in 2016–17.
- Eligibility for council-funded social care is subject to both a financial means test and a care needs assessment. Historically, there was wide variation in approaches to needs assessment and care needs thresholds for eligibility. Councils largely paid for this care using their council tax revenues and general-purpose grant funding from central government that was allocated to them based on an assessment of their overall spending needs.
- Recent years have seen central government exert greater control over social care policy. The Care Act 2014 set out a common approach to the assessment of individuals' care needs and minimum eligibility criteria that all councils must meet. It also imposed new duties on councils in relation to information provision, support for carers and the operation of 'deferred payment schemes' so that people need not sell their home to pay for care while they are alive.
- In addition, the introduction of the Better Care Fund, the Improved Better Care Fund and the Social Care Precept on council tax means a growing proportion of what councils spend on social care is specifically ring-fenced for that purpose by central government.
- More generally though, central government has been reducing its role in the funding of councils. There have been large cuts to the grants given to councils, and remaining grants are no longer updated as local council tax bases and spending needs change. The business rates retention scheme also means councils bear up to 50% of real-term changes in local business rates revenues, with plans for increasing this figure to 75% in April 2020 (and possibly 100% beyond that). These policies are designed to provide stronger incentives for councils to grow revenues and reduce spending needs. But they also increase the risk of funding divergences across the country if revenues and needs evolve differently.

State-funded social care services in England are largely the responsibility of local government, although central government provides financial support to disabled people and some of those providing informal care services via the benefits system. Eligibility for council-organised and funded services is subject to assessments of an individual's social care needs and their financial circumstances.

Councils traditionally had significant discretion to set eligibility criteria in their area and determine the services needed to meet the needs of their local population. Their expenditure on social care services was funded from a mix of their own council tax revenues and general-purpose grants from central government. These grants were allocated in a way that compensated councils for having higher spending needs or lower ability to raise their own revenues via council tax.

Recent years have seen changes to these arrangements. A new centrally determined approach to assessing individuals' care needs means that minimum eligibility criteria have been implemented nationally. The government is also considering changes to the financial means test and the introduction of a national cap on the care costs individuals may have to pay themselves. At the same time, an increasing amount of councils' funding is specifically ring-fenced for social care services. Broadly speaking, this ring-fenced funding is allocated in line with the most recent assessment of councils' relative needs for social care spending.

There are also changes to the general local government finance system. Ongoing reforms, including the introduction of the business rates retention scheme (BRRS), have reduced the share of councils' budgets coming from grants, and increased councils' financial exposure to changes in local tax bases and spending needs.

Appendix A discusses these changes in more detail. It also discusses the pros and cons of devolving responsibility for delivering and funding public services such as adult social care to local government in the first place.

Two key policy trends are evident:

- On the one hand, central government is playing an increasing role in adult social care services both in terms of service standards and eligibility and in terms of funding. This suggests the government is keen to ensure a consistent standard of adult social care services across the country.
- On the other hand, reforms to local government finance are reducing the role of central government in funding councils and the degree of redistribution between councils. The aim is to provide stronger incentives to councils to take action to boost local tax bases and reduce underlying spending needs. But the reforms mean councils bear more of the financial risk associated with changes in local tax revenues and spending needs. This suggests the government is willing to allow divergences in the ability of different councils to provide services in order for councils to have said financial incentives.

The next chapter illustrates the tensions between these two competing policy objectives.

3. The tensions between local funding and national standards of adult social care

Chapter summary

- If the *relative* demand for adult social care services in different council areas evolves differently from the relative size of the council tax and business rates tax bases of these areas, delivering a consistent standard of care across England could be difficult. This 'distributional' challenge is one reflection of the tensions between social care policy (which seems to be placing greater priority on consistent standards across councils) and local government finance policy (which means tolerating divergences in funding between councils to provide incentives for them to grow their local tax revenues and tackle underlying spending needs).
- Historically, assessed relative spending needs and local tax revenue capacity have changed quite differently in different councils. For instance, around one in five councils saw their relative need for social care spending increase while their share of local tax revenues fell between 2006–07 and 2013–14. Looking forward, one factor driving social care spending needs – population ageing – is likely to evolve differently across England. For instance, in one in ten council areas, the share of the population aged 75 or over is projected to increase by 6 percentage points or more by 2035. In another one in ten areas, that increase is just 1.7 percentage points or less.
- It also matters how *absolute* spending needs and revenues evolve. It could be the case that all councils struggle to meet the standards of service expected by their population and required by central government policy, if the growth in absolute spending needs outpaces the growth in absolute revenues.
- Previous research suggests the demand for social care spending could rise by 4.4% a year in real terms between 2015 and 2035. If council tax rates were increased in line with projected average earnings growth, and business rates revenues followed recent trends, meeting these needs would see adult social care spending take up half of the revenues from these taxes by 2035. That compares with less than one-third now. It would also imply the local tax revenues available for other services would actually fall a little in real terms over the same period. It is therefore almost certain that the government will have to top up council tax and business rates revenues.

The previous chapter argued that recent reforms to the social care system and social care funding suggest that the government is keen to ensure more consistent access to and standards of adult social care services across England. In contrast, recent and proposed reforms to local government finance suggest that the government is willing to tolerate greater divergences in councils' abilities to fund local services, in order to provide stronger fiscal incentives for them to grow tax bases and tackle the factors driving spending needs. Councils' funding will be more closely linked to the amount raised from council tax and business rates – at both a local and national level.

There are therefore clear tensions between social care and local government finance policy. This chapter illustrates two ways in which policies could come into conflict.

The first is about the **distribution of funding** for adult social care around the country. If the relative demand for adult social care services in different council areas evolves differently from the relative size of the council tax and business rates tax bases of these different areas, delivering a consistent standard of care across England could be difficult. A council seeing a reduction in the amount of business property in its area, and which was also seeing its population becoming older and poorer, could struggle to deliver national standards. In contrast, an area seeing lots of high-value property development and increasing affluence might be able to offer a higher standard of adult social care provision. How big an issue these differences are likely to be will depend both on the scale of changes in relative spending needs and tax bases and on how these are correlated.

To investigate this issue, we look at how councils' assessed spending needs per person and revenue-raising capacities (from council tax and business rates) per person varied in 2013–14, and how these had changed over the previous seven years. We also examine how varied changes in some of the factors driving adult social care need (such as disability rates and population age structures) have been across councils in recent years and may be in future. The more varied are changes, and the greater their mismatch with changes in tax revenue capacity, the harder it would be to deliver a national standard of care from local revenue sources.

The second issue is about **total funding for social care** across England. Total revenues from local tax might not keep up with national increases in demand for social care. If this happens, then *all* councils may find themselves unable to meet their social care obligations unless they are willing to reduce spending on other service areas (including children's social care) or unless a growing pot of additional funding on top of local tax revenues is made available.

3.1 The distributional challenge: local taxes and *relative* spending needs

As discussed in Chapter 2, across most of England councils now bear up to 50% of the real-terms changes in business rates revenues. This figure is set to increase to 75% in April 2020, and the government is piloting 100% schemes in growing numbers of councils. Alongside this, most remaining grant funding for councils will be abolished. Assessments of councils' spending needs and their ability to raise revenues via council tax are also no longer updated on an ongoing basis. Putting aside for now the issue of whether there is enough money in the local government funding system across England as a whole, these changes have big implications for the *relative* funding of different councils. In particular, there is greater scope for divergences to open up between different councils' relative spending needs and their relative shares of available funding.

This poses a theoretical challenge for a government that wishes to achieve consistency across councils in the provision of social care, a locally funded service. How much of a challenge depends on how much relative spending needs change over time and how well correlated these changes are with changes in local tax bases.

Unfortunately, it is difficult to predict the potential for divergence. There are three main challenges.

First is that we do not know how councils' relative spending needs and tax bases will change in future. In this analysis, we will use the experience of councils in the past to get a sense of what might happen in the future.

Second, as discussed in the last chapter, is the difficulty of measuring spending needs. We overcome this problem by using the years 2006–07 to 2013–14, a seven-year period during which we have a consistent set of annually updated spending needs assessments carried out by the Department for Communities and Local Government (DCLG).³ This will give us a sense of the extent to which (assessed) relative spending needs can change over time, and how these changes may compare with changes in local tax bases.

Third, the financial impact on councils and adult social care services of such changes in needs and tax bases will depend on the specific finance system in operation. This includes the share of changes in business rates revenues borne locally, rules around any safety nets or resets of the system, and the extent and nature of any grant funding councils would continue to receive. We do not know for sure what these system parameters will be. So in this chapter, rather than focus on outcomes under a specific system, we examine the relationship between assessed spending needs and councils' overall capacity to raise revenues from council tax and business rates. Councils would be fully exposed to differences between trends in these variables if there were 100% rates retention, but less exposed under 75% retention and/or if some element of grant funding remained in place.

Is redistribution important for social care funding?

Our first step is to analyse the relationship between the *levels* of relative spending need per person and tax revenue capacity per person of different councils. Figure 3.1 plots the correlation between these two variables for 2013–14. Panel A shows adult social care spending needs, whilst Panel B shows spending need for other service areas.⁴

Our measure of spending needs is based on the official relative needs assessment by DCLG. The term *relative* is important: the assessments were designed to assess how much each council needed to spend on services relative to other councils, not how much they needed to spend in absolute cash terms. Tax revenue capacity is defined as the amount per person that councils would raise from business rates and council tax if they set their council tax at the national average level.⁵

In Figure 3.1, both measures are indexed so that the average across England as a whole is 100. A figure of 120, for instance, would imply that assessed spending needs or tax revenue capacity per person was 20% higher than average. A figure of 80 would imply they are 20% lower than average.

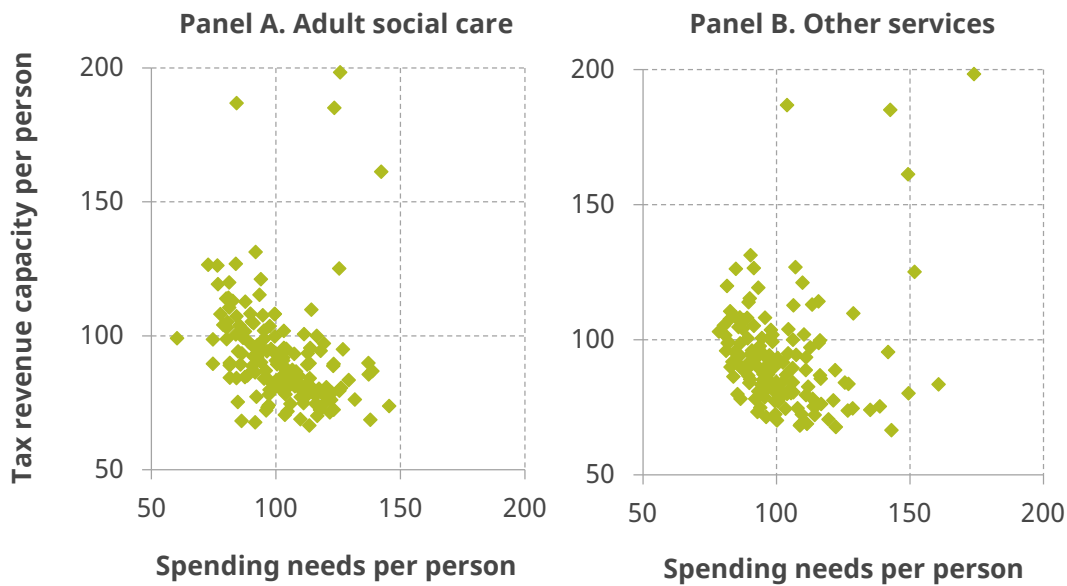
Panel A shows that, in general, there is a negative correlation between councils' tax revenue capacity per person and their per-person assessed need for adult social care

³ Since January 2018, the Ministry of Housing, Communities and Local Government (MHCLG).

⁴ Data sources for spending need, population, and business rates and council tax capacity, as well as details on how the measures are constructed, can be found in Appendix C.

⁵ Several adjustments are made to reported business rates revenues to make the data more comparable across councils and over time. Details are in Appendix C.

Figure 3.1. Correlation between assessed relative spending needs and relative tax revenue capacity per person in 2013–14 (mean = 100)



Note: City of London and Westminster are excluded from the figures as they are extreme outliers.

Source: See Appendix C.

spending. In other words, those areas with a relatively high need for adult social care spending per person tend to have relatively low capacity to raise revenues from local taxes, and vice versa. There are some significant outliers, though, with both high tax revenue capacity and high assessed needs: these are mainly London boroughs with large tax bases and high levels of deprivation. Excluding London, the correlation is -0.58 .

The negative correlation is not offset by other services. For that to have been true, assessed spending need for other services would have had to have been positively correlated with tax revenue capacity. However, Panel B shows that there is also, in general, a negative correlation between tax revenue capacity and assessed spending needs for other services (although again there are outliers).

This analysis therefore illustrates the importance of redistribution between councils – whether by grants, as historically was the case, or by tariffs and top-ups under the BRRS – to reduce geographic differences in service provision. The negative correlations mean that if there were no redistribution between councils, their ability to fund social care services and other services would vary radically. Councils with the highest (assessed) needs for spending would have the lowest revenues, and vice versa. Fully devolving the responsibility for councils to fund social care services and other services from their own tax revenues (e.g. without any tariffs and top-ups) would therefore be incompatible with delivering consistent service quality and access across the country.

Changes in spending need and tax revenue capacity over time

The fact that the BRRS does (and is highly likely to continue to) have redistributive tariffs and top-ups, the divergences between councils' assessed spending needs and tax revenue capacities can be addressed. However, the inflation indexation of the tariffs and top-ups

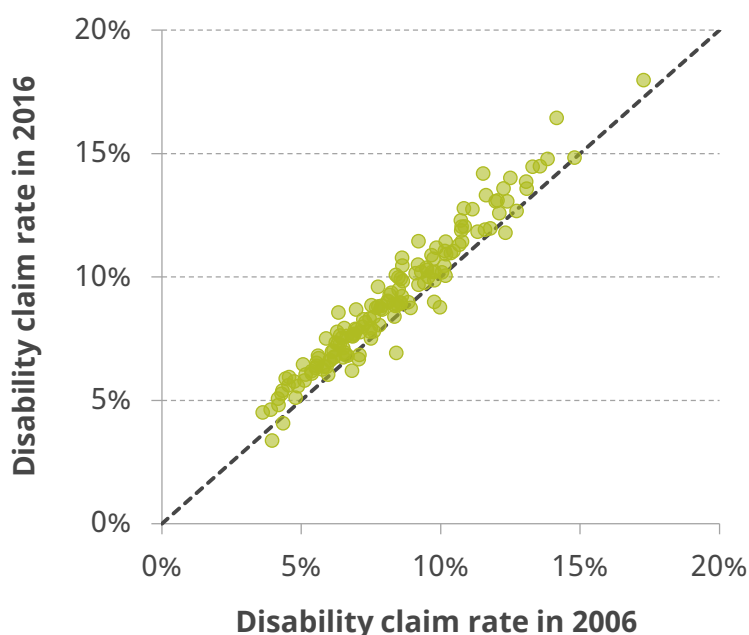
once they are set means that changes in the relative spending needs and tax revenue capacities of councils in subsequent years can lead to divergences opening up again.⁶

The relative spending needs and tax revenue capacities of different council areas can change as demographic and socio-economic characteristics change. For adult social services, for instance, things such as the prevalence of disability and low levels of income and wealth among the population are likely to be key drivers of spending need per person. These can and do change differently in different parts of the country.

Figure 3.2, for example, shows the proportion of the adult population claiming disability benefits in each council area in 2006 (the horizontal axis) and 2016.

It is clear that patterns of disability benefit claims are strongly persistent over time: those areas with the highest claim rates in 2016 are the same areas as had the highest claim rates in 2006, and similarly for those with the lowest claim rates. But there are changes over time: not all dots in Figure 3.2 are on the 45-degree line (which would indicate the

Figure 3.2. Correlation between the percentage of adults in a council claiming disability benefits in 2006 and 2016



Note: Annual claim rates are calculated using the average of quarterly claimant figures. Disability claim rate is the number of adult claimants of disability living allowance (DLA), personal independence payment (PIP) or attendance allowance as a share of the total adult population (aged 18+) in a council. Rates are calculated for each upper-tier authority, of which there are 152.

Source: See Appendix C.

⁶ Previous work by IFS researchers (Amin-Smith et al., 2016) has shown that even if tax revenue capacity were to grow at the same rate in all council areas, the income councils retain from the BRRS could still diverge. This is because the redistributive tariffs and top-ups increase in line with inflation but tax revenue capacity can grow by more or less than inflation. But divergences in income will likely be greater if there is significant variation in growth in tax revenue capacity. And divergences in ability to fund services will be greater if relative spending needs and relative tax revenue capacity change differentially.

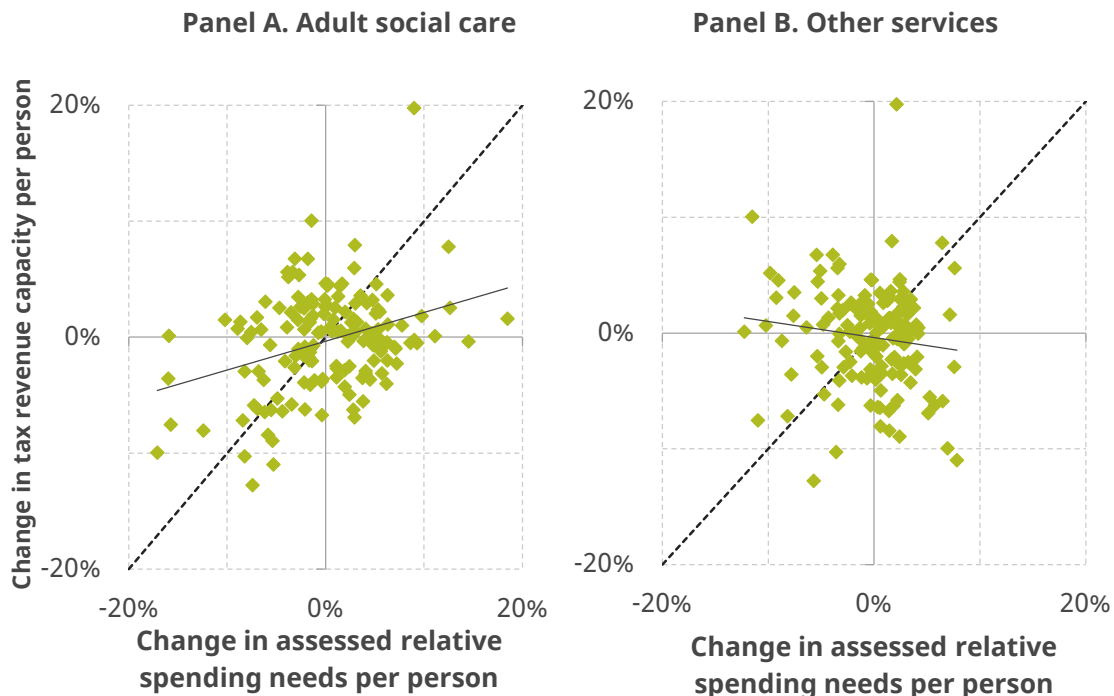
claim rate was the same in each year). And the size of the changes differs between council areas. One in ten saw the disability benefit claim rate increase by 1.5 percentage points or more, and another one in ten saw it increase by 0.1 percentage points or less (or even fall).

However, changes in the relative spending needs of councils need not be a problem if the distribution of revenue across councils changes in the same way. It is when trends in the relative needs and relative revenues do not match (or, worse, go in opposite directions) that it will be harder to deliver a consistent standard of services across councils.

With this in mind, Figure 3.3 shows the relationship between changes in assessed relative spending needs per person and changes in relative tax revenue capacity per person between 2006–07 and 2013–14. As we are looking at changes in *relative* need (not absolute need), the average for England as a whole is 0%. Positive numbers indicate an increase in spending need per person relative to the average across all councils. Negative numbers mean that need has fallen relative to the average across all councils (but absolute need could still have risen). Similarly, changes in tax revenue capacity are also measured relative to the average change across England as a whole.

Panel A examines changes in assessed relative spending needs for adult social care. It shows that there is, in general, a weak positive correlation between changes in assessed relative needs for adult social care and changes in relative tax revenue capacity. In other words, between 2006–07 and 2013–14, areas where there was an increase in the relative

Figure 3.3. Relationship between changes in per-capita assessed relative spending need and changes in per-capita relative tax revenue capacity, 2006–07 to 2013–14



Source: See Appendix C. Excludes City of London.

need for social care services tended to have slightly stronger growth in their tax revenue capacity than average.

A weak positive correlation between changes in relative spending needs and changes in relative tax revenue capacity is better than no correlation or a negative correlation. However, we still see there can be significant differences between the changes in relative tax revenue capacity and changes in relative spending needs for social care. For example:

- 33 out of 151 councils saw their relative spending need for social care spending increase and their relative tax revenue capacity fall (whilst 35 saw the opposite);
- 36 councils saw a gap between the change in their relative spending need and the change in their relative tax revenue capacity of 7.5 percentage points or more.

Changes in the assessed relative needs for other service areas (Panel B of Figure 3.3) were, on average, a little smaller than those for adult social care during this period. But there was effectively no correlation with changes in relative tax revenue capacity.

These patterns of changes indicate the potential for gaps to emerge between councils' relative revenues and relative spending needs under the evolving local government finance system. Exposure to a higher share of the changes in business rates revenues (as under plans for 75% or 100% retention), longer periods between any re-equalisations of funding levels (termed 'resets'), and making those re-equalisations only partial would all expose councils to more of the underlying risk of revenue and needs divergence. But they also provide stronger incentives for councils to grow their tax bases and tackle underlying spending needs. That is the tension between equalisation – to provide councils with the resources to provide comparable services – and financial incentivisation.

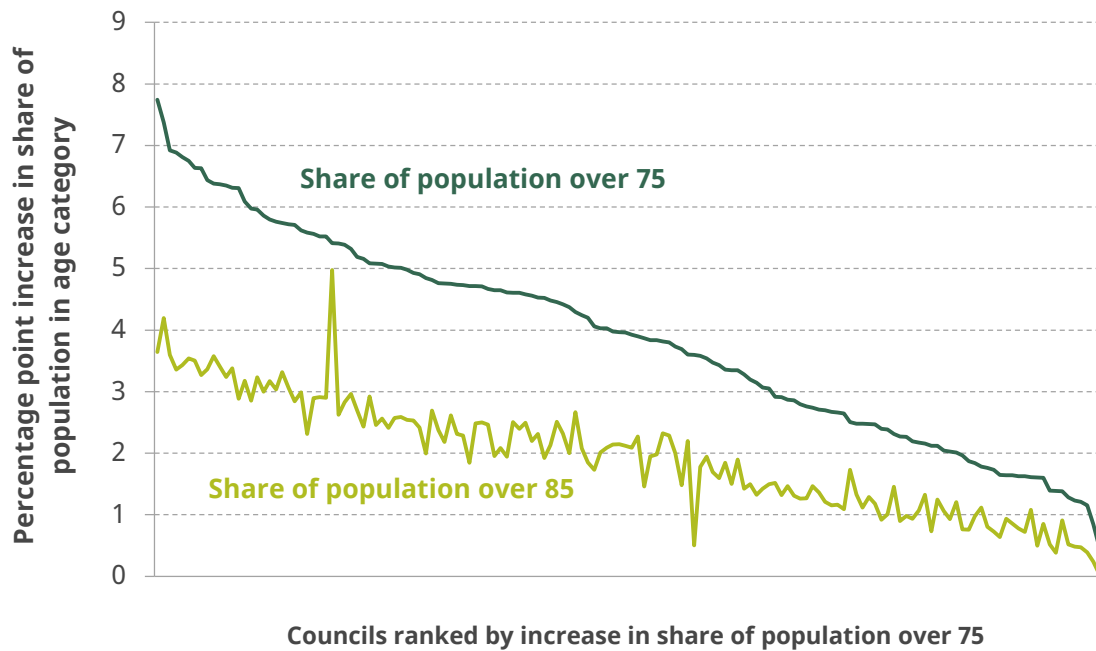
Projections for future demographic change

The analysis so far has looked at past levels and changes in tax revenue capacity and spending need. Of course, what matters for policy going forwards is how these change in future. We cannot know for sure, but we do have council-level projections for one factor expected to impact adult social care spending pressures in coming years: the growth of the elderly population.

Figure 3.4 plots the distribution of projected increases between 2016 and 2035 in the share of the local population that is aged 75+ and 85+. It shows that while the share of elderly people is expected to increase in all council areas, the increases are much bigger for some councils than for others. For instance, for one in ten council areas, the share of over-75s is expected to increase by 6.0 percentage points or more. In another one in ten councils, it is expected to increase by 1.7 percentage points or less.

This suggests that there is likely to be significant geographical variation in increases in demand for social care by elderly residents. Of course, other factors will also play a role. Because access to social care is means tested, changes in the incomes and assets of older people will affect the patterns of spending need. And we must not forget changes in the demand for and the cost of adult social care services for working-age people. Increased survival rates and longer life expectancies for those with severe disabilities and learning disabilities, for instance, have been and are projected to continue to be key drivers of

Figure 3.4. Increase in share of population that is over 75 and over 85 between 2016 and 2035, by council



Source: See Appendix C.

social care need (Wittenberg and Hu, 2015). These other factors could also impact different councils in different ways, contributing to changes in relative spending needs.

3.2 The national challenge: local taxes and *absolute* spending needs

The focus of our discussion so far has been on how changes in councils' *relative* spending needs may differ from changes in their *relative* tax revenue capacities. This is important because the bigger these differences, the more scope there is for divergences in the ability of councils to fund their services.

But even if relative spending needs and relative tax revenue capacity moved together one-for-one, that does not mean all councils would be able to fund the quality of services expected of them. It also matters how *absolute* spending needs and revenues evolve. It could be the case that all councils struggle to meet their spending needs if the growth in absolute spending needs outpaces the growth in absolute revenues. It is therefore worthwhile considering how the evolution of absolute spending needs may compare with the evolution of business rates and council tax revenues.

Wittenberg and Hu (2015) project the demand and costs of adult social care in England for the period 2015 to 2035. The projections are based on the current funding system and patterns of care. They do not take account of changes in expectations on quality or other behavioural changes. And they require assumptions to be made about how the costs of different types of care will evolve. They are therefore subject to significant uncertainty.

Bearing this in mind, their central projection sees the cost of social care for the over-65s increasing from £6.9 billion in 2015 to £17.5 billion in real terms in 2035. Their central

projection for adults aged under 65 is for a real-terms increase from £8.4 billion in 2015 to £18.4 billion in 2035. Together, their central projection is for expenditure to increase from £15.2 billion to £35.9 billion: 4.4% a year in real terms (i.e. above inflation).

What about business rates revenues and council tax?

Increases in business rates bills are capped at inflation by legislation.⁷ Even when properties are revalued and the bills of individual properties go up or down, the increase in the average bill is capped at inflation. In other words, without growth in the business rates tax base, there is no real-terms growth in business rates revenues. However, since 2010, the business rates tax base has grown only very modestly: 0.3% a year.⁸ If this trend were to continue, very little of the revenue required to meet projected increases in social care spending could be met by growth in business rates revenues.

There is, in principle, more flexibility over council tax increases. And development of new residential property means growth in the tax base is generally higher than for business rates. However, since 2012, increases in council tax above limits defined by central government are subject to a referendum of local residents. For instance, in April 2018, councils will be able to increase their standard council tax by up to 3% without holding a referendum. Furthermore, those with social care responsibilities will be able to levy a further 3% increase provided the additional revenue raised is allocated to adult social care. This is the SCP discussed in Chapter 2. Taken together, this means councils with social care responsibilities can increase their council tax by up to 6% without a referendum next year. Given current inflation forecasts, this is around 4% in real terms.⁹

However, it is not clear that such significant real-terms increases will be possible in future years.¹⁰ First, the 3% limit for increases in general council tax applies in April 2018 only. In recent years, the limit has usually been 2%. Second, councils that have made full use of the SCP may not be able to make further increases in this ring-fenced proportion of council tax after April 2018. This is because current policy puts a limit on the maximum size of this precept. Third, council tax seems to be particularly salient to people. Ongoing large real-terms increases in this tax could therefore be unpopular and perhaps politically unsustainable. This may be why, despite making large cuts to their grant funding as part of broader fiscal consolidation efforts, the coalition government of 2010–15 incentivised councils to freeze council tax (councils would have faced larger cuts if they had not frozen council tax).

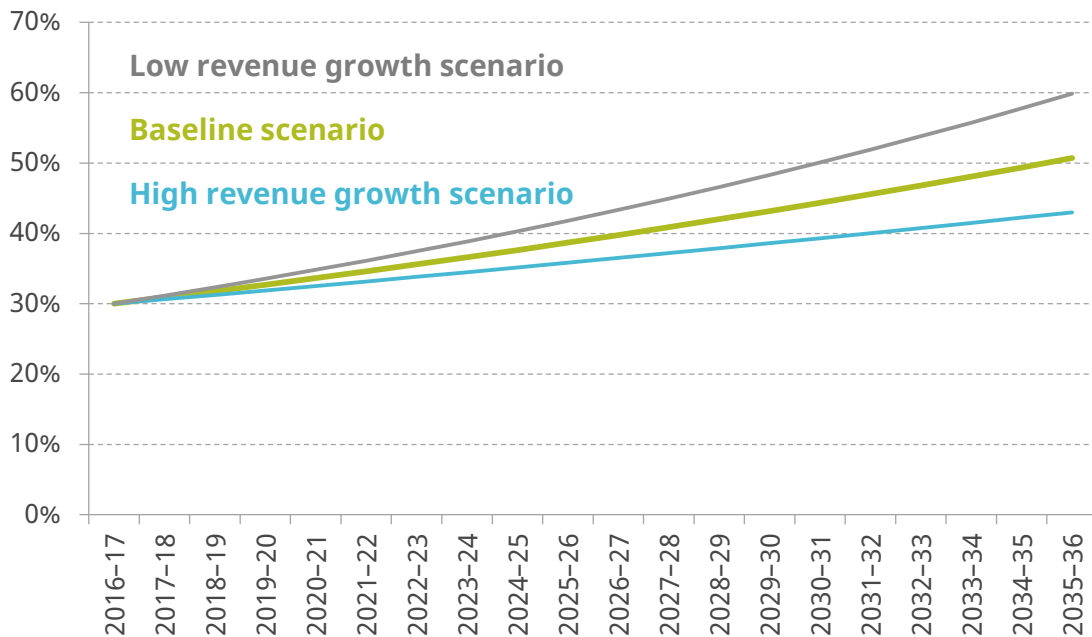
⁷ From this April, this is the CPI measure of inflation (it has historically been RPI inflation).

⁸ Authors' calculations using data from Department for Communities and Local Government (2017c) and equivalent data for 2010–11.

⁹ Inflation as measured by the GDP deflator, available at <https://www.gov.uk/government/statistics/gdp-deflators-at-market-prices-and-money-gdp-december-2017-quarterly-national-accounts>.

¹⁰ Even if ongoing large increases in council tax were possible, the resulting revenues would be distributed unevenly across councils. This is because council tax bases vary substantially across councils and, as we saw above, there is a negative correlation between tax revenue capacity and relative spending needs for social care and other services. Thus a reliance on large increases in council tax could reintroduce divergences in funding availability between councils even if, at the national level, it allowed sufficient revenues to be raised to meet rising spending needs.

Figure 3.5. Social care spending as a share of English council tax and business rates revenues, if spending grows by 4.4% a year, 2016–17 to 2035–36



Source: 2016–17 levels are from English council tax receipts in 2016–17 from Office for Budget Responsibility (2017, supplementary fiscal tables: expenditure table 2.15). Total non-domestic rating income after reliefs and accounting adjustments is from NNDR3 2016–17 release. Spending on adult social care excluding Better Care Fund is from our series explained in Appendix C. Figures for subsequent years are authors' calculations.

Taking into account all of the above, Figure 3.5 looks at the share of total English council tax and business rates revenues that could be spent on adult social care if spending were to increase by 4.4% in real terms each year for the next 20 years.

Our baseline scenario (the green line) is for council tax revenues to grow by 2.5% per year in real terms – which is roughly in line with what would happen if tax rates increased in line with average earnings – and business rates revenues to grow by 0.3% per year in real terms. In this scenario, social care spending would increase from its current 30% of council tax and business rates revenues to 50% by 2035–36.

What if council tax and business rates revenues were to grow at faster rates: 3.5% and 1% per year in real terms, respectively, for instance? In that case, meeting the 4.4% projected increase in absolute spending need would still mean 43% of all council tax and business rates revenues were allocated to adult social care by 2035–36. If local tax revenue growth were to be more sluggish, then the social care share would climb higher: to 60% if council tax revenue were to grow by 1.5% a year in real terms and business rates revenues fall by 0.4% a year in real terms, for instance.

Increases in the share of council tax and business rates allocated to social care would mean a smaller share would be available for other local public services. For example, under our baseline scenario, the funding available for other services would have to fall by 0.3% a year in real terms, on average, over this 20-year period. Overall, then, it seems highly unlikely that it will be possible to rely on business rates and council tax revenues to

meet rising absolute demand for social care spending without having potentially unsustainable knock-on effects on other areas of local government spending.

3.3 Summary

This chapter has explored the tension between the local funding of adult social care services and what seems to be an expectation of a more consistent national standard of service provision. This reflects the fact that if councils are more reliant on local tax revenues to fund their service spending, there is greater scope for gaps to emerge between spending needs and funding levels.

An examination of how assessed relative spending needs and local tax revenue capacity changed in the past suggests there is scope for some significant divergences in the *relative* levels of funding for adult social care (and other) services in different council areas. Also, population projections show that population ageing – expected to be one of the key drivers of real-terms increases in adult social care spending – is expected to progress at very different paces in different council areas in the coming decades. Finally, the projected increases in the absolute need for social care spending are significant. In contrast, it seems likely that the scope for real-terms growth in business rates revenues, and to an extent council tax, is limited.

If the government wants a high-quality and more consistent social care system across England, it therefore seems likely that councils' business rates and council tax revenues will not be sufficient to fund it. In the next chapter, we consider the options for providing more certain and higher levels of funding for adult social care.

4. Options for central government funding for adult social care

Chapter summary

- The government could top up council tax and business rates funding with ring-fenced grants that partially fund adult social care services, like the Better Care Fund and Improved Better Care Fund do today. This would reduce the exposure of adult social care spending to risks associated with changes in local taxes (albeit not fully). However, councils can reduce the amount of their own tax revenues they allocate to adult social care if they are given more ring-fenced grant funding. It is therefore difficult to ensure increases in such partial ring-fenced funding actually go to adult social care services.
- If the government wanted to ensure ring-fenced funding was used in full for adult social care services, such funding would need to cover all spending on adult social care services. This would also fully insulate adult social care funding from changes in local tax revenues. However, it would significantly reduce the discretion of councils to set local priorities and take account of local information when determining spending levels. Transitioning from existing spending levels to any new needs-based allocation of adult social care grants could also be difficult practically and politically, given that it could involve big reallocations of spending around the country.
- One way to make the introduction of centralised ring-fenced funding revenue neutral would be for the government to devolve new responsibilities to councils to fund from their council tax and business rates revenues instead. Finding responsibilities of the appropriate scale (around £15 billion or more) could be challenging. If the government could not identify spending of this scale to devolve, it could (in addition or instead) extract a share of councils' tax revenues. In particular, an 'adult social care tariff' could be imposed on the retained business rates revenues of councils with social care responsibilities.
- Such a system of 'adult social care tariffs' would also affect the risk of divergences in funding for other council services. The risk could increase because spending on these would have to bear all the risk associated with changes in local tax revenues; there would be no possibility of adult social care sharing the burden. On the other hand, the risk could decrease because spending on these services could be insulated from risk associated with changes in adult social care spending needs if the centralised funding for adult social care was needs-based. The overall effect would depend on the scale of these different risks. It would also depend on how much flexibility we think councils would really have on their adult social care spending if they retained responsibility for funding it.

In Chapter 3, we saw that there is a tension between reforms to social care and reforms to local government. Increased exposure of councils to changes in local tax revenues and spending needs may make it harder to deliver a consistent quality of adult social care (and other) services across the country. It also seems unlikely that revenues from council tax

and business rates will keep pace with rising social care costs and demand at a national level.

If the government wants to ensure a consistently high quality of adult social care services across England, it will almost certainly need to provide additional funding on top of councils' own tax revenues. It could do this within the existing local government finance system or make more radical changes to the funding of social care.

In this chapter, we consider two possible ways the government could direct funding to adult social care. First, it could continue to provide ring-fenced funding that partially funds councils' expenditure on adult social care. Under such an approach, the remaining expenditure would be funded by councils' own tax revenues as part of the BRRS.

Alternatively, the government could remove the funding of adult social care services from the general local government finance system. Ring-fenced grants aimed at fully funding social care services could be provided on the basis of assessed spending needs. This would make the funding of social care more similar to that for schools, where central government provides councils with a ring-fenced grant (the 'Dedicated Schools Grant').

These options would have different implications for the ability of government to target funding at social care and for the discretion of councils. They would also offer differing degrees of protection to the funding of social care from risks associated with changes in local tax bases. And they would have different implications for the funding risks facing other local government services.

4.1 Continued partial ring-fenced funding

As discussed in Chapter 2, recent years have seen a growing proportion of councils' adult social care funding coming from sources ring-fenced for that purpose by central government. This includes part of councils' own council tax revenues (the Social Care Precept) and transfers from the NHS and grants: the Better Care Fund (BCF) and the Improved Better Care Fund (IBCF). Recent announcements suggest that the ring-fenced BCF and IBCF will continue to be provided under the 75% BRRS planned for April 2020.¹¹ However, in the 100% business rates pilot in Merseyside, the IBCF has been rolled into the BRRS, so the longer-term future of these grants is less clear.¹²

Continuing ring-fenced grants to top up councils' own tax revenues could reduce the funding risk facing adult social care services. This is because, in principle, part of the funding for adult social care services would not be subject to variability in local tax revenue performance.

The higher the share of overall adult social care spending funded by ring-fenced grants, the more local authorities would be protected from the risk of local revenues failing to keep pace with needs. If ring-fenced grants were increased over time to help councils meet the rising absolute demand for adult social care spending projected (see Chapter 3), the degree of protection would therefore increase over time. Of course, the underlying

¹¹ Department for Communities and Local Government, 2017b.

¹² Department for Communities and Local Government, 2017d.

risk associated with divergences in councils' tax revenue – which would provide the remainder of funding for adult social care – would also likely grow over time.

The effect of ring-fenced grants on the financial risks borne by local authorities would depend also on how the grants were allocated. This could also affect the incentives facing councils. For instance:

- Allocating grants on the basis of frequently updated needs assessments reduces the risks associated with changes in needs for councils compared with using assessments fixed for considerable periods of time. However, the rapid adjustment of grants when assessed needs change would weaken the incentive for councils to tackle underlying social care spending needs.
- Taking account of changes in council tax and business rates revenues when allocating ring-fenced grants would provide more protection for councils against changes in local tax bases. However, if councils saw higher (lower) grants if their tax bases performed poorly (strongly), they would have weaker incentives to boost local tax bases. Such an approach would therefore conflict with the rationale for expanding the BRRS in the first place.

Thus, the same trade-off between redistribution and the provision of incentives found in the design of the general local government finance system is also found in the design of ring-fenced top-ups for social care services.

It is also worth noting that if ring-fenced grants only partially fund adult social care services, councils may have the ability to divert part of the funding from these grants to other purposes. This can be seen clearly by considering how current ring-fencing arrangements work. For instance, imagine a council receiving £10 million from the SCP and the IBCF. Current regulations require councils to state that they are spending £10 million more on adult social care than they would have if the SCP and the IBCF did not exist. However, the government cannot know for certain what councils would have spent in the absence of the SCP and the IBCF: it has to take their word for it. Councils could therefore channel funding elsewhere by claiming they would have spent less on adult social care in the absence of the SCP and IBCF than they really would have. This could be a particular temptation for councils facing falls in their other revenues and/or increases in demand for other service areas.

Thus, the insurance offered to adult social care by ring-fenced grants that partially fund spending in this area may be less than would initially seem. In particular, the amount actually available to adult social care services from the supposedly ring-fenced grants could be affected by changes in councils' tax revenues and the need for spending in other service areas.

4.2 Full ring-fenced funding

So what if the government wanted to ensure that its ring-fenced funding was used in full to pay for adult social care services? In that case, it would need to provide ring-fenced funding aimed at fully funding adult social care services. Doing so would also insulate social care spending from changes in local tax bases. And it could provide additional

insurance against changes in relative spending needs if this fully ring-fenced funding were based on frequently updated assessments of need (although recall that this blunts councils' incentives to take action to reduce underlying needs).

However, centralising funding decisions in this way would also represent a significant reduction in councils' discretion to determine spending in their locale. This would sacrifice some of the potential benefits that this discretion can have.¹³

Devolving funding decisions to councils allows them to choose a mix of tax and spending that they want – which is not necessarily the mix that would be determined by central government, for two reasons. First, councils can respond to the preferences of local residents. For instance, residents in some areas may prefer higher spending on adult social care and either higher local taxes or lower spending on other services. Residents in other areas may prefer lower spending on adult social care services. Allowing local areas to choose the balance and level of spending can therefore allow a better match with local preferences than centrally determined allocations can.

Councils may also have a better idea of how the relative and absolute needs for spending on different service areas are evolving in their local area than central government has. Fully allocating funding via ring-fenced grants based on assessed spending needs would provide councils with the funding to meet those assessed needs. But actual needs might differ from assessed needs. And the ring fences would also prevent councils from shifting funding between services if they thought actual spending needs were distributed differently between services from what was implied by the centralised needs assessment.

There are therefore clearly potential costs to centralising funding via ring-fenced grants, in addition to the potential benefits.

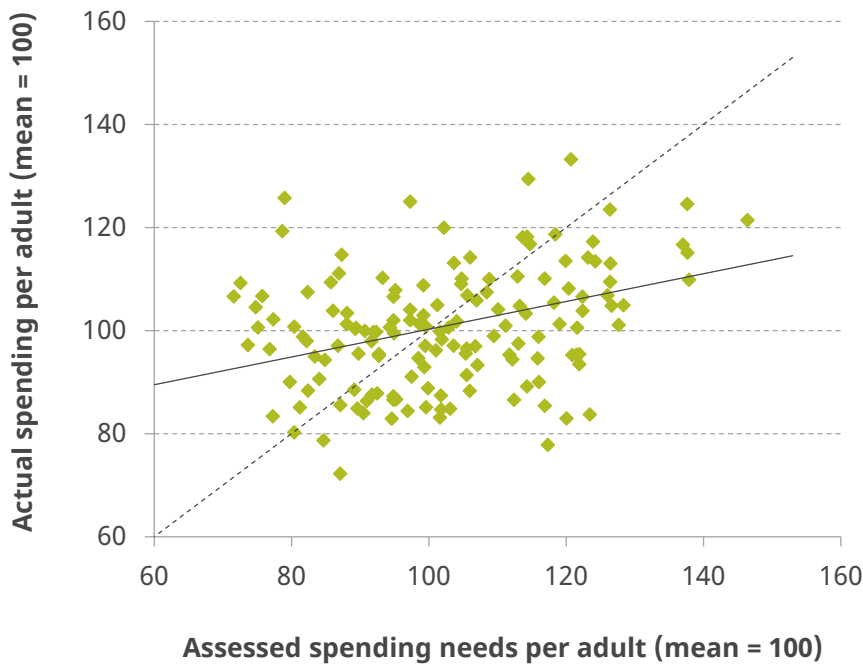
The challenge of moving to needs-based spending allocations

If the government wanted to centralise funding via ring-fenced grants based on assessed needs, it would also face a practical issue: there are big differences between councils' assessed needs for adult social care spending and what they actually spend on adult social care.

The scale of the gaps is illustrated in Figure 4.1, which shows the correlation between assessed needs per adult and actual spending per adult (where both are normalised so that the average equals 100). A council whose spending per adult matched its assessed spending needs per adult would be on the dashed 45-degree line. However, while there is a positive correlation between assessed spending needs and actual spending per adult (the solid trend line is positive), the relationship is relatively weak: variation in assessed needs per adult only explains around 13% of the variation in actual spending needs. Indeed, 44 councils had adult social care spending that was at least 10% higher than implied by the relative needs formula. Of these, in 13 councils it was at least 20% higher. Conversely, in 35 it was at least 10% lower and in 19 at least 20% lower than implied by the relative needs formula.

¹³ See Appendix A for a more general discussion of the pros and cons of devolution.

Figure 4.1. Comparing assessed relative spending needs for adult social care per adult resident, 2013–14, and actual relative spending on adult social care per adult resident, 2015–16



Source: Authors' calculations using assessed spending needs data explained in Appendix C and spending data explained in appendix A of Phillips and Simpson (2017).

This could be explained by several factors. As discussed above, the official assessment of relative needs may not capture true relative needs, and councils could be using the discretion provided to them by the current funding system to better meet local needs. It could reflect differences in the efficiency with which councils currently deliver adult social care services. It could reflect differences in the priority they place on adult social care services vis-à-vis other services and council tax rates. Or it could reflect variation in the funding councils receive from grants and the 50% BRRS.

Whatever the reason for these big differences, they mean that it would be impractical to move to ring-fenced grants based on assessed needs overnight. Instead, initial grants would have to be based on councils' actual spending on adult social care. If the government wanted to move to allocating the grants based on assessed needs, it would need to phase this in over multiple years. Even so, the slow move to needs-based funding would significantly redistribute adult social care spending across the country. This could be politically difficult, as the government has recently discovered with proposed changes to school funding (see Appendix B).

What sort of areas would gain and what sort of areas would lose from moving to needs-based funding? The relatively flat slope of the trend line in Figure 4.1 implies that councils with relatively low levels of assessed spending needs tend to spend more, on average, than their assessed needs. However, those with relatively high levels of assessed spending needs tend to spend less, on average, than their assessed needs. Funding based on current assessed needs would therefore tend to redistribute spending from areas assessed to have relatively low needs (which tend to have low levels of deprivation) to

those assessed to have relatively high needs (which tend to have high levels of deprivation).

4.3 Paying for full ring-fenced funding

Another practical issue the government would face in moving to full ring-fenced funding is finding the revenues to pay for it. When the government introduced the Dedicated Schools Grant to ring-fence funding for schools, it reduced the general grant funding it provided to councils by the equivalent amount. However, this would not be possible if the government wanted to introduce ring-fenced grants to fully fund adult social care: general grant funding is due to be abolished in 2020 under plans for the 75% BRRS. Therefore, if the government wanted the introduction of full ring-fenced funding for adult social care to be revenue neutral for councils, it would need to take a different approach.

Broadly speaking, there would be two ways to do this.

Devolving other spending responsibilities to councils

First, the government could make councils responsible for additional areas of spending that, at the time of devolution, were of the same size as the adult social care spending that councils would no longer have to fund from their tax revenues. Funding for the ring-fenced grants for adult social care could then come from central government's general tax revenues or a national tax specifically ring-fenced for adult social care.

As we do not know exactly how much councils will be spending on adult social care in the future, we do not know how big these additional spending responsibilities would have to be. However, under the assumption that ring-fenced funding for social care were used in full to increase social care spending by more than the change in general local government funding between 2016–17 and 2019–20, spending would amount to at least about £19 billion a year by 2019–20 in today's prices. Given the already ring-fenced BCF transfers from the NHS and IBCF grants (together worth just under £4 billion in today's prices by that year), that could mean finding around £15 billion of other spending for councils to fund.

That is a substantial amount of money. For instance, total spending on police and fire services is forecast to amount to around £13 billion in the current financial year. And spending by councils on services other than adult social care and education (which is largely funded by the ring-fenced Dedicated Schools Grant already) is expected to amount to around £26 billion in the current financial year. The responsibilities that would have to be devolved could therefore amount to close to 60% (£15 billion divided by £26 billion) of the existing spending responsibilities councils would be left with after the removal of adult social care spending.

It could be difficult to find spending responsibilities of this scale to devolve to councils. Councils might also face challenges in taking on funding such significant new responsibilities. In addition, it would be important for the government to consider whether it was willing to subject the services to be devolved to councils in place of adult social care to the potential funding risk associated with exposure to changes in councils' tax revenue capacities.

Imposing an 'adult social care tariff' on councils' tax revenues

A second approach would be to extract part of councils' tax revenues to fund the ring-fenced grants for adult social care. To do this, the government could utilise a feature of the BRRS: tariffs.

Recall that under the BRRS, councils do not actually retain 50% (or 75% or 100%) of the business rates raised in their area. Instead, those councils that, at the introduction or resetting of the system, are deemed to have higher business rates revenues than they need pay 'tariffs'. These tariffs then fund 'top-ups' to the revenues of those councils deemed to have lower business rates revenues than they need.

In order to raise the revenues required to set up a grant to fully fund social care, the government could introduce an additional 'tariff' on councils that currently have responsibility for funding adult social care. These 'adult social care tariffs' would be paid over to central government (rather than transferred to other councils as 'top-ups') to fund the ring-fenced grant for adult social care.

Councils would use the revenues they retain after paying these tariffs to fund their other services. The total amount would be significantly smaller than the amount councils control currently (because adult social care services would be funded by the tariffs instead). Of the remaining pot, children's social services and public health would account for around 40%. The remaining 60% would be a wide range of services which each have much smaller annual budgets, from highway maintenance to bin collection.

The government would of course need to decide how to set the initial adult social care tariffs and then how to index them over time.

As with the initial allocation of the grants themselves, it seems likely that the government would want to base the initial tariffs on councils' actual spending on adult social care as opposed to their assessed spending needs. This is because, as we saw earlier, there are significant differences between actual spending and assessed spending needs for many councils. Basing initial tariffs on councils' assessed spending needs would therefore lead to some councils having 'tariffs' that significantly exceeded what they were spending on adult social care. Such councils would have to cut back spending on other services or increase their council tax. On the other hand, other councils would have 'tariffs' that were significantly lower than what they were spending on adult social care. Such councils could therefore increase spending on other services or cut their council tax. Basing tariffs on actual spending would avoid such an immediate redistribution of revenues.

However, note that it would potentially be unfair if government (over time) changed grants to be based on needs, but tariffs remained based on initial spend. If those areas that had initially had spending higher than assessed needs had voluntarily afforded this spending by increasing council tax or reducing spending on other areas, then they would still be left with permanently higher council tax (or lower spending on non-social-care services), without the higher adult social care spending to show for it. This problem would be avoided if, over time, both tariffs and grants shifted to a needs-based allocation.

Abstracting from the transitional period, how should the tariffs be increased over time? Existing tariffs (and top-ups) are indexed according to inflation. That is, they are frozen in real terms. If the adult social care tariffs were frozen in real terms, the funding available

for adult social care would likely quickly fall behind that needed: recall that Wittenberg and Hu (2015) project that 4.4% real-terms increases in expenditure could be required. On the other hand, business rates and council tax revenues are unlikely to grow so rapidly. This means that councils would have to pay over a bigger and bigger proportion of their council tax revenues if tariffs were increased in line with projected increases in the need for adult social care spending. This would, over time, significantly squeeze the post-tariff revenues that councils had available to fund other service areas.

If the government did not want to reintroduce general or ring-fenced grant funding for these other services, it would need to ensure that, across England as a whole, councils' post-tariff revenues kept pace with the growth in demand for and cost of these services. The indexation of the adult social care tariffs would therefore need to be based on two key factors. First is the expected real-terms growth in business rates and council tax revenues at a national level. Second is the expected national-level real-terms increase in spending needs for the other services councils need to fund from their business rates and council tax revenues.

To ensure adequate funding for adult social care, the government would then likely need to provide additional funding on top of the adult social care tariff. This could be drawn from either its general tax revenues or a national tax specifically ring-fenced for adult social care.

4.4 How an 'adult social care tariff' could affect funding for other services

However, even if at a national level there were sufficient revenues to fund other council-provided services, the introduction of 'adult social care tariffs' could still affect the ability of different councils to fund them. This is because it would change the exposure of funding for these other services to changes in local tax bases and changes in local spending needs for social care. There are two broad effects, which are likely to pull in opposite directions.

- Funding adult social care via such a tariff could increase the impact of changes in local tax bases on the funding available for these other services, because it is funding for these other services that would have to bear the impact of any changes in different councils' local tax bases. This is in contrast to a system where councils continued to fund at least part of their adult social care expenditures from their general revenues. In that case, the impact of any changes in councils' tax bases could, at least *in principle*, be shared between adult social care services and other services. Insulating funding for adult social care services from changes in councils' tax bases would then *increase* the exposure of other services to funding risk associated with changes in councils' tax bases.
- On the other hand, funding for other services would no longer be exposed to changes in the relative need for adult social care spending: councils would instead pay their fixed adult social care tariffs. This contrasts to the present situation, where councils seeing an increase in their (relative) need for adult social care spending have to trade off meeting those needs with the fact that doing so reduces the funding available for other services. If councils have little choice other than to meet adult social care spending needs – e.g.

due to service standards imposed by central government – other services would likely lose out in such circumstances. They could therefore face *less* funding risk under a system of centralised funding for social care (part-)paid for by adult social care tariffs.

The direction and size of any impacts on the risk of divergences in the funding available to other services would therefore depend upon:

- how tax bases and spending needs (for adult social care services and other services) evolve over time across councils;
- the *real* discretion councils would have to adjust social care spending if they could given demand/cost pressures and central government rules on service standards;
- and, of course, the specific design of the general local government finance system, including, among other things, the share of business rates retained locally.

We do not know how tax bases and spending needs will evolve in future. So, as in Chapter 3, we use data on tax bases and assessed relative spending needs for a historical period – 2006–07 to 2013–14. This period can give us a sense of the extent to which these variables can change over time.

We also do not know exactly what the local government finance system will look like in future. While shorter-term plans are for 75% retention, the increasing numbers of 100% pilots suggest there is still an appetite in government for moving to 100% retention in the longer term. A 100% BRRS scenario therefore remains relevant when considering the design of a long-term social care funding system, and the impact of that funding system on the risks facing other services.

Given that, here we model the impact of levying an adult social care tariff on the funding risk facing other services under a version of a 100% BRRS based on scaling up the parameters of the existing 50% scheme.¹⁴ As under the 50% scheme, we assume that the general system of tariffs and top-ups is designed to redistribute revenues according to the assessed ‘need’ for revenue in the first year of the modelled scheme (2006–07). These general tariffs and top-ups are then indexed in line with RPI inflation, so that councils bear 100% of the real-terms changes in their tax revenues.¹⁵

We also do not know how much real discretion councils would have over adult social care spending. We therefore model the funding risk for other services under two different assumptions about this level of discretion:

¹⁴ In particular, we assume that in areas of the country where business rates are split between multiple tiers of local government, each area’s share under the 100% scheme is double its share under the 50% scheme.

¹⁵ We also assume that, as under the 50% scheme, tariffs and top-ups are adjusted to strip out the effect of the revaluation of business properties (a revaluation took effect in 2010–11). In addition, our modelling assumes that each council sets its council tax rate at the national average level. This allows us to focus on divergences between councils’ revenues and assessed spending needs that result from changes in tax bases and assessed needs, rather than from differences in the council tax rates set by councils. Full details are available on request.

- The first assumes that formal discretion fully translates into what we term real discretion. This means councils facing changes to their retained business rates and council tax income can share the effects across all services, including social care.
- The second assumes that councils have no real discretion over adult social care spending. They have to fund their share of assessed need for adult social care, shifting any revenue risk (and social care spending need risk) onto funding for other services.

Finally, we compare the scale of divergences in funding for other services across councils under these scenarios with the divergences that would arise if responsibility for funding adult social care were centralised and (part-)paid for via adult social care tariffs on councils' tax revenues (our third modelled scenario). In particular, we model the extent to which the *relative* funding available to different councils under the modelled 100% BRRS would diverge from their assessed *relative* spending needs in each of the three scenarios. The greater the divergences, the more we would expect the quantity and quality of these other services to differ across councils over time.

The risk of funding divergences for other services if councils have real discretion over adult social care spending

In our first scenario, the divergences relate to overall funding and assessed needs (i.e. including funding and need for adult social care spending). This is because councils are responsible for funding adult social care from their retained council tax and business rates revenues in this scenario *and* we assume that they have real discretion over spending on adult social care. This means changes in tax revenues can be shared between adult social care and other service spending.

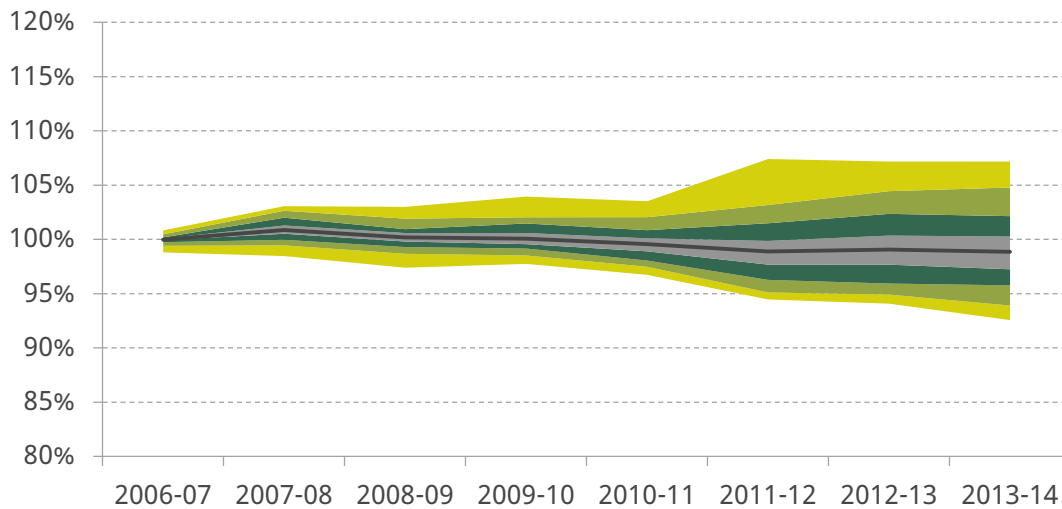
Our measure of funding divergence is the ratio of each council's share of national council tax and business rates revenues after accounting for tariffs and top-ups – which we term its retained revenues – to its share of national assessed spending needs. We call this a council's *relative funding ratio* and it measures the proportion by which a council's share of retained revenues is higher or lower than its share of assessed relative spending needs. A value less than 100% means a council's share of retained revenues is lower than its share of assessed relative spending needs. And a value over 100% means its share of retained revenues is higher than its share of assessed relative spending needs.

Figure 4.2 shows how the distribution of these relative funding ratios would have changed between 2006–07 and 2013–14 under this scenario. It is a fan chart: each pair of coloured bands represents 20% of councils, with 10% of councils above and 10% below the lightest green bands.

The figure shows that relative funding ratios diverge over time, reflecting changes in the relative size of different councils' tax bases and in their assessed relative spending needs.

For instance, in 2006–07, eight in ten councils would have had a relative funding ratio between 98.8% and 100.8% under our baseline scenario. That means their share of retained revenues would have differed from their share of assessed needs by up to around 1%. By 2010–11, eight in ten councils would have had a relative funding ratio between 96.7% and 103.5%. That is, their share of retained revenues would have differed from their share of assessed needs by up to around 3.5%. And by 2013–14, eight in ten councils would have had a relative funding ratio between 92.6% and 107.1%. In other

Figure 4.2. Evolution of relative funding ratios under a 100% BRRS, 2006–07 to 2013–14: scenario where councils have *real* discretion over adult social care spending



Source: Authors' calculations using data referenced in Appendix C.

words, their share of retained revenues would have differed from their share of assessed needs by up to around 7%.

These divergences in relative funding ratios could lead to divergences in the quality and quantity of services different councils could provide. Remember that, in this scenario, this includes adult social care services, as we assume councils have real discretion over spending on this area and are able to adjust spending as retained revenues change.

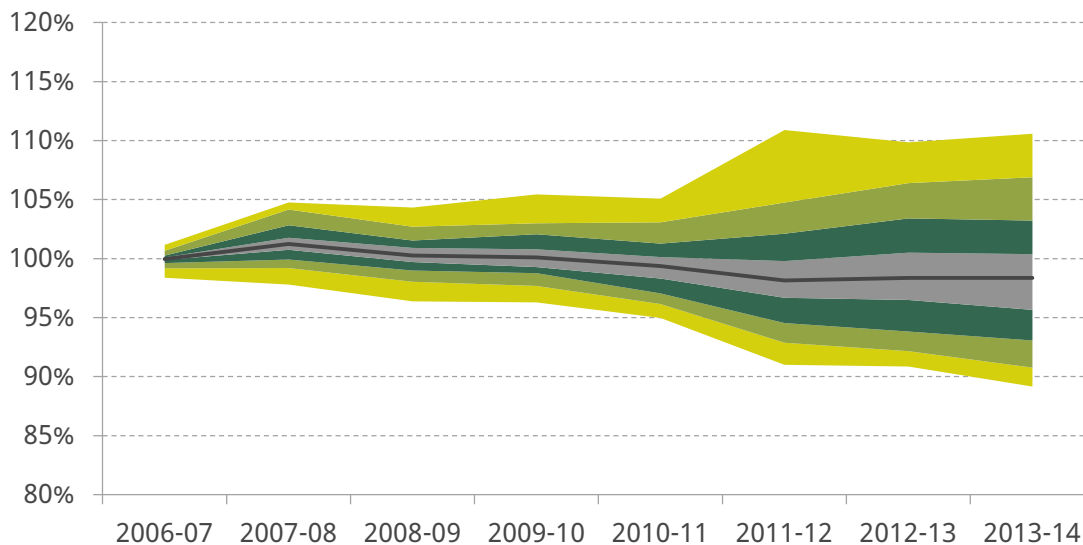
The risk of funding divergences for other services if councils *do not* have real discretion over adult social care spending

We now turn to the extent to which funding for other services could have diverged over time under our second scenario: where councils lack real discretion over their overall level of adult social care spending even if it is formally under their control. In particular, we assume that councils have to fund their assessed share of overall adult social care spending needs, irrespective of what happens to their retained revenues or spending needs for other services. This is an extreme assumption but it helps illustrate how important the assumption of full discretion in our first scenario was.

Figure 4.3 shows how the relative funding ratios would have evolved under this second scenario. It is clear that divergences would have grown larger over time. This is because spending on other services would have to bear all the adjustment, both when retained revenues change and when adult social care spending needs change.

For instance, in 2013–14, eight in ten councils would have had a share of retained revenues for other services (i.e. excluding adult social care) that differed from their share of assessed needs for these services by up to 10.5%. This compares with 7% under our first scenario, where we assumed councils had real discretion over adult social care spending.

Figure 4.3. Evolution of relative funding ratios under a 100% BRRS, 2006–07 to 2013–14: scenario where councils *do not* have real discretion over adult social care spending



Source: Authors’ calculations using data referenced in Appendix C.

A comparison of Figures 4.2 and 4.3 therefore illustrates that whether or not councils have *real* discretion to adjust adult social care spending when retained revenues change has an important effect on the degree of funding divergence other services could see.

The risk of funding divergences for other services if adult social care spending were centralised

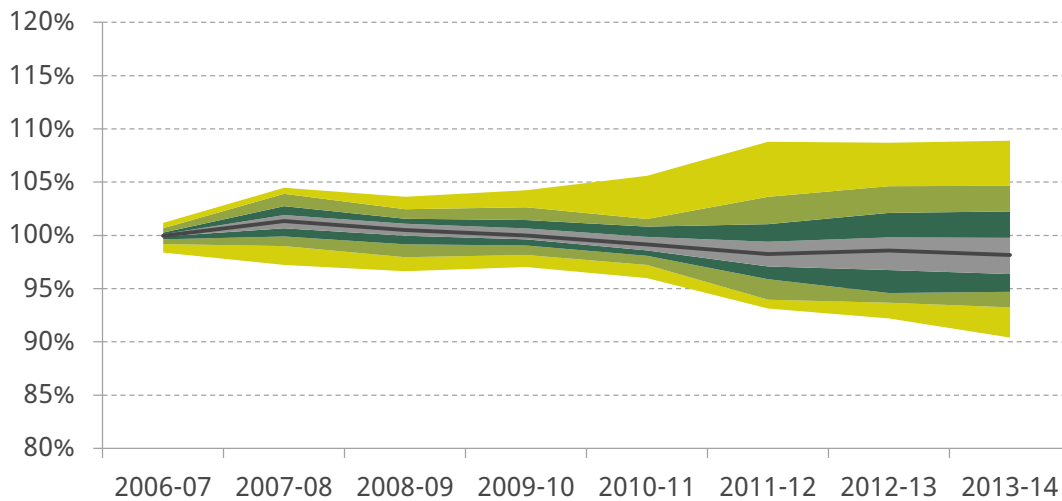
So, what if the responsibility for determining adult social care funding were centralised and councils contributed to this funding via ‘adult social care tariffs’?¹⁶ Figure 4.4 shows how relative funding ratios for other services would evolve over time.

Comparison with Figures 4.2 and 4.3 shows that the degree of divergence falls *between* the levels of divergence found in our two earlier scenarios: where councils have real discretion over adult social care spending and where they have formal but not real discretion, respectively. For instance, in 2013–14, eight out of ten councils would have had a share of retained revenues for other services that differed from their share of assessed needs for these services by up to around 9%. This compares with 7% under the ‘real discretion’ scenario and 10.5% under the ‘no real discretion’ scenario.

Our analysis therefore illustrates that it is unclear whether centralising the funding of adult social care and making councils contribute to this via ‘adult social care tariffs’ would increase or decrease the risk of divergences in funding for other services. But it illustrates some of the key mechanisms and factors at play.

¹⁶ The scenario modelled here involves setting each council’s adult social care tariff equal to its share of overall spending need for adult social care in 2006–07. In 2007–08 and beyond, the tariff is updated each year by RPI inflation plus 1%.

Figure 4.4. Evolution of relative funding ratios under a 100% BRRS, 2006–07 to 2013–14: centralisation scenario (with ‘adult social care tariffs’)



Source: Authors' calculations using data referenced in Appendix C.

- Centralisation would likely *increase* the risk of divergences in funding for other services if councils would otherwise have significant real discretion over how much to spend on adult social care. In that case, whereas they could share the impacts of changes in revenues between adult social care and other services if they controlled the total level of adult social care spending, centralising that responsibility would mean other services would have to bear any revenue changes in full.
- But centralisation would likely *reduce* the risk of divergences in funding for other services if councils would not have had real discretion over spending levels in any case. This is because other services would have had to bear the burden of adjusting to revenue changes anyway. Centralisation would then have the benefit of insulating these services from changes in adult social care spending needs.

This has an important implication. It means that the more stringent government rules are in ensuring councils deliver a particular standard and type of social care, the more likely it is that funding divergences for other services would actually be *lower* under centralised funding of adult social care. That is because such rules would probably reduce the degree of real discretion councils have over their adult social care services – even if they remained formally in charge of setting overall spending levels.

4.5 Summary

In this chapter, we have considered two possible ways the government could direct funding specifically to adult social care.

First, it could continue to provide ring-fenced grants that partially fund councils' expenditure on adult social care (with the balance coming from councils' own council tax and retained business rates revenues). We saw that this would, in principle, reduce the exposure of funding for adult social care services to changes in local tax bases. The degree of insurance provided would depend on the size of these grants relative to

councils' overall spending on adult social care, and whether they were frequently updated to take account of changes in councils' relative spending needs and tax revenues. However, updating grants in this way would also lower councils' incentives to reduce underlying spending needs and boost local tax bases.

We also saw that if ring-fenced grants only partially fund adult social care services, councils may have the ability to divert part of the funding from these grants to other purposes. This could be a particular temptation for those facing falls in their other revenues and/or increases in demand for other service areas. Thus the insurance against changes in local tax bases offered to adult social care by ring-fenced grants that provide only partial funding may be less than would initially seem.

This leads us to our second, more radical option for the government: providing ring-fenced grants to fully fund adult social care. This would give central government much more control over adult social care spending, ensuring supposedly ring-fenced funding was not diverted elsewhere. It would also fully insulate social care spending from changes in local tax bases. However, centrally determining adult social care spending in this way would reduce the ability of councils to tailor spending levels to local preferences.

There would also be a number of practical issues. First is that allocating grants according to centrally assessed needs would likely lead to a significant redistribution of adult social care funding around the country. This is because the correlation between what councils actually spend on adult social care and their assessed spending needs is pretty weak. To avoid large overnight changes in funding availability, initial grant allocations would therefore likely need to be based on what councils actually spend on adult social care. There could then be a transition to assessed-needs-based allocations over several years.

A second issue is how to fund these ring-fenced grants. If the government wanted to make the introduction of these grants revenue neutral, it would need to devolve other responsibilities to councils or extract part of councils' tax revenues. In total, it might need to find around £15 billion in today's prices if such a scheme were introduced in 2020.

Finding additional responsibilities of this scale could be difficult – it is more than is spent in total on police and fire services, for instance. These additional responsibilities would also become exposed to changes in councils' local tax bases.

If the money were extracted from local tax revenues instead, that could increase the risk of funding diverging from needs for other services. This is because spending on these would have to bear the risk associated with changes in local tax systems. In contrast, if adult social care remains at least partly funded from a council's own tax revenues, there is the possibility of sharing that risk with adult social care services.

However, if councils do not feel able to make adult social care services share in these risks, centralising funding for these services could actually reduce financial risks for other services. This is because the other services would already be bearing the full risk associated with changes in local tax revenues. And centralised funding of adult social care via 'tariffs' could insulate funding for other services from risks associated with changes in adult social care spending needs (e.g. because the local population becomes poorer and/or sicker): councils would just pay their fixed 'adult social care tariffs', whatever happens to these needs.

So would fully centralising responsibility for funding adult social care increase or reduce funding risks for other services? It depends on whether we think councils would otherwise be able to allow spending on adult social care to share in the adjustments required when local tax revenues fall. And it depends on the scale of revenue and spending needs risks for different services and how these are correlated.

5. Conclusion

There has been considerable recent debate on the future of social care spending, in particular on whether there is enough funding in the system, the balance between private and public responsibility for paying for care, and whether the net for state-funded support is cast widely enough.

This report has focused on a commonly overlooked issue: the role of local government in funding adult social care. While often discussed by central government policymakers, social care is funded and commissioned by councils. As a result, the way we choose to fund local government affects how much money is available for social care and who this money goes to.

This is not just a technicality – it is central to the debate about what we, as a country, expect from our system of social care. Recent reforms suggest that central government would like to make adult social care services more consistent around the country – so where you live doesn't affect your entitlement. But this is fundamentally at odds with other policy objectives – specifically, reforms to local government finance that seek to incentivise councils to invest in stimulating growth in their own tax bases and tackle underlying drivers of spending need. So with one hand the government has placed growing expectations on the social care offering of local councils, while with the other it is reducing the role of the mechanisms that have historically redistributed funding between councils to enable them to deliver services of equivalent quality.

The upshot, as demonstrated by the analysis in this report, is that if nothing changes, over time councils will likely see divergences in their ability to pay for adult social care, meaning that what you get will continue to depend on where you live. What is more – given that demand for adult social care is forecast to grow more rapidly in future than council tax and business rates revenues – all councils may struggle to maintain the quality of their services if they have to fund these out of local revenues without supplementary grants from central government.

If the government does not want to backtrack on its reforms to local government finance, it has several options for responding to these challenges. First, social care could remain a funding responsibility of councils, and central government could continue to provide ring-fenced top-up funding. These top-ups would need to increase over time if rising demand were to be met. However, because councils could divert the non-ring-fenced portion of their social care funding to other services, the effectiveness of this approach for targeting money at social care may be limited.

A more radical option would be the introduction of separate ring-fenced funding designed to fully fund social care in an area. This raises many issues discussed in detail in this report, including how to transition to such a system when spending varies so much around the country for reasons unrelated to assessed spending needs, and how to find the £15 billion to fund these grants at the point of their introduction.

Such a wholesale centralisation of funding responsibility would insulate adult social care spending from risks associated with changes in local tax bases. It could also allow the responsibility for organising social care to be transferred from councils to the NHS, for

instance. But it would represent a significant diminution of the discretion local areas currently have in determining spending on a major public service. It would take over one-third of councils' current service spending out of their control. And around 40% of the spending they would be left with would relate to children's social services and public health: two services where one might expect similar pressure for more consistent standards of service in the years to come. The question of whether adult social care funding should be the responsibility of local or national government is therefore part of a broader question which is not getting the attention it deserves: what is the right balance between national standards and local discretion when it comes to public services?

A proper public debate on this issue is long overdue, not least in the context of adult social care services. Of course, the government's Green Paper consulting on the future of adult social care funding is due to be published in the summer and is eagerly anticipated. Much of the focus will undoubtedly be on the balance between public funding and contributions from individuals themselves and on the overall cost of any increase in the generosity of public funding. But it would be a wasted opportunity if the Green Paper does not also consider how any public funding will actually operate: will funding remain largely the responsibility of local government, or will Westminster take firmer control? What is decided here will have fundamental implications for the overall resources that will be available for publicly funded adult social care at a national level, how that funding is distributed across the country, and how that distribution of spending changes could change over time. Ultimately, it will affect the extent to which people in different parts of England can expect similar access to, and standards of, care. And it will affect the extent to which they can have a say on adult social care provision in their area through the local ballot box.

Appendix A. Further detail on ongoing reforms to adult social care and local government finance in England

A.1. The changing social care system in England

Government financial support for those with disabilities and associated care needs is provided via three main channels.

First, those who have a health condition or disability that means they have difficulty undertaking day-to-day activities without support are, subject to assessment, eligible for benefit payments from central government irrespective of their income, assets or where they live: personal independent payment (PIP) and its predecessor disability living allowance (DLA) for those of working age, and attendance allowance for those aged 65 or over. Across England, 4.2 million people were in receipt of these benefits in 2016–17, at a cost of £17.3 billion. In addition, individuals who provide informal care of at least 35 hours per week, and who live in a family with low income and assets, can claim carer's allowance. Almost 700,000 people in England did so in 2016–17 at a cost of £2.3 billion.¹⁷

Second, individuals whose social care needs arise from a 'primary health need' may, subject to assessment, have their health and social care arranged and fully funded by the NHS Continuing Healthcare programme. There is no legal definition of what constitutes a primary health need, but guidance issued states that 'an individual has a primary health need if, having taken account of all their needs ..., it can be said that the main aspects or majority part of the care they require is focused on addressing and/or preventing health needs' (Department of Health, 2012). Differing interpretations of primary health needs by different NHS clinical commissioning groups (CCGs) may partly explain the wide variation in expenditure on the Continuing Healthcare programme in different parts of England illustrated in previous IFS research.¹⁸ Across England as a whole, just under 58,000 individuals were assessed as eligible for the programme at the end of 2016–17, and expenditure amounted to £3.2 billion in 2016–17, the most recent year for which data are readily available.¹⁹

Third, those deemed ineligible for NHS-funded care may be eligible for means-tested care organised and part or fully funded by their local council. Eligibility is based on an individual meeting two sets of criteria, one based on the severity of their social care needs and the other based on their financial circumstances.

We discuss the care needs criteria in the next subsection. The financial means test consists of two parts.²⁰ First, there is an asset test: those with (non-pension) assets of more than £23,250 are ineligible for council-funded care, and those with assets between £14,250 and

¹⁷ Further information on these benefits is available in Hood and Norris Keiller (2016). For data sources, see Appendix C.

¹⁸ See appendix B of Phillips and Simpson (2017).

¹⁹ For data sources, see Appendix C.

²⁰ This information is taken from Department of Health and Social Care (2018).

£23,250 must pay for at least part of their care. The value of an individual's main residence is excluded from this asset test if they or their partner continues to live there, but is included otherwise. Second, there is an income test that applies to those with assets below £23,250. In particular, an assessment is made of the amount of income an individual needs. If an individual's income is high enough that they can fully fund their care without their retained income dropping below this level, they are not eligible for financial support from their council. If their income is not high enough for this, the individual is responsible for paying up to the point their retained income falls to the level they are assessed to need, with the council paying for the remaining costs.²¹ Councils must also provide some services free of charge to those assessed as needing them, such as adaptations to an individual's home costing less than £1,000 and up to 6 weeks of 'reablement' services for those suffering a recent illness or disability.

The three channels of funding described above demonstrate that state financial support for those with care needs is split between central government (which pays for cash benefits), NHS CCGs (which pay for the Continuing Healthcare programme in their area) and local councils. It is part national and part local responsibility, operating within a framework set out by central government. There are both pros and cons of devolving the responsibility for organising and funding public services (and cash benefits) to subnational governments such as councils, as discussed in Box A.1.

Box A.1. The pros and cons of devolution

In discussing the pros and cons of devolution to subnational governments such as councils, it is worthwhile distinguishing between two types of devolution:

- **expenditure devolution**, whereby subnational governments have the responsibility to organise service delivery and determine how funding is allocated between services;
- **revenue devolution**, whereby subnational governments have responsibility for funding, at least in part, the services they provide via their own tax revenues, and have powers to vary the level and sometimes the structure of the taxes devolved to them.

In practice, systems of subnational governance often involve a combination of partial expenditure and revenue devolution, with central government providing frameworks and rules, which must be abided by, and redistributing revenues between subnational jurisdictions. This is the case for social care specifically and local government more generally in England, although, as discussed in this report, the balance of local autonomy and central rules is changing for both.

There are a number of potential benefits to devolving responsibility to subnational governments. First, both in terms of organising services, and allocating and raising revenues, they may be more informed about, and more responsive to, the needs and desires of the local population. People can also move to jurisdictions that better accord with their policy preferences. Second, there may be greater scope for policy innovation and learning as different subnational jurisdictions adopt different policies.^a Third, it has

²¹ Further information is available at <https://www.nhs.uk/Conditions/social-care-and-support-guide/Pages/local-authority-funding-for-care.aspx#financial-assessment>.

been suggested that complex issues – including addressing the care and safeguarding needs of vulnerable adults – require coordination between multiple service areas and organisations, and that this can be better done at a local level rather than by central government.^b Fourth, councils that have responsibility for raising part of their own funding via local taxes may have a greater incentive to improve socio-economic conditions in their area to grow the tax base and, once they have raised money, use it more wisely knowing the difficulty with which it was obtained. Similarly, subnational governments may have stronger incentives to tackle underlying spending needs if any grant funding they receive is not fully updated to reflect changes in their assessed needs.

However, there are also potential costs to devolving spending and revenue-raising responsibilities to subnational governments. First, there can be economies of scale and scope that make providing services centrally more effective. For instance, designing and operating a single system of disability and carers' benefits nationally is likely to be cheaper than designing and operating hundreds of local schemes. Second, some public infrastructure and services may benefit residents of multiple subnational jurisdictions, and organising and funding these locally may require costly coordination between jurisdictions and/or lead to under (or even no) provision of the item in question if such coordination is not feasible. Third, the potential movement of people and businesses as a result of policy variation between subnational jurisdictions could have negative (as well as positive) effects. For instance, if a jurisdiction were to significantly reduce the tax rate it charged, it might attract wealthier residents from other jurisdictions, undermining their tax bases. Similarly, a jurisdiction may be able to encourage residents it considers less desirable (or more costly) to move elsewhere by cutting back on the types of services that they use.

Finally, society may have a preference for consistency in terms of service availability and quality across geographic areas, and devolution could make this less likely. For instance, different subnational jurisdictions may choose different eligibility criteria for services and fund services of different qualities. The stronger incentives to grow tax bases and tackle spending needs when subnational governments have greater responsibility for raising their own revenues also mean greater risk of divergences in funding availability between areas where the level of and changes in tax bases and spending needs differ. The raising and redistribution of funding by central government instead can, in principle, allow more comparable levels of services to be delivered across subnational jurisdictions.

This complex mix of pros and cons helps explain the often complex pattern of centralised and devolved service responsibilities, centrally determined rules and local discretion, and grant and own-revenue financing of subnational governments. When the balance of power and responsibility between central and subnational governments is changed, it is presumably because either these underlying costs and benefits associated with devolution are thought to have changed or a different trade-off between these costs and benefits is being made.

^a This argument is often cited in the United States, where, in the 1930s, Supreme Court Justice Louis Brandeis argued that a 'state may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country'.

^b See, for instance, Cox, Henderson and Raikes (2014).

Recent reforms to the social care system

While central government provides a framework for the operation of adult social care services, councils have a significant amount of discretion over the operation of, and the level of funding for, these services in their local areas. However, councils now have less discretion than they had five years ago, as a result of two significant changes to the social care system.

First, the Care Act 2014 introduced new national regulations governing eligibility for publicly funded social care, replacing the previous 'Fair Access to Care Services' policy (FACS).²² Under FACS, there was significant variation in the social care needs assessments undertaken and eligibility criteria applied by different councils (although, over time, increasing numbers of councils restricted eligibility to those with the most substantial care needs only, especially as cuts to local government funding took effect from 2010 onwards).²³ The new Care Act regulations set out a common approach to assessing care needs and centrally determined minimum standards on what care needs would result in someone being eligible for care (subject to the financial means test). These standards say that an individual has an eligible social care need if:

- they have care and support needs as a result of a physical or mental condition;
- because of those needs, they cannot achieve two or more of a number of outcomes related to daily living, such as dressing or feeding themselves appropriately, keeping themselves safe, maintaining personal relationships, etc.;²⁴
- and, as a result of this inability, their well-being is significantly negatively affected.

The somewhat subjective nature of these criteria means that, in practice, different councils may interpret and implement the centrally determined rules in somewhat different ways. And they can use more generous rules if they so wish. But discretion is still reduced compared with under FACS (councils cannot apply rules that are less generous than the centrally determined ones).

In addition, the Care Act 2014 placed new statutory duties on councils to provide specific services. These duties include: to operate and maintain an information and advice service available to all; provide support for those providing informal care; to offer clear personal budgets to those receiving care; to arrange independent advocates for those unable to engage with the assessment and care process themselves; and to operate deferred payment schemes so that people need not sell their houses to pay for their care until after death.

The second major change is central government's growing use of ring-fenced funding to influence the total amount of money spent by councils on adult social care. Historically, funding for council-funded social care services came overwhelmingly from councils'

²² More information on eligibility under FACS can be found in Department of Health guidance from the time: http://webarchive.nationalarchives.gov.uk/20121205180615/http://www.dh.gov.uk/prod_consum_dh/groups/dh_digitalassets/@dh/@en/documents/digitalasset/dh_4019641.pdf.

²³ See National Audit Office (2014).

²⁴ A full list of the relevant outcomes that individuals are expected to be able to achieve is set out in the regulations that sit alongside the Care Act 2014, available at www.legislation.gov.uk/ukxi/2015/313/pdfs/ukxi_20150313_en.pdf.

general grant funding and council tax revenues, which they were free to allocate across services as they wished, subject to them being able to meet the statutory obligations placed on them. In the parlance of Box A.1, there was therefore a significant degree of expenditure devolution.

Now a significant proportion of the funding used by councils to pay for adult social care comes with the condition that it be spent only on these services. This includes transfers from the NHS to councils via the Better Care Fund (BCF) to pay for care services that have a health benefit; a ring-fenced grant, termed the Improved Better Care Fund (IBCF), provided directly by central government; and revenue from additional increases in council tax (beyond those normally allowed), which is termed the Social Care Precept (SCP). Funding via these streams could amount to £5.3 billion in today's prices in 2019–20, up from £2.2 billion in 2016–17 and virtually nothing in 2011–12.²⁵ The figure for 2019–20 is likely to be around 30% of councils' overall spending on adult social care in that year.

In addition to influencing the total amount of money spent on adult social care, these grants affect the distribution of spending around the country because they are allocated on the basis of a central assessment of relative spending need. Differences in historical house prices, and hence council tax bases, mean that the amount that different councils can raise from the SCP varies significantly.²⁶ However, the IBCF grant is allocated in a way designed to offset these differences and ensure that the overall pot of SCP and IBCF ring-fenced funding is allocated in proportion to the assessed relative needs for adult social care spending by different councils (as of the last official assessment in 2013–14).

Taken together, the increasing role of ring-fenced needs-based funding, and the introduction of a common approach to assessment, national minimum eligibility criteria and additional statutory duties, suggest a desire by central government for more consistent (and higher-quality and more-efficient) social care service provision across councils.

The transfers from the NHS via the BCF are part of broader efforts to better integrate health and social care services. Indeed, the BCF and IBCF involve councils and CCGs jointly agreeing pooled budgets and an integrated spending plan, covering elements of community healthcare as well as social care services.²⁷ In addition, groups of councils and local NHS organisations have been brought together in 'Sustainability and Transformation Partnerships' (STPs) to develop and agree proposals to jointly improve the efficiency of, and outcomes delivered by, local health and social care systems.²⁸ Central government has therefore taken a more active role in ensuring councils and local health organisations work together to address health and social care needs.

Proposed reforms to the social care system

In addition to the reforms already mentioned, the Care Act 2014 also set out longer-term plans for changes to the financial contribution councils would make for people's care, building on the recommendations of the Dilnot Commission (2011). The Commission highlighted two (related) issues with the current system: the low and sharp asset cut-off

²⁵ See Appendix C for data sources and methodology.

²⁶ See slides 6–10 of Phillips (2015).

²⁷ For further information, see <https://www.england.nhs.uk/ourwork/part-rel/transformation-fund/bcf-plan/>.

²⁸ For further information on STPs, see <https://www.england.nhs.uk/systemchange/>.

for eligibility, and the lack of insurance against high care costs for individuals with income and wealth above both this asset and the income means-test thresholds. It proposed an increase in the asset threshold for those requiring residential care; the introduction of a lifetime cap on the adult social care costs any individual must pay; and the common eligibility criteria already discussed. The Care Act 2014 took each of these forward, although the cap proposed (£72,000) was double that recommended by the Commission (£35,000), and just one year after the act was passed the introduction of the cap and increased asset threshold was delayed from 2016 to 2020. However, the plan would still have increased the degree of insurance offered to individuals with high care costs, increasing the cost of social care to councils. It would also likely have redistributed such costs between councils due to geographic variation in the proportion of people newly eligible for state-funded care and in the costs of this care.

The Conservative manifesto for the 2017 election scrapped these plans, instead proposing a common £100,000 asset threshold including an individual's primary residence for both home-based and residential care, but no lifetime cap on costs. However, following political pressure, there was an apparent U-turn on the abandonment of the cap on costs, although no specific detail was given on what any cap would be.²⁹ We now await a Green Paper due in Summer 2018 for more detail on new proposals for reform of social care funding. However, it seems likely that these will involve the state – and, if social care remains largely a responsibility of local government, councils – providing additional insurance to individuals and paying a higher share of the costs of social care.

A.2. The changing local government finance system in England

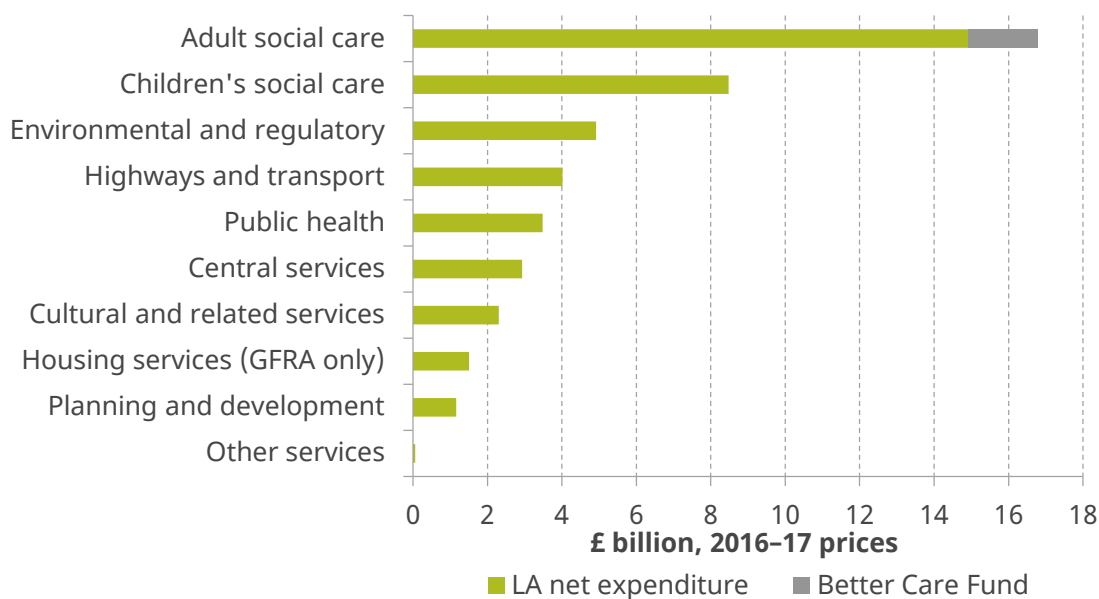
Adult social care is only one of the services English councils are responsible for. Figure A.1 shows councils' spending by service area in 2016–17. Spending on adult social care accounted for 34% (37%) of local government non-education service spending excluding (including) revenues from the Better Care Fund in that year (although, as shown in Phillips and Simpson (2017), this proportion varies significantly around the country).

Historically, councils funded these services via two main means: council tax, which is a tax levied on domestic property (i.e. housing), and grants from central government. A second property tax levied on non-domestic properties – business rates – was collected by councils but handed over to central government for redistribution as part of the grants provided to councils (although the size of these grants did not actually depend upon the business rates revenues actually raised). Figure A.2 shows that in 2009–10, under this system, 40% of councils' revenues (excluding those specifically for education) came from council tax, whilst 60% came from grants and redistributed business rates.

Council tax was and remains part-devolved. Central government determines the tax base: all houses are placed in a tax band from A to H based on their 1991 valuation, and the ratio between the taxes paid by properties in different tax bands is determined centrally and is the same across England. However, councils retain the revenues and, subject to centrally imposed limits on annual increases, determine the overall level of council tax charged in their area by setting the tax rate for a Band D property (with the tax rates for properties in other bands calculated using the aforementioned centrally determined

²⁹ See, for instance, <https://www.theguardian.com/society/2017/may/22/theresa-may-u-turn-on-dementia-tax-cap-social-care-conservative-manifesto/>.

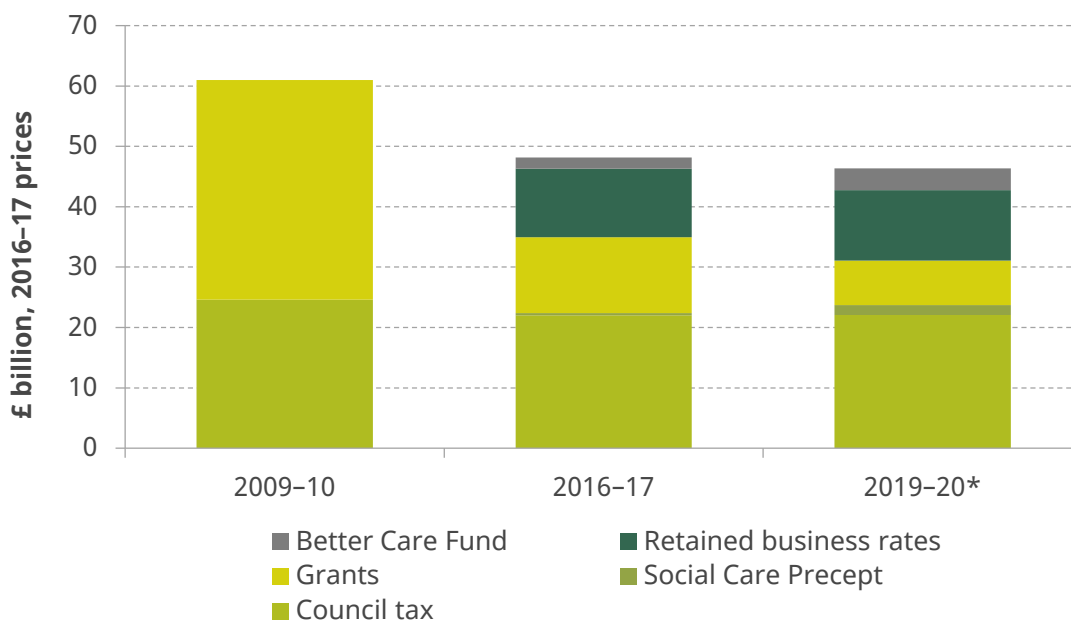
Figure A.1. Councils' net spending by service area, 2016-17



Note: Spending is defined as local authority net service expenditure, excluding spending by some authority types (police, fire and national park authorities) and on some service areas (education, police and fire). GFRA stands for General Fund Revenue Account.

Source: See Appendix C.

Figure A.2. Councils' revenues by source, 2009-10, 2016-17 and 2019-20 (forecast)



* Forecast.

Note: Grants include general and specific grants. In 2009-10, they also include redistributed business rates revenues.

Source: See Appendix C.

ratios). The average Band D rate in 2017–18 is £1,575, although the rate varies between £688 and £1,891 across councils.³⁰

Grants from central government are provided in the form of specific grants for particular services and general-purpose grants (termed ‘Formula Grant’). Until 2013–14, the general-purpose grants allocated to different councils were (in theory) based on two factors: first, an assessment of the relative spending needs of each council – which was a function of various socio-economic, demographic and other local area characteristics (see Box A.2);³¹ and second, an assessment of the amount of council tax that each council could raise if tax rates were set at the same level nationally. The idea behind this approach was that grants would compensate councils for differences in their spending needs and their capacity to raise revenues via council tax. This would, in principle, allow councils to provide comparable levels of service (including for adult social care) for the same level of council tax. Differences in the quantity and quality of services provided would therefore be the result of differences in councils’ efficiency, in the priority they placed on different services and in the levels of council tax they set.

However, two issues are worth bearing in mind. First, assessing spending needs is difficult and is likely to be subject to error. One needs to choose the characteristics that enter any needs assessment formulae and determine the weights to apply to them, which is difficult. Many factors are likely to influence spending needs, and these factors may interact or have non-linear effects on spending needs that are difficult to capture in any funding formulae. Data on relevant characteristics may be missing or only updated infrequently, meaning assessments get out of date. Moreover, we do not actually observe spending needs. Instead, we must proxy needs with something we do observe to estimate the weights used in the funding formulae. One approach is to use past expenditure as such a proxy. Weights can then be obtained by estimating the relationship between expenditure and local area characteristics. However, past expenditure will also reflect factors other than spending need. These include previous grant funding, and councils’ decisions on how much council tax to charge and how to prioritise different service areas. For instance, suppose richer areas decided to set higher levels of council tax to increase expenditure and provide higher-quality services. Using past expenditure as a proxy for spending need would mean our assessment of the relative needs of these richer areas would increase (and that of poorer areas would decrease), even though this reflects local choices rather than assessed needs.

Second, councils’ assessed spending needs and revenue-raising capacities were not the only factors that determined the general grant funding allocated to them. ‘Damping’ arrangements placed floors and ceilings on the annual change in the grants provided to different councils in order to provide greater funding certainty for councils. However, these also meant that if a council’s relative assessed spending need were to continuously increase or decrease, its grant funding might not keep pace with these changes. In particular, those seeing continuous and significant increases in their relative needs could see their damped share of grant funding fall further and further behind their share of assessed needs.

³⁰ These figures include fire and police council tax ‘precepts’ in addition to the council tax levied by councils. Source: CIPFA Council Tax Demands and Precepts Statistics 2017–18, available by subscription from <https://www.cipfastats.net/general/counciltax/Default.asp>.

³¹ For more examples of formulae used to assess councils’ relative spending needs, see Department for Communities and Local Government (2013).

Box A.2. How does the government measure the adult social care spending needs of councils?

Rather than one formula assessing the overall spending needs of a council, there are separate formulae for different service areas, termed service blocks, and sometimes within them, sub-blocks. For example, 'Adults' Personal Social Services (PSS)' is a service block divided into two sub-blocks: 'Older People's Personal Social Services' and 'Younger Adults' Personal Social Services'.

Most formulae work in broadly the same way. To start with, each council is allocated an initial level of need based on the number of relevant '*units*' it contains. A unit is normally a person who lives in that council area (e.g. an adult aged 65+ in the case of social services for older people), but can be something else (e.g. a kilometre of road in the case of highways maintenance). In addition to this, there are per-unit *top-ups* reflecting drivers of spending need over and above the number of units. For example, in 2013–14, the formula for social services for older people set spending need per adult aged 65+ as follows:

Spending need per adult aged 65 or over

= *Basic amount per adult aged 65 or over*

+ *Age top-up based on the share of the 65-or-over population that is 90 or over*

+ *Deprivation top-up based on the share of the 65-or-over population that is claiming attendance allowance, living in rented accommodation, living alone or on low-income benefits*

The sum of the basic amount and any top-ups is then multiplied by the number of units (e.g. adults over 65, road kilometres) in the council area. So in our example:

Initial Older People's PSS need

= *Number of adults aged 65 or over* × *Spending need per adult aged 65 or over*

Once the initial need has been calculated, the scores for sub-blocks are summed and an area cost adjustment (ACA) is then applied to each service block as a whole. ACAs adjust for differences in both labour costs and business rates bills between councils and are applied to each service block depending on the relevant proportion of expenditure in that block that goes on labour and business rates. In our example:

Final Older People's PSS need

= *Initial Older People's PSS need* × *ACA*

Finally, each council's overall assessed need is calculated by summing scores across all service blocks according to weights set by DCLG.

Note that the inputs to the social care funding formula are not direct measures of the number of individuals eligible for social care based on the individual eligibility criteria.

In practice, then, the general-purpose grants would not have fully compensated councils for differences in their relative spending needs and their ability to raise revenues via council tax. But the focus of the local government finance system was on redistribution between councils, with the aim of preventing large divergences between different councils' shares of available revenues and their shares of (assessed) spending needs.

Recent reforms to the local government finance system

Redistribution will remain an important part of the local government finance system in future. But recent changes have seen a shift in focus towards providing stronger incentives for councils to grow local tax bases and tackle underlying spending needs.³²

The legislative groundwork for a new system of local government finance was laid in the Local Government Finance Act 2012. Central to this new system was the devolution of a portion of business rates revenues to local government. Although the tax had always been collected locally, it had previously had no direct bearing on the total amount of funding available to local government or on the budgets of individual councils. This meant that councils had no financial incentive to grow the business rates tax base. The reforms aimed to provide such an incentive by creating a direct link between the budget of each council and the business rates revenues raised in its area.

The new system – dubbed the business rates retention scheme (BRRS) – came into effect in 2013–14. In that year, grant funding was reduced, and since then local government has instead retained 50% of the rates revenues collected by English councils. Figure A.2 shows the changed composition of council revenues: in 2016–17, 25% came from what is known as retained business rates, 27% from grants and 48% from council tax. Note that the increase in the share coming from council tax (up from 40% in 2009–10) reflects reductions in revenue from grants rather than increases in council tax revenues.³³

Although 50% of business rates are now allocated to local government as a whole, individual councils do not keep 50% of business rates raised in their local area. In general, the distribution of business rates revenues around the country is very different from the distribution of spending, so if individual councils were to have kept 50% of the business rates they raised, there would have been radical changes in budgets available to different councils.³⁴

Instead, a central assessment was made of how much business rates revenue each council needed and how much they were likely to receive in 2013–14. Those authorities expected to have revenues higher than their assessed need had to pay a 'tariff' equal to the difference. The income from all these tariffs was used to fund 'top-ups' for councils with relatively low business rates incomes compared with their spending needs.

³² The text here draws heavily on Amin-Smith et al. (2016), where readers can find more details on the changes.

³³ Indeed, council tax revenues fell in real terms, reflecting two factors. First, councils were incentivised to freeze their council tax rates in cash terms between 2011–12 and 2015–16. Second, the localisation of council tax benefit in 2013–14 replaced the council tax that had previously been paid on behalf of low-income households by the Department for Work and Pensions via council tax benefit with a (smaller) grant for councils to design their own benefit.

³⁴ For more information on the distribution of revenues and spending, see Amin-Smith, Phillips and Simpson (2018).

These transfers between authorities meant that in the first year the system operated, councils received similar funding levels to those under the old system of needs-based grant funding (despite the funding system looking very different). The difference between the old system and the new system of business rates retention lies in what happens next.

The key thing to note is that in each year since 2013–14, tariffs and top-ups have simply been increased in line with inflation. They are not updated to reflect any changes in the distribution of spending needs or business rates revenues around the country. The upshot is that individual local councils bear up to 50% of the real-terms changes in business rates revenues raised in their area. They see their income increase when, for instance, new non-residential property is developed in their area and they see their income decrease when such property is demolished (although particularly large reductions in income are prevented by so-called ‘safety-net’ payments that replace lost business rates revenues).

In addition to the partial devolution of business rates, 2013–14 also saw the ending of annual needs assessment for the remaining general grants allocated to local authorities. This is the reason why recent ring-fenced funding for social care services is still based on needs assessed in that year. Similarly, grant allocations since 2016–17 are based on different councils’ council tax revenues as of 2015–16, and have not taken into account changes in council tax bases since then.

Alongside the BRRS, these changes provide stronger financial incentives for councils to grow their local tax bases and address underlying spending needs: offsetting changes to general grant funding are no longer made when their tax base or assessed spending needs change. But the flip side of these stronger incentives is that councils bear more of the financial risk associated with changes in their tax bases and needs. These changes may be affected by the policies and performance of councils but will also be affected by factors outside of councils’ control.

Councils seeing relatively strong growth in their tax base and/or falls in their relative spending needs would see their funding levels increase relative to their needs. But councils seeing relatively weak growth or falls in their tax base and/or increases in their relative spending needs would see their funding levels fall relative to their needs. This could lead to divergences in the ability of different councils to provide services to their residents. To prevent such divergences growing indefinitely, the government planned to reset funding according to assessed needs in 2020 and every decade thereafter (likely with ‘damping’ arrangements to phase in any resulting big changes in funding implied by the reset).

It is worth noting that at the same time as these reforms, central government has made large cuts to local government funding through a combination of reductions in the generosity of grants and imposed council tax freezes. As a result, local government revenues (measured on a consistent basis as in Figure A.2) fell by 21% in real terms between 2009–10 and 2016–17.³⁵ Many councils chose to insulate adult social care from the full brunt of austerity, meaning that spending on adult social care fell by a more modest 6% over the same period.

³⁵ Service spending, measured on a similarly consistent basis, fell by slightly less – 18%.

Upcoming and proposed reforms to the local government finance system

Until June 2017, it was government policy that the share of real-terms growth in business rates revenues that would be retained locally would increase to 100% by 2020. At the same time, general grant funding for councils would be abolished, and additional spending responsibilities would be devolved to councils to fund out of their council tax and increased share of business rates revenues.³⁶ In addition, it was proposed that the periodic funding resets be made partial so that councils retained at least a proportion of any changes in their business rates tax base in the long term.³⁷ The increase in the fraction of real-terms revenue changes borne locally and moves to partial resets would provide stronger incentives for councils to grow their business rates base. But it would also increase the potential for funding divergences to open up between councils over time.

Since June, things have changed somewhat. The legislation required to deliver the 100% BRRS did not pass prior to the June 2017 election, and has not been resurrected since. Instead, in his speech to accompany the draft local government finance settlement for 2018–19, Sajid Javid, the Secretary of State for Communities and Local Government, announced the intention of moving to a 75% BRRS in April 2020.³⁸ However, pilots of the 100% BRRS were rolled out in areas including Cornwall, Greater Manchester and Merseyside in April 2017. A further 11 pilot areas have been announced for April 2018, including Berkshire, Derbyshire, Leeds, Suffolk and Surrey. And Sajid Javid has indicated that there will be additional pilot areas from April 2019 as well.

Thus, while a national roll-out of the 100% BRRS is on hold, there are firm plans to further increase the share of business rates retained by councils across England. And the roll-out of further pilots of the 100% scheme suggests there is still appetite for moving towards making councils bear real-terms changes in local business rates revenues in full. This means a further shift in the philosophy of the local government finance system away from equalisation towards the provision of financial incentives for tax base growth. The implication is that the government must be willing to tolerate greater divergences in the ability of different councils to fund services in order for those financial incentives to operate.

A.3. Summary

This chapter has set out the evolving systems of state-funded adult social care and local government finance. State-funded adult social care services are largely the responsibility of local government, and while they operate under a centrally determined framework, councils have discretion on the operation and funding of these services in their area. That discretion has been reduced in recent years, though, with new centrally imposed requirements on individuals' care needs assessments and eligibility criteria and on the services councils must provide. An increased share of the funding for adult social care is also specifically ring-fenced for that purpose. This suggests the government is keen to ensure a consistent standard of adult social care services across the country.

³⁶ The devolution of additional spending responsibilities was deemed necessary because the business rates revenues being devolved would, by 2020, significantly exceed the general grant funding councils were receiving.

³⁷ See Department for Communities and Local Government (2017a).

³⁸ See Department for Communities and Local Government (2017b).

At the same time, reforms to the local government finance system have reduced the role of central government in the overall funding of councils. Large cuts to grants, the ending of the annual updating of councils' spending needs assessments, and the introduction of the BRRS all mean councils' funding will depend more on local tax revenues than for decades. These policies are designed to provide stronger financial incentives for councils to grow their revenues and tackle spending needs. But they mean councils bear more of the financial risk associated with changes in local tax revenues and spending needs. This suggests the government is willing to allow divergences in the ability of different councils to provide services in order for councils to have said financial incentives.

Appendix B. Funding schools via the Dedicated Schools Grant

Prior to 2006–07, most of the funding for schools came from council tax revenues and general grants. In principle, councils had discretion over both the overall level of spending on schools³⁹ and allocations to individual schools (subject to their funding formulae meeting central requirements). Since that year, however, school funding has come in the form of the Dedicated Schools Grant (DSG), with general grant funding reduced as a result. The DSG is ring-fenced specifically for schools, was designed to fully fund them, and was initially set on the basis of each council's school spending prior to its introduction. As a result, it represents a hard floor below which school spending cannot fall and, while councils can top up the DSG from their general revenues, very few do in practice.⁴⁰ However, councils retain significant discretion over how they allocate revenue between schools, subject to floors on the year-to-year changes in funding per pupil that are imposed by central government.

Since 2006–07, each council's DSG has been updated each year according to the change in the total DSG available across England as a whole and to changes in that council's share of overall pupil numbers (by age band). There has, as yet, been no shift in relative funding levels towards relative needs as of 2006–07, let alone a shift towards a more up-to-date estimate of needs.

In December 2016, the government published plans to address this. The relative school spending needs of different councils would have been updated (using a new formula), and a new national school-level funding formula that would remove the discretion of councils in allocating funding between schools would have been introduced. These changes would have resulted in significant relative winners and losers, so would have been phased in over multiple years.

With the overall school budget being held down as part of overall cuts to public service spending, the plans would have also led to many councils and schools seeing falls in their cash budgets over the next few years. The unpopularity of this effect led the government to announce additional funding to increase the amount of transitional protection offered to losing schools and to put on hold plans for the national school-level formulae.

Experience with the DSG therefore shows that it is possible to centralise funding for a key public service that councils formerly had discretion over. But it also highlights the challenges with moving towards more centralised needs assessments, especially when that is attempted after a long period since the last assessment of needs and in a period when budgets are tight, limiting the ability to compensate the losers from such reforms.

³⁹ Although from the early 2000s the so-called passporting policy had strongly encouraged councils to pass on increases in central government's assessment of school spending needs to schools.

⁴⁰ See Sibieta (2015).

Appendix C. Data and methodology

Data sources and adjustments are based on previous IFS reports, specifically Simpson (2017), Phillips and Simpson (2017) and Amin-Smith, Phillips and Simpson (2018). This data appendix draws extensively on similar sections in those reports.

Population data

Our population measures, both estimates and projections, come from Office for National Statistics (ONS) official estimates. Available as 'Population estimates – local authority based by year of age' on NOMIS (<https://www.nomisweb.co.uk/default.asp>).

Historical data on council revenues and spending

The measures of local authority revenues and spending used in this report are based on the local authority revenue expenditure and financing statistics, available at <https://www.gov.uk/government/collections/local-authority-revenue-expenditure-and-financing>.

Local authority revenues are defined as the total of general grants, specific grants (inside Aggregate External Finance, AEF), retained business rates (including the business rates supplement) and council tax, for all local authorities in England excluding police, fire and national park authorities. To this starting figure we make the following adjustments:

- We exclude revenues accruing to local authorities for police and fire services (some non-police non-fire authorities have responsibilities in these areas).
- For comparing levels of revenues over time, we also exclude revenues used for education and public health as local authority responsibilities in these areas have been inconsistent over time.
- In 2009–10, we add on local expenditure associated with the 'Valuing People Now' initiative. This is spending on long-term support for those with learning disabilities, which prior to 2011–12 was the responsibility of the NHS but has shifted to local authorities since that year. Our source for these data is the government response to consultation on this funding shift, available at http://webarchive.nationalarchives.gov.uk/20130107105354/http://www.dh.gov.uk/prod_consum_dh/groups/dh_digitalassets/@dh/@en/documents/digitalasset/dh_122563.pdf. This only gives allocations for 2010–11, so we assume that real-terms expenditures were the same in each local authority area in 2009–10 as in 2010–11.

Local authority spending is based on the measure of net service spending in these accounts. As with revenues, we exclude spending on police, fire, education and public health (and spending by police, fire and national park authorities). Similarly, we add 'Valuing People Now' expenditure to 2009–10 and 2010–11 figures. In some instances, we include in both measures transfer payments made by the NHS to local authorities.

Figures on pre-2015 transfers are taken from appendix C of NHS Digital, 'Personal Social Services: expenditure and unit costs, England – 2015–16', 2016, available at <http://digital.nhs.uk/catalogue/PUB22240>.

Since 2015–16, these transfers have happened through the Better Care Fund. BCF allocations are taken from the Supporting Information to the 2015–16 local government finance settlement, available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/400630/Spending_Power_2015-16_Supporting_Information_FINAL.xlsx.

The share of this total allocation going to social care is based on national-level analysis by the NHS, which implies that just over half (£1.81 billion in cash terms) of the NHS's compulsory contributions to the Better Care Fund (£3.46 billion) supported social care activities. Available at <https://www.england.nhs.uk/wp-content/uploads/2015/06/bcf-meta-analysis-summary-feb-update.pdf>. This approach is the same as that taken in NHS Digital (2016).

Forecasting local authority revenues

Local authorities' future revenues are uncertain – they depend both on how the local tax base grows over time and on how local authorities choose to use the council tax flexibilities available to them.

Out-turn data are available up to 2016–17. For subsequent years, we use the following assumptions to construct a forecast for local authority revenues:

- The revenue support grant is as set out in the 2017–18 provisional local government finance settlement (December 2016, <https://www.gov.uk/government/collections/provisional-local-government-finance-settlement-england-2017-to-2018>).
- Any other government grants for which plans are not available (including special grants) are assumed to remain fixed in nominal terms at their 2016–17 level.
- Retained income from the business rates retention scheme changes in line with Office for Budget Responsibility (OBR) forecasts in *Economic and Fiscal Outlook: November 2017* (available at <http://obr.uk/efo/economic-fiscal-outlook-november-2017/>), stripping out the effect of the 100% business rates retention pilots in 2017–18 and 2018–19.
- The business rates supplement grows in line with overall retained income from the BRRS.
- The council tax base grows in line with OBR projections in *Economic and Fiscal Outlook: November 2017* (available at <http://obr.uk/efo/economic-fiscal-outlook-november-2017/>). All authorities increase their council tax by 2% per year. In addition, councils with social care responsibilities increase council tax by an additional 3% in 2017–18 and 2018–19 (making full use of the Social Care Precept).

- The real-terms value of the Better Care Fund and the share of funding going to social care will remain constant over the entire period.
- The value of the Improved Better Care Fund is as set out in the core spending power spreadsheets that accompanied the 2018–19 provisional local government finance settlement (December 2017, <https://www.gov.uk/government/collections/provisional-local-government-finance-settlement-england-2018-to-2019>).

Tax revenue capacity

As in Amin-Smith, Phillips and Simpson (2018), our overall measure of tax revenue capacity is the sum of business rates and council tax revenue capacity.

Council tax revenue capacity

Councils have (some) discretion over the council tax rates they charge. As a result, council tax rates vary significantly across England. A significant proportion of the variation in council tax revenues therefore reflects differences in council tax rates as opposed to differences in council tax bases. To calculate our measure of council tax revenue capacity, we therefore apply the national average council tax rate to each council area's council tax base ('Taxbase for tax setting purposes, Band D equivalents', from the Chartered Institute of Public Finance and Accountancy, 'Finance and General Estimates: 2006-07 to 2015-16', 2016, <https://www.cipfastats.net/general/financegeneral/>).

The average council tax rate applied excludes that raised via parish precepts and for fire and police services. To do this, in areas where the county (or unitary authority) council is responsible for fire, we subtract the average amount in council tax charged by separate fire authorities in areas where they exist, before including the county in our calculation of average council tax rates. We make some further adjustments for the sake of consistency when examining changes over time. In particular, when examining changes in revenue capacity over time, we add back reductions in councils' tax bases as a result of their council tax reduction schemes (which pay council tax bills for those with low incomes) for years between 2013–14 and 2015–16. This is to make figures consistent with the prior period before the localisation of these schemes. However, when examining the level of council tax revenue capacity in 2015–16, we do not make this adjustment.

Business rates base and revenue data

Unlike council tax, the level of business rates is set nationally, so there is no variation in tax rates across councils. We therefore use actual business rates revenues in each area as the basis for our measure of business rates revenue capacity. Revenue data come from 'NNDR3 local authority data: 2006 to 2007 – 2013 to 2014' (available at <https://www.gov.uk/government/statistical-data-sets/national-non-domestic-rates-local-authority-level-data>).

However, several adjustments are made to reported business rates revenues to make the data more comparable across councils and over time.

First, councils have scope to offer discretionary reliefs on top of those mandated by central government, which on average amount to 0.2% of pre-relief revenues. We add back the value of these reliefs so that our revenues capture the underlying revenue capacity.

Second, we estimate and strip out the effect of changes to the empty properties relief and small business relief schemes. We do this because under the BRRS, councils are compensated for changes in their business rates income that result from policy changes made by central government.

Third, we strip out the estimated effects of the 2010 revaluation of non-domestic properties. We do this so that our analysis captures changes in the underlying quantity and quality of non-domestic property, rather than changes in valuations, which are stripped out of the business rates revenues retained under the BRRS.

Fourth, we strip out the effects of transitional relief, as these are also stripped out of the business rates revenues retained under the BRRS.

Full information is available from the authors on request.

DCLG assessed spending needs

The formula used by the Department for Communities and Local Government (DCLG) to assess spending need was updated over time. In order to focus on changes in spending need using a fixed definition of need, we reconstruct the spending needs assessment using the formula from 2006–07 and input data for subsequent years. The necessary information was provided directly by the DCLG.

For context, information on the most recent needs assessment is available in Department for Communities and Local Government, ‘Calculation of 2013–14 Formula Funding’, 2013, <http://webarchive.nationalarchives.gov.uk/20140505105851/http://www.localcommunities.gov.uk/finance/1314/CalcFFs.pdf>.

Benefits data

Information on expenditure is taken from <https://www.gov.uk/government/publications/benefit-expenditure-and-caseload-tables-2017>; specifically, ‘Benefit expenditure by country and region 1996/7 to 2016/17’.

Caseloads are calculated as the average of quarterly data from 2016 and 2017 using information from DWP Stat-Xplore (<https://stat-xplore.dwp.gov.uk/webapi/jsf/login.xhtml>) and from NOMIS (<https://www.nomisweb.co.uk/default.asp>).

Continuing Healthcare

Caseload figures from ‘NHS Continuing Healthcare Activity Statistics for England, Quarter 4, 2016–17’, <https://digital.nhs.uk/catalogue/PUB30018>.

Expenditure figure taken from FOI response,
https://www.whatdotheyknow.com/request/chc_fnc_and_agency_expenditure_2_2#incoming-1018695.

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