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Council tax 2021/22 – Understanding the implications of local tax rises on service delivery

Executive summary

Council tax is a key element of the public finances. It is recognisably a visible link between local authorities and the communities to whom they are accountable. However, there is a complexity surrounding council tax that is often overlooked. Firstly, it combines separate charges called precepts, and secondly increases are decided locally. When the spending review announced that council core spending power would increase by 4.5% for 2021/22 government based this on the assumption that all councils would increase council tax up to the referendum limit of 4.99%.

Faced with the reality of placing such a high above-inflation rise on their taxpayers, many councils have decided not to increase council tax by the maximum and we see an average rise in England and Wales of band D council tax of 4.3%.

We estimate that this will result in a shortfall of around £217m[1] against the spending power that the government assumed in the 2020 spending review. This shortfall will need to be managed locally and while the approach may differ across the country, in all cases hard decisions will be needed about services being provided.

Economic context

Despite the fiscal stimulus announced by the chancellor in the Budget, amounting to nearly 3% of GDP in net giveaways, the near-term support belies a fundamental weakness in how public services are funded. Taxation is the primary means by which governments raise revenue to deliver services ranging from health and social care to schools, transportation and town planning, but the incidence of these costs increasingly bears little relation to the ability to pay and by whom. Despite projections by the Office for Budget Responsibility (OBR) that GDP will return to its pre-COVID level by mid-2022, scarring to the economy may result in a smaller tax base in the medium to longer-term.

Another important aspect of tax policy is the redistribution of resources from rich to poor. While progressive taxes such as income tax and national insurance help to reduce inequalities exacerbated by the pandemic, council tax does not. The latter, based on 1991 house prices that have not been revalued since, is distortionary and regressive.

In his review on reforming the UK tax system, James Mirrlees promoted the ideas of neutrality, simplicity and stability. Yet since its introduction nearly 30 years ago, the average annual rate of increase in council tax has been more than double that of inflation. Meanwhile, the high variability of council tax paid both within and across geographic regions has meant that households in similar circumstances may face considerably different outcomes regarding their liabilities.

The government's strategy to level-up the country will be difficult to administer, let alone monitor, under such a flawed system. Wider funding reforms will hopefully be addressed in the fair funding review later this year.

[1] 0.7% of £31bn council tax requirement recognising difference in precepts.

Local government funding background

At the onset of the COVID-19 pandemic and the national lockdown, the necessary public sector response was led by local government.

Central government has now provided over £7.2bn of additional expenditure funding for local authorities.[2] But as local government income has decreased the accompanying rise in demand for services has created a funding imbalance not just for 2020/21 but for 2021/22.

This disparity of funding to support local services is not solely because of the pressures of the last 12 months. Local government has been underfunded over many years and this has led to an increasing reliance on council tax, which raises over £30bn per year.

In 2016/17, the first year of the introduction of the adult social care precept, Band D council tax was £1,530. By 2021/22 the average band D council tax has risen to £1,884.[3] This is an increase of 23% against what would have been a 9%[4] rise to £1,666 had it kept pace with inflation.

The social care precept was introduced in response to the need for additional funding for social care and the money raised by this precept can only be spent on this service area. However, council tax rises are not only attributed to this element.

Council tax is not local government's only income; it is also funded through other sources such as government grants, business rates, sales fees and charges and can use reserves to fund day to day expenditure. Additionally, the usually strict rules around the funding of revenue expenditure have been relaxed for several authorities. But this combination still does not provide sustainable long-term funding.

Funding gap across councils

On 4 February 2021, MHCLG published the final local government finance settlement for 2021/22.[5] This included the 'council tax requirement' for each local authority in that year. The council tax requirement represents an estimate of the amount of council tax that could be raised by a local authority. This is different from the actual amount that will be raised.

MHCLG's assessment of the council tax requirement of £31bn was based on assumptions around the level of increase and the tax base growth. This, combined with other funding streams, resulted in the 4.5% increase in core spending power.

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[2] www.gov.uk/government/publications/covid-19-emergency-funding-for-local-government/covid-19-funding-for-local-government-in-2021-22-consultative-policy-paper
[3] England and Wales
[4] www.ons.gov.uk/economy/inflationandpriceindices/timeseries/l55o/mm23
[5] www.gov.uk/government/publications/core-spending-power-final-local-government-finance-settlement-2021-to-2022

The findings from the CIPFA survey indicate that councils did not choose to increase council tax by this assumed figure. The data from the CIPFA council tax survey estimates that the council tax increases are lower than assumed and this will create a funding gap of approximately £217m.

This shortfall arises because the spending review assumed that all councils would increase their council tax by the maximum allowed. In 2021/22 these maximums were 1.99% for council tax and 2.99% for the adult social care precept[6]. Councils that increase council tax by less than this amount are facing a funding gap that they need to manage. The reality of increases will vary according to the circumstances of each authority.

The adverse consequences of a post-COVID council tax rise of 4.99 % on council taxpayers in 2021/22, many of whom will be in a challenging financial position, has been noted by commentators as a concern and this no doubt will have been a factor in local decisions. Because of decisions made across the England and Wales, band D council tax has increased on average by 4.3%.

A local picture of council tax

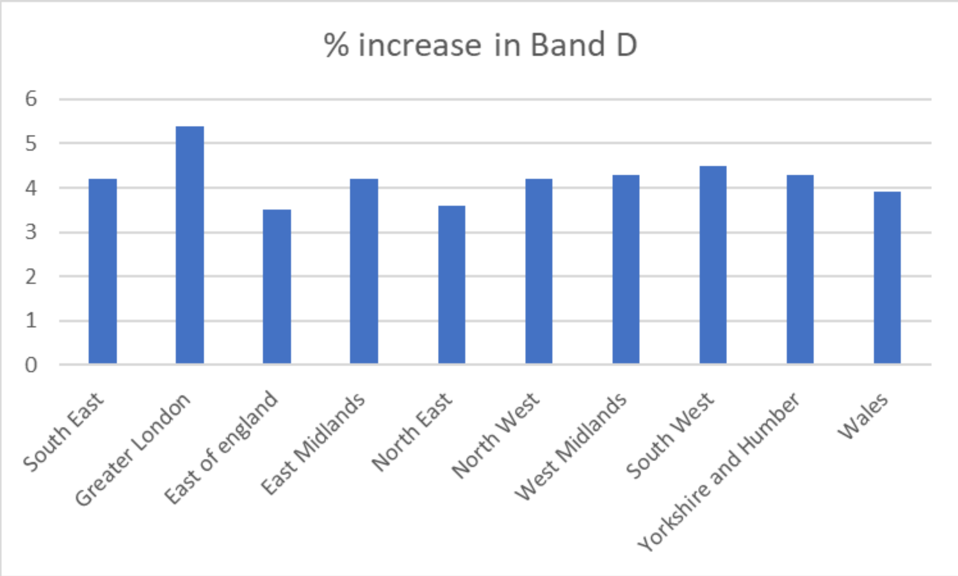
For the first time we see two regions that have average band D council tax of over £2,000 per year. The regions impacted are geographically diverse: the Northeast and the Southwest.

While no council's band D properties are set to rise by over £100 per year, increases of £89 will be seen in bills for outer London.

The table below shows the different percentage increases in council tax across the regions in England and Wales.[7] The lowest percentage increases are in the East of England at 3.5% or £64. The Northeast follows with an increase of 3.6%. The starting point for council tax is different across the country so lower increases in council tax may still lead to higher council tax charges in absolute terms.

For example, even though the council tax rise in the Northeast was 1.8% less than Greater London, taxpayers in the Northeast are still paying more on average than taxpayers in Greater London.

[6] There are exceptions under referendum principles.
[7] Council tax in Wales has no social care precept.



Across England there is also a difference in the increases to band D council tax properties according to the type of local authority. Again Greater London councils increased council tax by the highest amount: 5.4%[8]. In contrast, non-metropolitan authorities increased by an average of 3.8%.

While not all councils provide social care, an element of every council tax bill in England contains a charge for this service. In the Northwest where council tax increased by £78, £40.87 was for the adult social care percept. For the rest of England increases ranged between £34 to £39.

While this social care funding is welcome, there are significant issues with funding raised through a council tax precept. Perhaps the most significant is that it divorces the discussion on need from ability to raise income. A long-term solution is needed and progress has been worryingly slow.

Potential solutions to bridging the funding gap

This funding gap will need to be addressed alongside the other pressures being faced by local authorities. Chief finance officers in discussion with service leaders and stakeholders will have proposed a series of options for members to consider, in line with the agreed strategic direction. Where possible these are often designed to protect frontline services but as there is a legal obligation to deliver statutory services this may not be achievable.

While there is no one solution to bridging the gap, the potential approaches will fit into one of seven areas and may well require a blended approach supported by strong financial management.

1.Service improvement efficiencies and transformation

This includes a broad spectrum of initiatives. At one end small efficiencies can make a significant difference. At the other, broader scale transformation can take advantage of new approaches including digital delivery in the post-COVID world. These new approaches will need to sit alongside

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[8] The 4.99% referendum level does not include precepts such as police, fire, parishes etc, therefore council tax can rise beyond 4.99 when these are all combined.

the more traditional opportunities offered through contract renegotiation, debt recovery, improved contract monitoring and robust procurement policies.

2. Commissioning and partnerships

There may be an opportunity to develop further partnership models and make more effective use of commissioning. COVID-19 has seen the public sector work very effectively with both private and voluntary organisations strengthening this approach. Developing government policy such as community asset purchase may provide additional opportunities.

3. Reduction in service

This would be the least attractive way of bridging a gap in spending as it has a direct impact on local services. Careful consideration would need to surround this approach and any case would need to be based on sound evidence often supported through consultation.

The capacity to effectively deliver a programme of cuts is an important consideration when looking at the sustainability of the budget position.

4. Accounting flexibilities

Councils have recently asked for capitalisation directions from central government. This is a flexibility that allows capital funds to be used for revenue expenditure. While this and other approaches can provide short-term respite it does not solve the longer-term issues of a spending gap.

5. Increased revenue from sales, fees and charges

While this is not a significant figure for some authorities, it is especially important to district authorities. It may be possible to explore several areas dependent on authority type including charges around the transport agenda or those associated with adult social care.

6. Grant maximisation

Several grants available to local government require bids to be secured. This has been accompanied by a reduction in formula grant funding, which does not require individual bids. All authorities will need to ensure that they maximise their access to all grant funding while recognising that the conditions attached to this extra money will come with conditions.

7. Prevention

It may seem counter-intuitive, but money spent on prevention is money that will reduce the spending gap. The challenge is that this type of spend is at high risk during a period of cost cutting. While preventative spend is often identified as effective value for money the outcomes are often difficult to evaluate and therefore any business cases must contain effective evidence and sound outcome-based criteria.

Conclusion

Council tax has increased in 2021/22 as it has done every year since 2010/11. However, it will never be sufficient to cover local authority funding gaps and assumptions on core spending power linked to tax rises amplify this gap. The increases highlight the reliance on this form of taxation and shine a spotlight on its shortcomings. While it has positive features as an effective tax it is fundamentally regressive and does not relate to ability to pay emphasised by the regional variations.

As can be seen from the findings of the CIPFA council tax survey there is a great disparity in council tax across the country and this divergence is set to continue if the percentage increase approach continues to be championed by central government. The relationship between the ability to raise income and service need will continue to diminish.

Council tax needs to be reformed and this conversation needs to reflect the total local government funding landscape. This conversation needs cross party-political support as no short fix can be found. A road map is needed and must start this year.