




In The Balance

Granting local authorities new financial flexibilities to cope with the downturn

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New Local Government Network (NLGN) is an independent think tank that seeks to transform public services, revitalise local political leadership and empower local communities. NLGN is publishing this report as part of its programme of research and innovative policy projects, which we hope will be of use to policy makers and practitioners. The views expressed are however those of the authors and not necessarily those of NLGN.

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Introduction

The prospects for the worldwide economy in 2009 will have significant and differing ramifications for local communities across the country – yet there is a total reliance on central government as the lead agency to take counter-cyclical measures. In a country as centralised as the UK it makes sense that the Chancellor of the Exchequer, in concert with the Bank of England, should spearhead the strategy to counteract the worst impact of the downturn. Some projections suggest that the economy may shrink by around 3% in 2009, with unemployment already topping two million at the beginning of this financial year. Fiscal and monetary policy are the primary vehicles through which businesses and residents can see their income and expenditure plans eased throughout this period. But should there be a new role for local government to supplement the broader strategy pursued by the centre?

In this short paper we suggest the following:

- The current financial and legal constraints placed on local authorities – who are the largest employers in some communities – may create more harm than benefit, especially at a time when precisely targeted local interventions to help specific employers, workforces or neighbourhoods may be required.
- The current maturity in local authority financial competence should allow the budgetary rules to be revisited and refreshed, suggesting a **multi-year balancing framework** may now be a reform whose time has come.
- With the Budget suggesting great volatility in government grant to local authorities in future years, we argue that multi-year balancing may be a necessary tool to avert waste and facilitate smoother planning, avoiding service quality ‘shocks’.

Rules, balanced budgets and the current dilemma

Councils have been required to match their expenditure to their income for a very long time, arguably since the 1880s and certainly throughout the period when the rating system and poll tax were in place. Section 32 of the Local Government Finance Act 1992 sets out the requirement for local authorities to balance their budgets in each separate year, aggregating the expenditure they estimate will take place against the income they project and calculating their budget requirement as the difference between these sums. Precepting authorities have a similar requirement under section 43 of the same Act. 'In-year' balancing is a fundamental tenet of local government finance at present, a function not only of the statutory parameters in which councils have been allowed to exist by Parliament, but also provisions used as a safeguard against irregularities and abuses.

The political pressures on governments to rein in 'basketcase' authorities in the 1970s and 1980s led to a series of strictures reiterated in legislation as late as the mid 1990s. However, the inspection and improvement agenda implemented by Ministers over the past twelve years has seen a gradual transformation in the character and capability of local authorities, bodies which have matured and earned significant new autonomy, freedoms and flexibilities. These included new latitude on capital borrowing powers in the 2000 Local Government Act which freed councils of the requirement to seek credit approval for borrowings, as long as certain criteria concerning guaranteed income streams to cover repayment terms and synergy with national economic policies were met.

Today, while cynical perceptions still remain about local councils based on out-of-date prejudices, the truth is that local authorities are fiscally competent, actuarially shrewd and business-minded institutions displaying vastly improved internal management systems suggesting they lead the field when compared with most other public bodies. Evidence of local government achieving its 3% annual efficiency targets year after year while other corners of the public sector have fallen short illustrates the ability of local democratic

leadership – supported by the performance assessment and improvement framework – to deliver results. The progression which local government has made now means a new suite of freedoms and flexibilities should be awarded by Whitehall. New moves towards a negotiated relationship of ‘equals’, which the Local Area Agreement and Multi Area Agreement era point towards, also mean that a fundamental reassessment of the strictures in which councils operate should take place.

Reserves policy – contingency .vs. strategy

As local authority financial capabilities have matured, the attitude taken by many local authorities to their budgeting strategy has begun to develop. The advent of the CIPFA Prudential Code and other practices encouraged by Government have transformed budgeting policies in many councils, and although the in-year budget balance requirement is a stricture to which councils adhere, latitude and flexibility has been gradually introduced. The days when local authorities went on a ‘Mad March Spend’ – faced with a surfeit of income and a need to divest the money on any viable programmes that might be passing before the year end – have died out. This is largely thanks to practices, adopted by a growing number of councils, where around 2% of the budget can be carried over between years where certain strict criteria are applied. Nevertheless, this carry-forward arrangement is typically a function of cash flow rather, than a deliberate choice of policy and programming. Perhaps the time has come to build on this tentative step forward and allow the use of reserves for more strategic purposes.

The reserves that local authorities have posted over the years, largely thanks to a rule-of-thumb 5% requirement, have accrued to over £30 billion today, according to recent Treasury figures. These reserves are primarily used for contingency purposes, in particular as a buffer against recurring costs that may be less predictable or uncertain. However, to only view reserves through this ‘cashflow and contingency’ prism may be to miss a more strategic opportunity that exists.

Some local authority Finance Directors are beginning to query the logic of a routine 5% reserves posting. If a council needs to call on its reserves for emergency reasons, but is then ‘required’ to immediately replenish that sum in the following financial year, it brings into question the whole purpose of having reserves at all. In some ways, the current operation of reserves policy can feel driven more by legal and accounting practice than by a strategic approach to medium term policy and management. There is now an opportunity to extend further the flexibilities offered by reserves management in order to achieve broader goals, for instance, the avoidance of council tax shocks, or the maintenance of vital service programmes between years.

The local dimension of a new economic policy

The current dilemma facing the Government is this: when the national administration is able to run a budget deficit in order to finance prudent investment over the economic cycle in ordinary times – never mind able to run an extraordinary deficit to facilitate a fiscal stimulus during the exceptional period of the current downturn – is it right that local administrations should be forced to trim their expenditure in-year to meet what may be temporarily reduced income levels?

If local councils believe they have no option but to match their in-year expenditure with their income, then recession-induced financial shortages, for example through lower planning fee and charge yields, will result in an increasing number of redundancies. Should councils be forced to make people redundant and compound the recessionary impact on unemployment at a time when the public sector should learn the lessons of Keynes and counteract the economic cycle with a boost in activity, rather than exacerbating the contraction? Viewed from a different perspective, should councils be forced to raise their council tax at times of resident hardship (or be prevented from offering a one-off council tax discount) because they are legally obliged to match their income to local expenditure in-year?

The Government have recently taken steps to place a broad economic ‘place-shaping’ responsibility on the shoulders of local authorities, with a new duty to assess conditions for economic development and a series of governance changes encouraging sub-regional clustering around Economic Prosperity Boards. Yet the ability of local government to show a catalysing lead in new infrastructure development, to forge new partnerships with business or to provide support to local firms requiring assistance is in many cases dependent on the resource profile available to local councillors. Council tax revenues and income from fees and charges are the only remaining sources of significant income authorities can affect, representing barely 20 per cent of total income. Grant income sees authorities now very dependent on the Treasury – but the advent of the three year spending settlement means councils have greater predictability in the monies they will have at their disposal.

The importance of the three year Spending Review period

Although councils have enjoyed slightly greater certainty with the three year time horizon on settlements, the ability to manage programmes beyond a single year has been growing slowly – as all projects and departments in local authorities know that the annual budget round could jeopardise their plans. The importance of moving beyond this annual caution has been reflected in recent years, with CLG heralding the first commitment to a three year settlement announced at the end of 2007, setting out plans for increases of 4%, then 4.4% and finally 4.3% in financial year 2010/11 – taking total grant allocation to over £76 billion. This announcement was welcomed as providing “stability and predictability” for local authorities.

It may seem obvious, but the ability to manage beyond the short term has started to transform attitudes to both local public policy and the delivery cycle on the ground. Environmental programmes rolling out carbon reduction strategies can now be phased over several years with greater certainty, ensuring that a longer term approach can be taken. Local authorities have been able in some cases to pass on their three year certainty to the voluntary sector who in turn receive their income from councils. And Local Strategic Partnerships have had further insight into the forward plans of their local councils, who in turn can apply pressure on other corners of the local public sector to commit to more ambitious new activities spanning the medium term.

Recent rumours that the Treasury sought to re-open the three year Spending Review commitments were worrying and if true would have jeopardised the management steps forward made in the past two years. Reverting to the annual cycle would see a retreat in forward planning and a shying away from partnering on a longer term basis because of the uncertainties and risks involved. Punishing public service managers who have been brave enough to pool budgets, give longer term commitments mutually or who have torn down ring-fenced pots of money would be extremely unfortunate. In the end, it appeared that common sense won the day and CLG Ministers were able to

maintain their crucial commitment to a three year spending round. This was an important victory, even if no-one was aware of the looming threat.

The postponement of the next three year Comprehensive Spending Review process due in 2009 signals that the era of benign growth in grant finance is over. The Budget announced that from 2011/12 overall public expenditure would grow by only 0.7% in total. When 'priority' departments such as the Department of Health and DCSF have had their lion share of this, we can easily expect a negative settlement effect on growth for local government grants in 2011/12, perhaps of the order of -2% or -3%. The Chancellor's announcement foretells a significant cliff-edge problem for councils when compared to the final 'golden' year of 2010/11. **If councils do not manage their budgets over a multi-year framework, then the immediate decrease in available resource between these two years will be stark and painful.** All the more important, therefore, for councils to be able to smooth their plans over at least a three-year spending period.

A new three year statutory financial balance requirement

Councils need to urgently face up to the impending volatility of grant settlements, and Ministers need to extend management freedoms for local government, implementing a new accounting approach to local authority finances. If the accounting rules allowed authorities to balance their books over a three year cycle, in tandem with the three year settlement for central grant, then a number of new policy choices will become available to local councillors – and at no extra cost over the medium term to the taxpayer. Ultimately such a move would require a new level of trust between the centre and local government, but the need for good faith and gestures of trust may well be greater than ever.

A simple amendment to the current Local Government Bill finding its way through Parliament at present could facilitate this change. Although local authorities do have the ability to post resources to their reserves in years where their income exceeds expenditure plans, as we know, these reserves are treated as a resource for urgent or extenuating times rather than as part of an active business planning cycle for policy managers. Sending an explicit signal to chief executives and leaders that the Government expects greater latitude in approaches to medium term policy commitments could deliver the following:

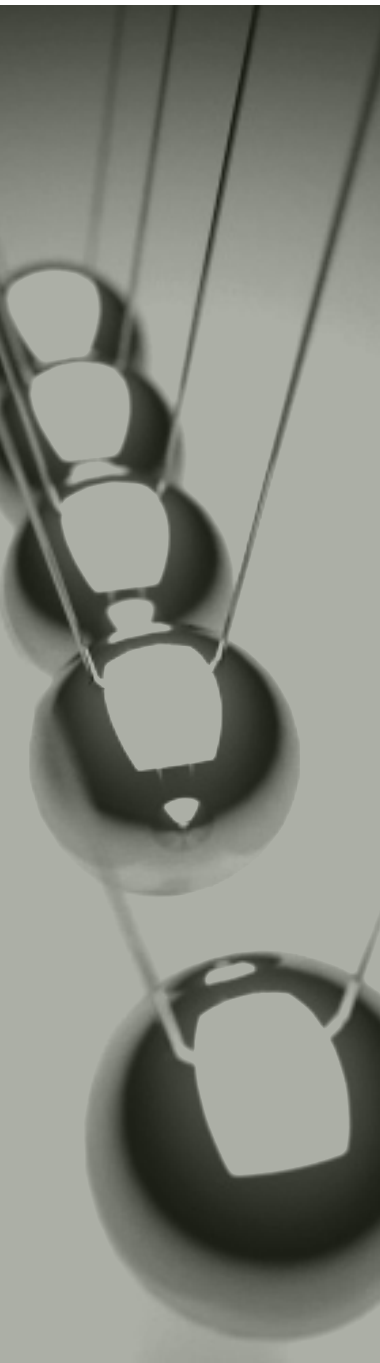
- The ability to give residents council tax discounts in a particularly difficult economic year.
- The ability to retain staff, facilities and programmes which would otherwise face termination because of the in-year balance requirement.
- The ability for councils to take advantage of circumstances when their income growth exceeds expectations and facilitate a 'dividend' to service users or taxpayers in future years.
- The ability to challenge the Police, JobCentrePlus, Primary Care Trusts and others to commit jointly to new programmes beyond core service provision and over the medium term.

Were it the case that the Chancellor of the Exchequer had no option but to match its national spending plans with the revenues and receipts generated in one particular year, the Government would find its ability to manage public policy in chaos. Yet although Whitehall has the ability to manage its budgeting over a long time frame – and in the current circumstances we see that the Government is aiming to return to fiscal balance in seven years time – local authorities have to abide by the firmer strictures of an in-year balance.

When Ministers want to see local authorities play a new role in shaping their local economy but are perplexed and frustrated at the sluggishness of the sector to respond, it is in part because of the current in-year accounting approach.

Nobody would argue that we should sacrifice the hard-won achievements of local government prudence and sound finance, and there should be no return to reckless budgeting or open-ending spending inflation. A *statutory* requirement to balance over three years would ensure that section 151 officers and Directors of Finance take all legal steps necessary to deliver sound budgets, but planned over a different, longer time frame.

The announcement in the Budget of a ‘Total Jobs Fund’ of around £1 billion is extremely welcome, with some estimates that around 700 meaningful jobs could be created in each upper-tier local authority area as a result. Yet at the same time, local councils are making redundancies and adding similar numbers to local jobless totals. Rather than perpetuate this oddity of public sector management, allowing councils greater latitude in budgeting and with reserves policy could transform their impact on the local economy and avert service reductions in the years ahead. The benefits are clear and there could be no time more in need of these new flexibilities than now.



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But should there be a new role for local government to supplement the broader strategy pursued by the centre?

In this short paper we argue that multi-year budget balancing is a reform whose time has come, helping councils counteract the downturn and cope with a volatile grant settlement over the years ahead.