

Leicester  
City Council

Finance, Resources and Equal  
Opportunities Scrutiny Committee  
Cabinet

04 July 2002

15 July 2002

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## Revenue Grant Distribution Review – A Fair Deal for Leicester

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### Report of the Chief Financial Officer

#### 1. PURPOSE OF THE REPORT

- 1.1 The purpose of this report is to outline the progress to date of the Revenue Grant Distribution Review (RGDR) and to highlight the concerns the Council has about the possible outcomes of the Review. It also seeks support for a lobbying strategy that aims to address these concerns.

#### 2. BACKGROUND

- 2.1 The RGDR was launched just after the Local Government Finance Green Paper in 2000 with the aim of replacing the Standard Spending Assessment (SSA) with a new revenue grant distribution mechanism from 2003/04. It is now finally drawing to a conclusion, and reports setting out options for change are currently being prepared by civil servants for local government and education ministers. A public consultation process will begin in late summer.
- 2.2 The Review is highly significant – 80% of Leicester's revenue funding comes directly from the Government. Leicester has received the lowest cumulative SSA increase of all similar authorities since 1996/97: had we received only an average increase our current SSA would be £22 million higher. This would mean an extra £22 million to spend on services or £300 less council tax on a band D property in Leicester.
- 2.3 The Council needs a reversal of this decline in its financial fortunes. There is an opportunity for this to happen through the Review, but there is also a significant risk that the Review could merely extend (or worsen) the current funding inequities.
- 2.4 Unfortunately, much of the detail has still to be decided, and so at this point it is impossible to say whether any authority will be better or worse off under the new system. However, despite the lack of detail, there are four very important, high-level issues that we are concerned about:

- 2.4.1 Area Cost Adjustment – we will argue that the current mechanism over-compensates authorities in London and the South-East for their additional staff costs, and should be changed to compensate only the actual additional costs of these authorities. Doing this would release funds into the system and could increase Leicester’s education funding by up to £4 million.
- 2.4.2 Deprivation Funding – this needs to be protected (if not increased) within mainstream local government funding. Leicester receives a significant amount of funding in respect of deprivation. It is estimated that Leicester could lose over £5 million per annum if a simpler system, with inadequate deprivation funding, is introduced.
- 2.4.3 Ethnicity Funding – Leicester receives £13 million per annum in respect of its culturally diverse community. It is therefore crucial that this is maintained at least at its current level in order to enable proper investment in culturally sensitive services and to ensure that Leicester continues to build upon its international reputation for racial harmony.
- 2.4.4 Persons From Abroad – new funding streams for the additional education and social services costs associated with the recent arrival of EU-citizens to Leicester are essential.

#### Putting our case

- 2.5 The City Council is an ambitious local authority that has many of the socio-economic problems associated with large cities. In order to provide good quality services to the public, and to invest in priorities for improvement, the Council requires adequate funding. If the Government’s review of funding results in a poor outcome for Leicester it will affect the Council, its taxpayers and its service users for years to come.
- 2.6 It is therefore vital that Leicester continues to make its case to ensure that it receives a “fair deal” from the new system. The Council will continue to press the Government for a fair share of resources and will seek the support of local MPs, head teachers and the special interest groups to which it belongs in order to get the message across to Government.

### **3. RECOMMENDATION**

- 3.1 Finance, Resources and Equal Opportunities Scrutiny Committee and Cabinet are recommended to:-
- (i) note the City Council’s concerns relating to the Revenue Grant Distribution Review.
  - (ii) support lobbying efforts to secure a “fair deal” for Leicester.

### **4. FINANCIAL and LEGAL IMPLICATIONS**

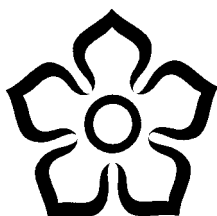
- 4.1 This report is concerned solely with financial issues.

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**CHIEF FINANCIAL OFFICER**



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#### SUPPORTING INFORMATION

#### 1. Purpose of the Report

- 1.1 The purpose of this report is to provide detailed information on the progress to date of the Government's Revenue Grant Distribution Review (RGDR) and to highlight the concerns that the Council has about the Review's possible outcomes. The report also provides information on the work so far undertaken by the Council in its efforts to address these concerns.
- 1.2 Members should note that this report refers in the main to events occurring before the resignation of Stephen Byers. At present we do not believe that the Secretary of State's resignation will materially affect the course of the RGDR. References to DTLR, however, should now be taken as references to the new Office of the Deputy Prime Minister.

#### 2. Background

##### The SSA system

- 2.1 Standard Spending Assessment (SSA) is the Government's assessment of each local authority's need to spend relative to other authorities and is the prime driver in the calculation of Revenue Support Grant (RSG). The Government determines the amount it expects each authority to raise from its own resources: this is known as Council Tax at Standard Spend (CTSS); and the Government pays RSG to meet the difference between SSA and CTSS. The overall effect is that, if every local authority spent at SSA, all other things being equal, council tax levels would be the same everywhere in the country. Any spending in excess of SSA is met entirely from council tax. Effectively, every £1 of additional SSA results in £1 of additional RSG.
- 2.2 The SSA distributes a fixed amount between all authorities, which results in a "zero sum gain" from any changes (i.e. if one authority's share increases another will fall). The total SSA is made up of 6 service blocks:

- (i) Education
- (ii) Personal Social Services
- (iii) Highways
- (iv) Fire
- (v) Environmental, Protective and Cultural Service
- (vi) Capital Finance

- 2.3 These service blocks are in turn made up of various sub-blocks. Each sub-block is derived by multiplying client data, such as population and pupils, by a standard amount that is then increased by various “add-ons” to reflect factors such as deprivation.
- 2.4 The weightings attached to each indicator are derived from historical spending patterns that are calculated through a complex statistical technique known as regression analysis.
- 2.5 The SSA has been subject to much criticism in the past. Criticisms include:
- the historic spending patterns are no longer relevant (and at the time were skewed by rate capping requirements);
  - much of the data driving the formulae are census-derived and therefore insensitive to annual changes in a local authority’s circumstances;
  - changes in one authority’s data can have an effect on another authority’s settlement (creating a lack of predictability from one year to the next).
- 2.6 Recently, however, this major drawback (lack of predictability and stability) has been mitigated to some extent. This is due to the Government’s freeze on changes to SSA methodology while the Review was taking place, and also to the introduction of grant ‘floors’ and ‘ceilings’ which ensure that no authority’s grant changes radically from year to year. Leicester benefited from a grant floor payment in both the 2001/02 and 2002/03 settlements.
- 2.7 However, among all other comparable authorities, Leicester has received the lowest cumulative increase in SSA since 1996/97. Had we received only an average increase since that time our current SSA would be £22 million higher; alternatively, our band D council tax would be £300 lower.
- 2.8 The Government announced its intention to review the current system of local authority funding in the 1998 White Paper “Modern Local Government – In Touch With The People”. The aim of such a review was to introduce an alternative system to the current Standard Spending Assessment (SSA), since the technical drawbacks of the SSA (namely, reliance on both out-of-date expenditure data and complex statistical processes) were well-known.
- 2.9 The publication of the 2000 Green Paper “Modernising Local Government Finance” showed the results of the debate so far. The debate had taken place at the level of principle rather than detail, and the Green Paper reflected this, stating that a good finance system should basically be fair and intelligible, with a degree of year-on-year stability. On the basis of these principles two working groups were set up with the aim of developing a range of funding system options, which ministers could consider in time

for implementation in 2003/04. These groups, which comprise civil servants, local government experts and other interested parties, are:-

- The Education Funding Strategy Group (EFSG), responsible for Education funding, and accountable jointly to the Secretaries of State for Transport, Local Government and the Regions, and Education.
- The Formula Review Group, responsible for all non-Education funding, and accountable to the Secretary of State for Transport, Local Government and the Regions.

2.10 Both groups are now in the process of drawing their research together in the form of a 'draft final' report for ministers. Ministers will consider these reports before final reports are issued for consultation at some point before September.

### The New System

2.11 In broad terms, it is clear that the new system is likely to be similar to the current system in that it will be formula-based, with a basic amount of grant per client, together with top-ups for deprivation and for geographical areas with high costs (London and the South East). The formulae will be derived through a mixture of regression analysis, other costing exercises and ministerial judgement. The system will also continue to be supported by grant 'floors and ceilings'.

2.12 There is slightly more clarity in relation to education funding. DfES has already made clear that future education funding will be split between a schools block and an LEA block. The aim is to provide greater transparency between funds provided for schools' functions and funds provided for central functions. The schools block will be based on a pupil-driven formula with enhancements for 'additional educational need' (AEN) and area costs.

2.13 Unfortunately, within this broad outline, specific illustrations of the effect of the new system are not possible since these depend heavily on factors to be determined either by research not yet concluded or by ministerial judgement. Given this high level of uncertainty, Leicester is very concerned that the final outcome of the Review could be detrimental. 80% of the Council's revenue funding arrives via the Government's grant distribution formulae, which makes the authority highly sensitive to change.

## **3. Key Concerns**

3.1 In general, there are four areas of concern where it is suggested the Council should continue to make its case to the Government in order to protect or, in some cases, enhance its position.

3.2 These areas are:

- Area Cost Adjustment
- Deprivation
- Ethnicity
- Persons from Abroad

## **4. Area Cost Adjustment**

- 4.1 The ACA is the mechanism that supports the higher costs (principally pay) experienced by authorities in London and the South-East. It is currently based on a “General Labour Market (GLM)” approach, by which regional pay differentials are calculated from the average earnings of all inhabitants of an area. This can be contrasted with a “specific cost approach”, which would compensate higher cost authorities only for the additional amounts they demonstrably incurred (i.e. earnings of local government employees).
- 4.2 Whilst there is broad agreement that there is a need in principle for an adjustment for area costs, it is believed that the calculation needs reviewing because it *over-compensates* ACA authorities for the actual additional costs they incur. Many other authorities share this view, especially after a late adjustment to the 2002/03 ACA - relating to 350 high-earners in the finance and media sectors who had been inadvertently omitted from draft figures - resulted in large losses for non-London authorities. The effect on Leicester was a £1.7 million loss in grant. These high earners clearly do not compete for jobs in the local government sector and should therefore be excluded from the ACA calculation. Such a feature of the current system demonstrates its illegitimacy in distributing large sums of money to local authorities. Approximately £3.3bn (7% of total SSA) is distributed in respect of the ACA.
- 4.3 A paper prepared by Coventry City Council in March highlighted the effect of this over-compensation for ACA authorities. This paper showed that only 40% of the additional education resources received by the ACA authorities actually funds additional staff costs; the remaining 60% is used to hold down council tax bills (which may explain why London has some of the lowest band D rates in the country).
- 4.4 The DfES has suggested that it could consider a move towards a ‘specific cost approach’ in funding areas where the majority of costs are clearly determined by national pay scales (viz. Education, Police and Fire) and where actual staff costs are thus easier to quantify. This approach is clearly a more robust method of determining an ACA. It is an option that addresses the concerns raised in the Coventry paper, and can be supported. If this approach were implemented, it would greatly benefit Leicester (education funding could increase by up to an estimated £4 million).
- 4.5 The City Council would like to Government to:
- adopt a specific cost approach for funding education.
  - exclude from the GLM approach the high-earners who do not work for local government.

## 5. Deprivation

- 5.1 The Government stated in the Local Government Finance Green Paper that the new funding formulae should be simpler than the current formulae, in order to make them easier for stakeholders to understand. There is nothing wrong with the principle of simplicity. However, there is a danger that this could compromise other aims of the review, such as fairness. Leicester receives approximately one third of its SSA on the basis of indicators of need that are included in the current SSA. While there is no prospect of

this funding being withdrawn in its entirety, any reduction of the funding distributed by means of these indicators will impact adversely on Leicester.

- 5.2 A DTLR paper presented to the Formula Review Group in February illustrated the possible effect of such simplification. This paper presented the outcome of a simpler formula that could replicate local authorities' funding to within 2% of the existing SSA, indicating that a 2% variation "was within acceptable limits". It is impossible to say how Leicester fared in this academic exercise since no individual results were published. However, for illustration, a 2% reduction in SSA would equate to loss of £5.6 million for Leicester (or a £75 increase in Leicester's band D council tax). This is a clear case of the principle of simplicity undermining the conditions of fairness.
- 5.3 DTLR has intimated that simplification may occur only at the level of presentation, and that the underlying formulae may continue to adequately capture authorities' differing circumstances. Such a proposal is attractive.
- 5.4 It should be noted that the recently introduced Neighbourhood Renewal Fund cannot be considered an adequate alternative to mainstream deprivation funding, because of the limited size of the pot and the fact that it is not guaranteed beyond 2003/04.
- 5.8 The City Council would like the Government to:
- Take proper account of the additional spending needs of authorities with higher levels of deprivation; and
  - ensure that the amount of resources distributed with regard to deprivation in the new system is at least the same as is currently distributed.

## 6. Ethnicity

- 6.1 Leicester receives significant additional funding to support its culturally diverse population (more, proportionately, than does any authority outside London). For 2002/03 Leicester received the following allocation in respect of ethnicity in the SSA:

Education	£9.1 million
Personal Social Services	£1.0 million
Environmental, Protective & Cultural Services	<u>£2.7 million</u>
Total	<u>£12.8 million</u>

- 6.2 Generally, the Government has recognised that high ethnicity is a driver of a local authority's 'need to spend'. However, it has not as yet indicated how much will be distributed on this basis from 2003/04. We are very concerned that the RGDR will reduce the amount of ethnicity funding directed to local authorities at a time when supporting culturally diverse communities requires more investment rather than less (as part of its "simplicity" aims).
- 6.3 It is important to recognise that the nature of the additional cost that cities like Leicester incur in supporting diverse communities is evolving. Government resources have clearly enabled authorities to make much progress in raising the outcomes for culturally diverse populations. This is



particularly the case in education where research has shown that certain ethnic minorities are now attaining very high levels of exam success. However, many ethnic groups still continue to fall further behind. There are also new costs emerging, as the issue of 'community cohesion' becomes increasingly important. Leicester was identified as representing best practise in race relations in the Cantle Report.

- 6.4 There have been numerous papers throughout the review focussing on ethnicity. Significantly, unlike the ACA, no evidence or case has been presented that indicates that the current quantum of resources allocated to ethnicity in the formula is inappropriate. We believe that the present levels of funding are absolutely necessary and should be increased.
- 6.5 It seems likely that education funding will include some measure of ethnicity, which can be welcomed. However, no indication has yet been given of how much is likely to be distributed by this indicator.
- 6.6 In 1999/2000 ethnicity was removed from the Children's Personal Social Services SSA. Leicester's SSA reduced by approximately £3 million as a result. Leicester is a member of High Ethnicity Special Interest Group (HEASIG). HEASIG has provided a case that Social Services funding should be increased in order to recognise the higher incidence and cost of ethnic minority children in care. Similarly, it is very important that ethnicity be recognised as a driver of many of the services covered by the Environmental, Protective and Cultural Services block.
- 6.7 The City Council would like the Government to:
- Ensure that the total quantum of education and EPCS resources distributed on the basis of ethnicity is at least maintained at current levels.
  - Re-introduce an ethnicity indicator to the Children's PSS block to take into account the additional incidence and cost of providing care in high ethnicity areas.

## **7. Persons From Abroad**

- 7.1 The Council will argue its case with the Government for appropriate recognition of the additional costs or recent arrivals of E.U. citizens. Current (and likely future) formulae are not expected to be sufficiently responsive to this need, and we will press the case for additional "targeted" funding.

## **8. Making our Case**

- 8.1 Leicester has been pro-active in the past at arguing its case with the Government for resources and will continue to do so in the future. In 1999/00 the Council successfully lobbied the Government about its finance settlement and as a result secured an additional £1.3 million of grant.
- 8.2 The Council will have a formal opportunity to respond to the Government's proposals which are expected some time between July and September. A further report will be brought back to Cabinet at that time. In the meantime Leicester will continue its lobbying strategy:

- through our 3 local MPs.
- directly to Government ministers and departments.
- through our membership of SIGOMA and HEASIG.

## 9 Background Papers – Local Government Act 1972

*Local Government Finance Settlement 2002/03*: DTLR 28 January 2002.  
*Local Government White Paper “Strong Local Leadership Quality Public Services”*: DTLR December 2001

## 10. OTHER IMPLICATIONS

- 10.1 This report is concerned solely with financial issues. Other implications are shown in the table below:

Other Implications	Yes/No	Paragraph referred
Equal Opportunities	Yes	5,6,7
Elderly/People on low income	No	-
Policy	No	-
Sustainable & Environmental	No	-
Crime & Disorder	No	-
Human Rights Act	No	-

## 11. CONSULTATIONS

All departments have been consulted on this paper.

## 12. OFFICER TO CONTACT

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