

**LOCAL GOVERNMENT FINANCE - FORMULA GRANT DISTRIBUTION
CONSULTATION**

Report of the Finance Director

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Executive Member: David Beatty

1. Purpose of the Report

- 1.1 To agree the County Council's response to the Government's consultation on formula grant distribution.

2. Summary and Conclusions

- 2.1 The areas within the consultation where the County Council could experience the largest potential losses of funding are:
- a. Area Cost Adjustment (worst case option is a reduction in funding of £9.8 million)
 - b. Resource Equalisation (worst case option is a reduction in funding of £12.4 million)
 - c. Education (the worst case option is a reduction in funding of £10.9 million)
 - d. Environmental, Protective and Cultural Services (the worst case option is a reduction of £10.7 million)
- 2.2 The deadline for commenting on the options presented in the consultation document is 30 September 2002.
- 2.3 The key decisions for Cabinet are:
- i) to agree the response for submission before 30 September
 - ii) to agree any further action, including whether to request an audience with the Minister and the future lobbying strategy (the first debate for Members of Parliament is scheduled to take place in the House of Commons on Tuesday 15 October).

3. Background

- 3.1 In 1999 the Government commenced a review of the Revenue Grant Distribution system. This followed the 1998 White Paper *Modern Local Government; In Touch with the People*, when the Government announced its intention to investigate whether there was a better way of determining the distribution of Revenue Support Grant (RSG) which was simpler, stabler and more robust than the present arrangements for Standard Spending Assessments (SSA's). During the period of the review no changes have been made to the SSA methodology.
- 3.2 Three groups were set up to look at alternatives to the present SSA formula, the Formula Review Sub Group, the Education Funding Strategy Group and the Police Allocation Formula Working Group.
- 3.3 A consultation paper on the Formula Grant Distribution was issued on 9 July setting out possible changes to the distribution formulae. This document presents 47 options for changes to the current grant distribution formulae, together with exemplifications of what their impact would be on the 2002/03 SSA for each local authority. There are options for changes relating to each of the SSA service sub-blocks, together with further options covering general cross service issues such as Area Cost Adjustment (ACA), fixed costs, population decline etc.
- 3.4 The new system for distributing general revenue grant will be introduced from 2003/04, when it will replace the current Standard Spending Assessments (SSAs). We do not expect to know the outcome of the consultation until the Provisional Local Government Finance Settlement is announced in late November/early December.
- 3.5 The Government has stated in paper 45 (02) to the Formula Review Sub Group that in designing the new system it will apply the following principles to the formulae:
- They should be based on factual evidence. Past spend should not determine future provision. Instead, where possible, formulae should be developed that are based on evidence about what it costs to provide a service today.
 - They should be simpler, and more intelligible to stakeholders. The number of variables used in the formulae should be reduced, wherever this can be done without introducing serious distortions. The structure of the formulae should be simple and use variables which stakeholders will recognise as plausibly related to the cost of services.
 - They should not create perverse incentives or penalise authorities for improving efficiency.
 - They should use reliable, accurate and updateable data.
 - They should improve stability and inhibit large year on year changes in grant.
- 3.6 This report includes a proposed response at Appendix 1. Further detail on the current system, the proposals and their implications, including the potential gains and losses for the County Council is provided at Appendix 2. If a copy of the full consultation paper is required please contact Mike Woodward in Corporate Finance on 01992 555332.

4. Financial Implications

- 4.1 The potential change in the County Council's funding which could result from this consultation ranges from a loss of £52 million to a gain of £14 million. County Councils as a group could lose up to £800 million from the options presented, with resources being redirected to Metropolitan and Inner London authorities.
- 4.2 The financial impact of each individual option has been exemplified within the consultation paper on the basis of its effect on the 2002/03 Standard Spending Assessment using 2002/03 control totals and 2002/03 data. These figures are detailed in Appendix 2 to this report. Although this provides an indication of the relative impact of each option, the actual figures in the 2003/04 settlement will vary from this as a result of changes to the control totals and the data as well as the combined effect of different options.
- 4.3 The Government has also said that the components of the new system will not necessarily all be drawn from the consultation.

Background information referred to by the authors.

Strong Local Leadership – Quality Public Services: A White Paper, December 2001.

Report of the Revenue Grant Distribution Group, May 2002.

Report of the Education Funding Strategy Group, May 2002.

Local Government Finance Formula Grant Distribution: A Consultation Paper, ODPM, July 2002.

Comprehensive Spending Review 2002: Statement from the Chancellor, 15 July 2002.

Various Research Papers presented to the Formula Review Sub-Group and Education Funding Strategy Group.

DRAFT REPOSE

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Dear Mr Meyler

**LOCAL GOVERNMENT FINANCE - FORMULA GRANT DISTRIBUTION
CONSULTATION**

I am writing in response to the consultation on formula grant distribution.

The Government's promises of additional spending and improved services in the July 2002 Comprehensive Spending Review have increased public expectation that councils will provide improved services and we are very concerned at the impact the new grant distribution system will have on our ability to deliver this. Many of the options show that Hertfordshire County Council could face large reductions in funding, compared to the current position. As a result the authority would have no option but to either make a very large council tax increase in 2003/04 or significant service reductions. This comes on top of the latest comprehensive spending review, which already builds in a significant council tax increase.

We are disappointed that the proposals in the consultation fail to address many of the principles set out for the new system, namely:

- It is not simpler, more intelligible or more transparent than the existing system.
- The new system still relies on past spending. This gives rise to double counting on issues such as deprivation, where top ups have also been included and introduces perverse incentives by rewarding those authorities who have chosen to spend at higher levels in the past and penalising those who, like Hertfordshire County Council, have acted to improve their efficiency.
- Depending on the basket of options implemented it is likely to generate large changes in funding for individual authorities. This authority could potentially lose up to £52 million of funding or over 6% of our existing SSA. The introduction of any new system, which produces such large swings in funding for many authorities would clearly be at odds with the Government's aim of providing more stability and less volatility.
- The proposed system is not entirely based on factual evidence but still includes elements of judgement.

I have enclosed with this letter a paper detailing our comments on each of the specific questions posed in the consultation paper. However, in summary our main comments are focused on the following four areas:

1. **Resource equalisation** - The County Council is strongly opposed to each of the options presented for resource equalisation on the grounds that they reward authorities who have chosen to spend at higher levels than is justified by their relative needs. The three options presented are at significant cost to the taxpayers of those authorities who have operated most efficiently in the past and/or made policy decisions, which keep council tax levels low. In our opinion the present system of resource equalisation works well and should not be changed.
2. **Education** - The County Council does not support any of the options although there are elements within the four models, which it does favour. Specific concerns relate to:
 - (a) the new funding arrangements of additional education needs. We believe that further research and consultation should be undertaken before implementing the new methodology;
 - (b) the omission of any details on how the Government will deliver its pledge that “no school will lose out in real terms”; and
 - (c) the LEA sub-block. This represents a significant proportion of the total for Education, but we are unable to comment due to insufficient information being provided in the consultation paper. We urge the Government to share its research in support of this proposal before a decision is taken.
3. **Environmental, Protective and Cultural Services** - The County Council does not support any of the options. In particular we are very concerned that the amount included for the concurrent service adjustment for upper tier authorities is inadequate.
4. **Area Cost Adjustment** - We are pleased that the options which the Government has included in the consultation are all based on the General Labour Market Approach. Of these our preference is for Option ACA 5, which reflects the principles of the recent NERA report commissioned by the south-east authorities. However, in order to minimise major disruption to the overall finances of the south-east, Option ACA1 would be the alternative we could support on the grounds that it minimises volatility.

Finally, we believe that the consultation is fundamentally flawed in that:

- We are concerned that the Government will not be limiting the outcome to options presented in the consultation paper and could implement further options/variants of options without giving authorities the opportunity to comment on them.
- There is a lack of information on some critical issues, for example floors and ceilings. As ODPM have previously indicated that in real terms no authorities would be worse off, we are planning on last year’s floors and ceilings. Given the possible size of changes and the very short timescale, I should be grateful if you would confirm that this is a reasonable planning basis.

- We believe the underlying problem with the current system relates to an insufficient quantum and a balance of funding which results in high gearing. This has not been addressed.

In view of the significant impact the outcome of this consultation could have on this authority we are requesting the opportunity of a meeting with the Minister to discuss our position.

I look forward to your response.

Yours sincerely

Bill Ogley
Chief Executive

c.c. Local Government Association

HERTFORDSHIRE COUNTY COUNCIL

LOCAL GOVERNMENT FINANCE - FORMULA GRANT DISTRIBUTION CONSULTATION

1. Education

i) Which of the above options for education formulae do you prefer?

The County Council does not support any of the options included in the consultation.

ii) Are there any alternative or additional changes you would wish to see made?

There are elements within the four models that the County Council does favour. The model that most closely aligns with that of the County Council is option two, subject to:

- (a) applying a higher threshold above 50 to the additional education needs (AEN) index; and
- (b) using the cost of living approach based on the relative house prices for the area cost adjustment.

The above modified option would also include the following principles which the County Council would like to see in whatever model that is finally chosen. That is:

- *Incidence of additional education needs - deprivation indicators:* the County Council believes that low-income families are likely to have similar needs to the unemployed. Consequently, the Government should use Working Families' Tax Credit as an indicator in all of the education blocks and sub-blocks.
- *Additional education needs - higher thresholds:* the AEN top-up should only be targeted to those authorities, which have significant deprivation as all authorities suffer from deprivation to some degree or another. This means that the threshold and therefore the number of authorities that receive no AEN top-up should be set at a high level and preferably above the 50 threshold.
- *Funding met needs only:* would only support the funding of met needs from the current level of SSA resources. If the Government wants unmet needs to be catered for, additional money needs to be put into the Formula Grant for this purpose. Funding unmet needs from the current level of SSA resources would place additional strain elsewhere in the education system.

We have also set out below comments on a number of specific issues.

A. Additional Education Needs (AEN)

The County Council is very concerned about the new arrangements for the funding of additional education needs and believes that further research and consultation should be undertaken before adopting such a new methodology.

School Block

The concerns can be summarised as follows:

- the research behind the AEN proposals is not conclusive.
- judgement is being used rather than factual evidence in setting the thresholds.
- the potential exists for double funding for deprivation through both general formula grant and specific/targeted grant.

LEA Block

The Working Families' Tax Credit should be used as a deprivation indicator in this block to reflect additional education needs for the reasons given above in response to question ii) above.

B. Floors and Ceilings

The County Council is very concerned that the consultation paper has failed to set out the structure of the floors and ceilings system, as it will be applied to the Education block. We would like to know how the pledge that “no school will lose out in real terms” will be applied, what the level of the floor will be, how long will the damping arrangements last for and how the arrangements for the Education block will work alongside/within the overall damping system.

The County Council would like the Government to rectify this omission at the earliest possible opportunity given the significant uncertainties there are in terms of setting budgets within local authorities for next year.

C. LEA block

The County Council is very concerned that it is unable to comment upon such an important and large sub-block since the consultation paper provides the minimum of information (one short paragraph) with only one option.

The County Council would like the Government to share its research in support of this block with local education authorities and to explain (a) how the “recent patterns of expenditure have ... been used to inform the proposed formula” and (b) what factors will influence the judgement on the final weights.

D. School Block: House Price

The County Council tends to favour the house price option for reasons of simplicity and for ease of understanding. However, there was insufficient information contained in the consultation paper to arrive at a final decision. The concerns of the County Council are similar to those raised by the County Council Network and we believe that further research and consultation should be undertaken before adopting this methodology.

2. Personal Social Services

i) *Which of the above options for social services formulae do you prefer?*

Children - the County Council supports option SSC3

Younger Adults - the County Council supports option SSO2

Elderly People - the County Council supports option SSE2

ii) *Are there any alternative or additional changes you would wish to see?*

In whatever model is chosen, the County Council would be very concerned at any double counting like the inclusion of ethnicity in option SSE3 since ethnicity factors are already covered by deprivation indicators.

We are very disappointed that the options presented for Personal Social Services do not address the issue of the allocation of funding for learning disabilities, for which we would like to have seen a separate sub-block. The County Council has raised this issue with the Government on a number of previous occasions as it is of particular concern to the authority. Hertfordshire has a higher than average number of people with learning disabilities within its population and it is estimated that the additional costs add over £15 million to our budget. However, the PSS formulae included in this consultation continue to provide funding for this service through the Other (Younger Adults) sub-block. This is based on the population aged between 18 and 64 and does not take account of the numbers of people with learning disabilities nor is there any recognition of the needs of the over 65's. As a consequence the County Council will continue to be underfunded in this area.

3. Police

i) *Which of the above options for police formulae do you prefer? (note that POL2, POL3, POL4 AND POL5 can be combined in any permutation)*

The County Council has no comments which it wishes to make on this issue.

ii) **Are there any alternative or additional changes you would wish to see?**

The County Council has no comments which it wishes to make on this issue.

4. Fire

i) *Which of the above options for the fire formula do you prefer?*

Of the options presented, the County Council supports option two, which makes the minimum change to the current formula in terms of updating the expenditure database and replacing the perverse fire call indicator with a fire risk index.

ii) Are there any alternative or additional changes you would wish to see?

No

iii) How far should the formula rely on weighted risk area?

Reliance on this indicator should be restricted to category 'A' risks (major city centres and certain industrial areas) only, until further research on developing the proxies for risk areas and weightings has been concluded and consulted upon.

iv) Which of the variants, if any, that are within option FIR4 should be included?

The County Council does not support option 4.

v) Should provision for fire safety be rolled back into the main formula?

No. The County Council supports the current arrangements, which attempts to recognise the cost drivers for this important aspect of the fire service.

5. Highways Maintenance

i) Which of the above options for highways maintenance formulae would you prefer?

The County Council does not support any of the options.

ii) Are there any alternative or additional changes you would wish to see made?

Whatever model is chosen the County Council would like to see:

- (a) the Snow Lying Days indicator in the current Winter Maintenance formula replaced with a Predicted Gritting Days indicator (see also response to question 4 below);
- (b) the adoption of the new Geographical Information System (GIS) for collecting road lengths data from 2003/04 to ensure a greater consistency of measurement by using the same sources and method of measurement for each local authority; and
- (c) the judgement weight of 12 given to heavy goods vehicles (HGVs).

iii) Do you agree that we should remove thresholds from the formula?

No.

iv) Do you agree that we should use average temperature instead of days with snow lying?

The County Council agrees in principle that average temperature is a move in the right direction because temperature is a greater determinant in deciding whether to salt/grit the road network not whether snow is lying on the ground.

However, the decision to grit is a complex one and is **not** dependent upon temperature alone, as acknowledged in Formula Review Group Paper (02) 130.

6. Environmental, Protective and Cultural Services

i) Which of the above options for EPCS formulae do you prefer?

The County Council does not support any of the options.

ii) Are there any alternative or additional changes you would wish to see made?

The County Council would like to see the following principles in the final model:

- the main base for distributing resources should be resident population on grounds of simplicity and for ease of understanding; and
- the inclusion of Working Families' Tax Credit, along-side Income Support, for deprivation measures in upper tier EPCS, on the grounds that low-income families are likely to have similar needs to the unemployed.

The County Council does not favour the inclusion of incoming commuters and day visitors in the formulae on grounds of simplifying the present enhanced population arrangements. However, if an option is chosen which includes indicators for commuters and visitors a cap should be used so that it has minimum influence.

iii) How should concurrent services in two-tier areas be handled?

The County Council would only support the removal of the concurrent service adjustment (CSA) if the control total for upper tier authorities reflected actual spend data in order to protect the current level of service provision. The analysis of concurrent services costs carried by the County Council Network, based on actual spend supplied by the Office of Deputy Prime Minister concluded that a shift in resources of £650 million to £700 million from lower to upper tier authorities was necessary.

If the concurrent services adjustment is not abolished, the County Council believes that the current CSA formula should remain intact subject to the percentage transfer being adjusted to reflect latest spend data.

iv) How should the adjustments for transport in London and the GLA be made?

The County Council has no comments it wishes to make on this issue.

- v) *Are there any structural changes you would wish to see, such as a separate block for waste management?*

The County Council agrees in principle to a separate block for waste management for distributing general grant between local authorities, but is unable to comment further until more information is provided, in particular the distribution methodology.

7. Capital

- i) *Which of the above options for capital finance formulae do you prefer?*

The County Council supports Option 4, in line with the comments of the County Council Network.

- ii) *Are there any alternative or additional changes you would wish to see made?*

The County Council is disappointed that the Government has yet to consult local authorities on options for supporting capital investment under the new prudential system for capital finance, which may be via the RSG system or by some other route. Consequently, no further changes should be made to this block until the arrangements for the new prudential regime are published and consulted upon.

8. Area Cost Adjustment

- i) *Which of the above options for an area cost adjustment do you prefer?*

The County Council is pleased that the options, which the Government has put forward in relation to the Area Cost Adjustment are all based on a General Labour Market Approach. We believe that this is the most robust approach and one which is supported by economic theory, independent academic work and evidence.

Of the options presented we support Option 5 as it incorporates the methodology for which we have argued in the past. However, we recognise that Option 1 would cause the least disruption and volatility and could also support this option.

- ii) *Are there any alternative or additional changes you would wish to see made?*

Professor Elliott concluded that the current ACA is insufficient to compensate authorities in the south-east for the additional labour costs incurred as a result of geographical location. If the Government accept the Elliott methodology they should also address the issue of the quantum and increase the overall level of funding for ACA.

National Economic Research Agency's (NERA) work on estimating regional wage differentials for England found that in identifying the impact of geography on regional wage relativities it was better to base the analysis on private sector data. We support this argument on the basis that:

- i) to include public sector data as well introduces a circular argument and allows past spending to influence future funding
- ii) private sector wages provide a better indication of the underlying regional wage variation as they are not influenced by the funding constraints of the public sector.

Options two and three incorporate a lower limit. This was not part of Elliott's original model and we do not believe it should be included. Setting a lower limit involves a judgmental decision and gives rise to the potential for significant changes arising from marginal changes in data.

9. Fixed Costs, sluggish costs and population change

A. Fixed Costs

- i) *Which of the above options for fixed costs do you prefer?*

The County Council does not support either of the options put forward in the consultation and does not agree that any provision should be made within the system for fixed costs.

- ii) *Are there any alternative or additional changes you would wish to see made?*

If any option relating to fixed costs is taken forward then this should be limited to district councils and financed from the lower tier Environmental, Protective and Cultural Services (EPCS) sub-block only. If other types of authority are included we believe that any methodology should recognise that the level of fixed costs incurred by Social Services/Education authorities is higher than that incurred by shire districts.

B. Population Change

- i) *Whether or not we should provide additional support to areas of rapidly increasing and/or decreasing population?*

All authorities with growing populations should receive support to reflect the fact that the data used in the formula is out of date and understates their service needs.

We do not believe that further support should be given to areas with declining population as they already benefit from the two year lag in the population data and are further protected by the floors and ceilings mechanism.

- ii) *If so, which of the above options do you prefer?*

We do not support any of the options presented.

- iii) *What are the appropriate threshold rates of population change to use?*

If Option PC2 is pursued for increasing populations, all authorities should receive support and therefore the threshold should be set at 0%.

iv) Are there any alternative or additional changes you would wish to see made?

The data used in the formulae should be as up to date as possible and we would support any improvements that can be made to reduce the time lag in the data.

If Option PC2 is pursued, the amounts per head should be adjusted at individual authority level to reflect differential area costs where appropriate.

10. Resource Equalisation

i) Do you favour any of the above options for changing resource equalisation, or a retention of the status quo?

The County Council is strongly opposed to each of the options proposed on resource equalisation. The present system of resource equalisation works well and should not be changed.

Our reasons for this are:

- The current standard spending assessment system produces figures which the Government consider to be appropriate levels of expenditure for authorities. If the Government believes that this level of spending is inadequate and authorities have greater spending needs, then the Government should fund its share through an increase in the total amount of central grant to be distributed and the shortfall should not fall solely on the council tax payer.
- We are not aware of any research to support either the total amount that the spending blocks have been uprated by or the most appropriate method of doing this. Any increase should be based on the change in authorities' need to spend and not on past spending.
- The options presented here rewards those authorities who have spent at the highest levels in the past, regardless of the level of need and the policy choices they have made. Moreover, the proposals also reward those who are operating least efficiently. This contravenes a number of the principles on which the government has set out for the new system, namely that past spending should not determine future provision and that it should not create perverse incentives or penalise authorities for improving efficiency.

ii) Are there any alternative or additional changes you would wish to see made?

No

11. Predictability and Stability

A. Floors and Ceilings

i) Which of the above options for calculating the baseline for floors and ceilings do you prefer?

Without further information explaining in more detail the calculations behind each of the three options, in particular how any floors and ceilings mechanism will apply to the Education block, or exemplifications we do not feel in a position to be able to comment on the options presented.

Whatever methodology is adopted it is essential that for the authorities affected by transfers in and out of the settlement, the adjustments to the baseline must be split across Council Tax at Standard Spend (CTSS) and Central Support to give a like-for-like comparison.

ii) Are there any alternative or additional changes you would wish to see made?

We would have liked the consultation to have included some detail on the proposed levels at which the floors and ceilings will be set. Not having this information in advance hampers financial planning and is out of line with the Government's aim of improving predictability and stability.

For the future we would also like to see three year indications of floors and ceilings as this would improve the predictability of our resources and thereby assist us on our forward financial planning and budget process. It would also allow us to conduct an informed and meaningful consultation with the public on council tax / spending decisions.

B. "Smoothing" – the use of more than one year's data

i) What are your views on whether the ACA data should be smoothed?

We do not support the smoothing of data as it dampens the impact of data changes, which already have a built in time lag. Whilst smoothing would improve stability we feel that this issue should be addressed by controlling methodology changes. The most up to date data should be reflected as quickly as possibly in the grant formulae and it is more important that funding is directed in accordance with the latest needs than funding levels remain stable. However, improving predictability would be helpful and we would welcome any further improvements to this, including earlier notification of grant amounts. An alternative to smoothing data, which could also improve predictability, would be to use trends so that the data more accurately reflects the current position. Actuals could then be adjusted for in future years.

ii) What are your views on whether interest rates should be smoothed?

No data should be smoothed in the new system – see our comments under i) above.

iii) What are your views on whether any other data should be smoothed in the new system?

No data should be smoothed in the new system – see our comments under i) above.

12. A simpler presentation of the new system

i) Would it be helpful to present the system in this way, even if the underlying formulae are more complex?

We feel very strongly that simplification should not be at the expense of fairness. As long as the underlying formula is not simplified and is also made available as required, we welcome a simpler presentation for appropriate audiences.

13. Merging Revenue Support Grant and Redistributed Non-Domestic Rates into a single grant stream

i) Do you consider that merging RSG and NNDR into a single grant stream would be helpful in improving transparency and intelligibility?

As stated in our response to the Local Government Bill, the County Council is opposed to merging of RSG and NNDR grant. We believe that this would remove transparency from the system instead of aiding it, as the contribution to local government funding from business rates would be masked.

The County Council believes strongly that the total level of business rates in Hertfordshire should be returned to the County to fund local services. This would also improve accountability and increase the interest of the local business community in the expenditure and performance of local authorities.

LOCAL GOVERNMENT FINANCE - FORMULA GRANT DISTRIBUTION CONSULTATION

BACKGROUND INFORMATION ON THE EXISTING SYSTEM, THE PROPOSALS AND THEIR IMPLICATIONS

1. Education

1.1 The Current System

1.1.1 The current Education SSA is comprised of five sub-blocks: under 5s, primary, secondary, post-16 and other. The calculation of the SSA elements for each of these reflects different client groups and associated unit costs. Cost adjustments are incorporated in the formula to reflect the increased costs associated with additional educational needs, the provision of free school meals, the sparsity of the population in an area and differences in the costs of provision between areas. Historical patterns of past spending are used to determine the weights attached to each of these factors.

1.2 Proposals for Change

1.2.1 The proposal is to split general education funding into two blocks; a schools block and a LEA block. However, the paper makes the point that the split between the two blocks is not equivalent to the current concept of delegation to schools.

1.2.2 The schools block is divided into four sub-blocks; under 5s, primary schools, secondary schools and high cost pupils. With the exception of the high cost pupils sub-block, the sub-blocks have a similar structure. That is a basic entitlement for each pupil, with top-ups for significant deprivation and for being in an area where it costs more to recruit and retain staff.

1.2.3 Four options have been published for consultation, suggesting different ways of calculating extra funding on top of the basic entitlement, which includes an element for 'basic' additional educational needs. The options vary the way allocations are made for:

- The incidence of 'extra' additional education needs (AEN), using deprivation indicators of income support alone or also working families tax credit
- The threshold for AEN payments: below which it is assumed that all authorities are funded equally through basic entitlement
- The area cost adjustment

The treatment of English as an additional language (EAL) and of ethnicity is the same in all four options. The primary schools block is the only sub-block that includes an element for sparsity.

1.2.4 Only one option has been identified for the LEA block, which allocates funding as follows:

- 26 per cent: number of pupils in an authority's schools
- 37 per cent: the number of pupils resident in an authority
- 10 per cent on sparsity, largely to reflect the higher costs of home to school transport and also differing institutional costs: allocated by resident pupils
- 27 per cent on a mixture of income support and English to reflect the additional needs of deprived areas: allocated on a mixture of pupil and resident pupils

This is common to all four of the Education options.

1.2.5 The differences between each of these options are summarised in the below table

Options	Deprivation Indicator	AEN Unit Cost	Threshold (see note A)	ACA
EDU 1	Income Support	Met and Unmet Needs	Low – 5 LEAs	Current
EDU 2	Income Support and Working Families' Tax Credit	Met Needs only	High – 50 LEAs	Current
EDU 3	Income Support and Working Families' Tax Credit	Met and Unmet Needs	Medium – 30 LEAs	Current
EDU 4	Income Support	Met Needs only	Low – 5 LEAs	House Price

Note A: The threshold (5, 30 or 50) refers to the number of authorities who receive no AEN top-up.

1.2.6 These options would have the following effect on the authority's SSA:

EDU 1		EDU 2		EDU 3		EDU 4	
£m	%	£m	%	£m	%	£m	%
-10.9	-1.3	5.1	0.6	-7.9	-1.0	5.8	0.7

2. Personal Social Services (PSS)

2.1 The Current System

2.1.1 There are three sub-blocks within the PSS block; children, elderly and other.

2.2 Proposals for Change

2.2.1 The PSS block has been sub-divided into three blocks; children, younger adults and elderly people. The children's and adults formulae are largely unchanged. There are new options for the treatment of elderly people, some of which keep the distinction

between residential and domiciliary care and some that put forward a combined formula.

Children

2.2.2 Government propose the following structure for the children’s formula:

- a **basic amount** per child aged 0-17 that would be the same for all authorities;
- a **deprivation top-up** recognising the children in certain social circumstances are more likely to be in need of care than others;
- a **fostering cost top-up** recognising variation in unit costs of foster care over and above the variation in area costs; and
- an **area cost top-up** reflecting variation in pay costs around the country.

2.2.3 Because the children’s formula was the result of research carried out in 1999/2000, the review has focused on the foster cost adjustment, which has attracted the most critical attention. The options are:

Option SSC1 - represents no change other than to increase the weighting for the foster care adjustment from 17.5% to 19.4% to reflect latest expenditure data.

Option SSC2 - keeps the same indicators used in the current foster care adjustment, but alters the weighting for each indicator to reflect latest expenditure data. The resultant figure is then given a weight of 19.4% as in Option SSC1.

Option SSC3 - is a new foster care adjustment based on a model developed by the Thomas Coram Institute, based on 2000/01 data but still relying on regression against past expenditure.

2.2.4 These options have the following effect on the authority’s SSA:

SSC1		SSC2		SSC3	
£m	%	£m	%	£m	%
-0.1	0.0	1.1	0.1	1.3	0.2

Younger Adult’s

2.2.5 Government propose the following structure for the new younger adults formula:

- a **basic amount** per adult aged 18-64 that would be the same for all authorities;
- a **deprivation top-up** recognising that adults in certain social circumstances are more likely to be in need of care than others; and
- an **area cost top-up** reflecting variation in pay costs around the country.

2.2.6 The options under consideration are:

Option SS01 - similar to the current formula but with an updated expenditure base (from 1990/91 to 2000/01) and a reduction in the number of indicators from the existing twelve to three.

Option SS02 - similar to SS01 but keeps the existing twelve indicators.

Option SS03 - introduces a separate formula for Mental Health, which moves away from the reliance on past spending.

2.2.7 These have the following effect on the authority's SSA:

SS01		SS02		SS03	
£m	%	£m	%	£m	%
1.3	0.2	1.9	0.2	1.9	0.2

Elderly

2.2.8 Currently there are two formulae for elderly services: one for residential and nursing care, and one for domiciliary services such as home helps and day care. The options include separate or a single combined formula.

2.2.9 Government propose the following structure for the elderly people formula:

- a **basic amount** per elderly person that would be the same for all authorities;
- an **age top-up**, recognising that some authorities have an elderly population with a higher proportion of people aged 75-84, or over 85
- a **deprivation top-up** recognising that elderly people in certain social circumstances are more likely to be in need of care than others;
- a **sparsity top-up** (domiciliary or combined formula) recognising the higher costs of providing domiciliary services in rural areas;
- a **low income top-up** reflecting authorities differing ability to raise income from charges; and
- an **area cost top-up** reflecting variation in pay costs around the country.

1. Separate Residential and Domiciliary Formulae

These options use updated data from the General Household Survey (from 1994 to 1998)

Option SSR1		Option SSR2		Option SSD1	
£m	%	£m	%	£m	%
-0.4	0.0	-0.7	-0.1	0.1	0.0

2. A Combined Elderly Formula

These options used a combined formula for elderly and domiciliary care. The options vary according to whether:

- ethnicity is included or not as an indicator of deprivation; and
- total resident population or household population plus the number of elderly people in residential care supported by the local authority is applied.

Option SSE1: total resident population but excludes ethnicity

Option SSE2: household population plus the number of elderly people in residential care supported by the local authority but excludes ethnicity

Option SSE3: ethnicity and household population plus the number of elderly people in residential care supported by the local authority

Option SSE1		Option SSE2		Option SSE3	
£m	%	£m	%	£m	%
1.2	0.1	1.3	0.2	0.5	0.1

3. Police

3.1 Hertfordshire Constabulary and Police Authority will be responding on this part of the consultation.

4. Fire

4.1 The Current System

4.1.1 The existing fire formula is based on regression against past spending, using resident population with adjustments for population density, coastline, fire calls, 'A' risk areas, fire safety, (enforcement and education), area cost adjustment and pensions.

4.2 Proposals for Change

4.2.1 Four options are included. All remove the current fire calls indicators, which is seen as a perverse incentive. The new fire formula consists of a basic entitlement per head of population with top-ups, which vary from option to option with the exception of FIR3. The options are:

Options FIR1, FIR2 and FIR4 - still rely on weights set by reference to past spending patterns although the expenditure database has been updated to a three-year average up to 2001.

Option FIR3 - in which each authority receives a flat rate increase each year, based on national fire control total increases; starting from authorities' actual spend on fire.

4.2.2 These options have the following effect on the authority's SSA

FIR 1		FIR 2		FIR 3		FIR 4	
£m	%	£m	%	£m	%	£m	%
-1.1	-0.1	0.1	0.0	-0.4	-0.1	-0.9	-0.1

5. Highways Maintenance

5.1 The Current System

5.1.1 The current SSA formula provides funding for general maintenance and additional winter maintenance and is based on regression against past spending (1990/91) where the main formula indicators are weighted road lengths, traffic flow above threshold level, population above threshold, days with snow lying and area cost adjustment.

5.2 Proposals for Change

5.2.1 The Government proposes a formula consisting of:

- a **basic amount** per kilometre of road, with top-ups for:
- **traffic flow**;
- **winter maintenance costs**; and
- **pay costs**.

5.2.2 The formula options have been exemplified using existing data on built-up areas (based on speed limits) and winter maintenance (based on days with snow lying). The two options are as follows:

Option HM1 - updates the spending base from 1990/91 to 1998/99 but retains from the current formula population density as an explanatory factor for road maintenance spending.

Option HM2 - as HM1 but removing population density from the formula.

5.2.3 These options have the following effect on the authority's SSA:

HM 1		HM 2	
£m	%	£m	%
-1.2	-0.1	-1.6	-0.2

6. Environmental, Protective and Cultural Services

6.1 The Current System

6.1.1 There are two main sub-blocks which covers services provided by county and district authorities. Within both of these main sub-blocks the basic allocation is for enhanced population (residents adjusted for day and night visitors and for net commuter flows) with additional sums for population density, population sparsity, deprivation and area costs.

6.1.2 There are also five minor sub-blocks that provide funding for housing benefit administration, rent allowance payments, flood defence, coast protection and national parks.

6.2 Proposals for Change

6.2.1 The Government proposes to change only the two main sub-blocks for services provided at county and district level for which there are four options.

6.2.2 For each main sub-block, options are in the form of:

- a **basic allocation** per resident;
- a **deprivation** top-up;
- a **population density** top-up;
- **other** top-ups which are included in some options but not others are for population sparsity, ethnicity, visitors and commuters; and
- an **area cost** top-up reflecting variation in pay costs around the country.

6.2.3 All four options adjust the amount allocated for resident population as well as varying the means of assessing top-ups.

6.2.4 These options would have the following impact on the authority’s SSA:

EPC 1		EPC 2		EPC 3		EPC 4	
£m	%	£m	%	£m	%	£m	%
-7.7	-0.9	-1.9	-0.2	-3.0	-0.4	-10.7	-1.3

7. Capital

7.1.1 The Current System

There are three sub-blocks (debt charges, interest on reserved receipts and other interest receipts). The two interest receipts sub-blocks represent income, not expenditure, and therefore have a negative control total.

7.2 Proposals for Change

7.2.1 The consultation paper states that “if the government decides to continue to provide support for traditionally-funded investment via the RSG mechanism, then the debt charges sub-block would continue in its present form, with credit approvals being replaced by assessments of the need for new capital investment Alternatively, if support for new investment were provided outside the system, the Government would continue to support existing borrowing through the debt charges sub-block in its present form.”

7.2.2 All four options discontinue the two ‘negative’ sub-blocks; which take account of interest receipts and interest on reserved capital receipts. The options, which are outlined below, vary as to how this reduction is managed, whether within the capital finance block or all sub-blocks outside the capital finance block that contribute to the need to hold cash balances and reserves.

Option CF1 - removes the two interest receipts sub-blocks from the control total with a corresponding reduction in the debt charges sub-block.

Options CF2, CF3 and CF4 - adjust other block control totals to offset a removal of the two interest receipts sub-blocks.

7.2.3 These options have the following effect on the authority's SSA:

CF 1		CF 2		CF 3		CF 4	
£m	%	£m	%	£m	%	£m	%
-0.6	-0.1	-5.3	-0.6	0.1	0.0	6.2	0.8

8. Area Cost Adjustment

8.1 The Current System

8.1.1 The Area Cost Adjustment (ACA) is a multiplier which forms part of the existing SSA formulae and reflects the need of some authorities to spend more to provide a standard level of service because of the higher labour market and locality costs which they face. Currently the calculation of the ACA is based on the "General Labour Market Approach" and uses evidence from the labour market as a whole. This basically reflects the fact that because local authorities have to compete within the general labour market to attract staff, they must pay salary rates typical for their area.

8.1.2 The ACA is currently focused on London and south-east authorities and in 2002/03 amounts to £2.2 billion or just over 4% of SSAs. The ACA represents a significant part of the county council's SSA funding at £88.4 million or 10.9%.

8.1.3 Authorities outside the south-east have for some time challenged the ACA, with their main arguments being that local authorities are independent of the wider labour market, operating within national pay scales and therefore the ACA should be based on specific actual costs.

8.1.4 Despite this opposition there is, however, general agreement that it does cost more to deliver services in London and surrounding areas and that any system should contain recognition of this. The debate is around the methodology and data used for calculating this, including who should receive the top up and how much weight it should be given.

8.1.5 In 1996 the ACA was reviewed independently for the DETR by Professor Elliott of Aberdeen University. The review examined all approaches to the ACA, including the specific cost approach, and recommended the general labour market approach, but proposing that it should be applied across the whole country to compensate high cost pockets outside the south east. This review also confirmed that the existing ACA actually undercompensates authorities in the south-east for the higher costs they face. The south-east authorities accepted the approach recommended by Professor Elliott but this was not implemented at the time.

8.2 Proposals for Change

8.2.1 Five options are presented in the consultation which apply to all of the service blocks (ACA1 to ACA5.) These are outlined below. A further option is presented for the Education block only (EDU4) and this is discussed in section 4 of this report.

Option ACA1 – this is based on the current approach but extends the ACA to include Cambridgeshire, Northamptonshire, Warwickshire, Avon, Gloucestershire and Wiltshire. The inner and outer fringe areas of London are combined and given a single ACA value. Like the existing ACA, it is based on data from the New Earning Survey (NES).

Option ACA2 – this is based on the Elliott approach but also incorporates a lower limit below which authorities do not receive an ACA. The same authorities receive ACA as in Option ACA1. The ACA factors for outer London and the fringe have been subdivided to reflect the fact that wage pressures are higher to the west of London than the east. This option is based on data from the Labour Force Survey (LFS).

Option ACA3 – this is the same as option ACA2 but is based on private sector wage data only.

Option ACA4 – this is also based on the Elliott approach but unlike options 2 and 3 does not have a lower limit so that all authorities have an ACA factor. This option is based on NES data.

Option ACA5 – this is the same as option ACA4 but is based on private sector wage only.

8.2.2 All of the options are based on three years of earnings data rather than the one that is used in the current formula. This is intended to reduce volatility between years.

8.2.3 The differences between each of these options are summarised in the below table:

Details	ACA 1	ACA 2	ACA 3	ACA 4	ACA 5
Method	Current	Elliott	Elliott	Elliott	Elliott
New ACA receivers	Yes	Yes	Yes	Yes	Yes
Lower limit	No	Yes	Yes	No	No
ACA factors	Single ACA factor for fringe	County specific (ACA receivers)	County specific (ACA receivers)	All counties own factor	All counties own factor
Data source	NES	LFS	LFS	NES	NES
Public & Private Sector data	Both	Both	Private only	Both	Private only

8.2.4 **Option EDU4** – uses a further variant of ACA but this applies purely to the Education block. This differs from the above in that it is based on a house price indicator rather than an earnings based indicator.

8.2.5 These options would have the following effect on the authority’s SSA:

ACA 1		ACA 2		ACA 3		ACA 4		ACA 5	
£m	%	£m	%	£m	%	£m	%	£m	%
3.6	0.4	-9.8	-1.2	2.9	0.4	-2.5	-0.3	7.1	0.9

8.2.6 The impact of the ACA change with Option EDU4 would be to increase the Education SSA by £7.7m (0.9%).

9. Fixed Costs, sluggish costs and population change

A. Fixed Costs

9.1 The Current System

9.1.1 The current SSA formulae has been criticised in the past by smaller authorities for not reflecting the fact that all authorities incur to a certain extent “fixed costs” from being a local authority, such as holding elections, preparing best value performance plans, auditing accounts etc.

9.2 Proposals for Change

9.2.1 The consultation paper includes two options for taking account of these costs, both of which create a separate new subblock within the Environmental, Protective and Cultural Services (EPCS) sub-block. These are:

Option FC1 – provides £300,000, to each shire district and Education/PSS authority (a total of £116.4 million), to be funded from within the existing EPCS control total.

Option FC2 – as FC1 but in addition also providing £300,000 to each police and fire authority (totalling £11.4 million and £9.3 million respectively), funded from within the existing control totals for these sub-blocks.

9.3 Implications of the Proposals

9.2.2 These options have the effect of reducing Hertfordshire County Council’s SSA by the following amounts:

FC 1		FC 2	
£m	%	£m	%
-0.4	-0.1	-0.6	-0.1

9.2.3 These both have the impact of shifting resources to shire districts from all other types of authority.

B. Population Change

9.3 The Current System

9.3.1 The current SSA formulae incorporates population data. However this is historic and lags the real figures for the year in question by two years, eg the 2002/03 settlement was calculated using estimated population figures as at June 2000. Arguments have been put forward that areas with declining population are not able to reduce costs at the same rate as the decrease in population and that areas with growing population do not receive adequate funding for services because of the lag in the data.

9.4 Proposals for Change

9.4.1 The proposals introduce targeted grants for areas of rapid population change and fund these by top slicing the total formula grant. The options are:

Option PC1 – the grant is targeted to authorities whose population is projected to decrease by more than 0.5% in the two year period between the latest population estimates and the settlement year. The total targeted grant would be £10.6 million.

Option PC2 – the grant is targeted to authorities whose population is projected to increase by more than 1.5% in the two year period between the latest population estimates and the settlement year. The total targeted grant would be £35.6 million.

9.4.2 These options have the effect of reducing Hertfordshire County Council's SSA by the following amounts:

PC 1		PC 2	
£m	%	£m	%
-0.2	-0.0	-0.7	-0.1

10. Resource Equalisation

10.1 The Current System

10.1.1 The current system of grant distribution is designed so that if all authorities spent at the level of their standard spending assessment then the council tax for a Band D property would be the same across the whole country for the same type of authority. In this way the distribution of Revenue Support Grant takes account of both differences in spending need and variations in the tax base and equalises for these at standard spending.

10.1.2 Authorities are currently able to choose to spend above or below the level of their SSA and as a consequence of this levels of council tax will vary across the country. It has generally been the case that authorities do set their budgets above the level of their SSA. The amount Hertfordshire County Council spends above its SSA (5% in 2002/03) is relatively low compared to other authorities, with the budgets of 90% of county councils exceeding their SSA by a greater amount.

10.2 Proposals for Change

10.2.1 The proposals put forward on this issue all uprate the total SSA so that the total SSA is closer to the total of local authority budgets. It is intended that the increase in SSA is met by a compensating increase in the amount contributed from council tax at standard spending. The three options included in the consultation differ in the amount that they uprate the SSA by and the method of doing this:-

Option RE1 – uprates all spending blocks by a fixed national percentage to eliminate the gap between total national spending and actual spending.

Option RE2 – uprates each service block separately to bring it in line with spending for that block.

Option RE3 – this option reduces rather than eliminates the gap by uprating the control totals for the Personal Social Services and Environmental, Protective and Cultural Service blocks.

10.2.2 These options would have the effect of reducing the amount of general grant received by the authority by the following amounts:-

	£m	%	Estimated Impact on Council Tax
RE 1	-10.4	-1.9	3.8%
RE 2	-12.4	-2.2	4.5%
RE 3	-5.6	-1.0	2.0%

10.2.3 By funding the uprated SSA through council tax this has the impact of shifting resources from authorities with relatively low levels of spending and relatively high council tax bases to areas where spending is high and the capacity for collecting council tax is relatively low. Consequently Hertfordshire County Council, along with all of the other county councils would lose out under any of these proposals and resources would transfer to London and the Metropolitan authorities.

11. **Predictability and Stability**

A. *Floors and ceilings*

11.1 The Current System

11.1.1 Under the current grant distribution system there is a floors and ceilings mechanism which sets an upper and lower limit on the grant change between the year in question and the previous year (after recalculating the figures for the base year to adjust for changes in function and funding into and out of the settlement to allow a like-for-like comparison).

11.1.2 The system is intended to be self financing within each group of like authorities (i.e. Education/PSS authorities, Police authorities and Shire Districts). However, in 2002/03 the amount raised by the ceiling did not fully offset the cost of funding the floor and the Government transferred additional money into RSG to fund this.

11.1.3 In 2002/03 the floor level for Education/PSS authorities was set at 4.0% and the ceiling was set at 7.0%.

11.2 Proposals for Change

11.2.1 The Government has stated that it intends to continue to use floors and ceilings in a similar way to 2002/03. However, the upper and lower limits will not be announced until the autumn.

11.2.2 The three options for change included in the consultation paper relate to the method used to calculate the adjusted base year grant figures in order to achieve a like-for-like comparison. These aim to address the issue that, under the current method of adjusting for changes in function, changes arise for the baseline figures of authorities not directly affected by the changes in function. The current method is also felt to be complex and difficult to understand.

11.2.3 The options under consideration are:

Option BYG1 – this splits the national council tax at standard spend (CTSS) for the base year according to actual base year formula spending, not on adjusted base year formula spending.

Option BYG2 – this freezes the split of national CTSS between 2003/04 to 2005/06 at 2002/03 values.

Option BYG3 – this adjusts actual base year grant by the difference between actual and adjusted base year formula spending amounts.

11.2.4 No exemplifications have been provided in the consultation of the impact of each of these options.

B. “Smoothing” – the use of more than one year’s data

11.3 The Current System

11.3.1 The data used in the current formulae all just relates to a single year, representing the most up to date information available.

11.4 Proposals for Change

11.4.1 With the aim of improving stability and predictability, the government are seeking views on whether data should be smoothed in the new system and specifically refer to ACA and interest rate data. No exemplifications have been provided on the impact of such changes.

12. A simpler presentation of the new system

- 12.1 One of the Government's aims is that the new system should be simpler and more intelligible to stakeholders. The consultation asks for opinions on whether it would be helpful to present complicated formulae in a simplified way to make it easier for people to understand. They suggest the following format:

Basic allocation + deprivation top-up + pay cost top-up + other top-ups.

The intention is that this amount could then be multiplied by the number of the relevant client group to arrive at each authority's total.

13. Merging RSG and Redistributed Non-Domestic Rates into a single grant stream

13.1 The Current System

- 13.1.1 Local authorities currently receive government funding under the SSA system through two separate general grants, Revenue Support Grant (RSG) and redistributed National Non-Domestic Rates (NNDR). NNDR is distributed as a standard amount per head of population for each category of authority. RSG is distributed so that if every authority set its budget at SSA then council tax would be at the same level across the country for the same property band (i.e. $RSG = SSA - NNDR - \text{Council Tax at Standard Spend}$).

13.2 Proposals for Change

- 13.2.1 It has been suggested that having two types of general support grant is complex and makes the system difficult to explain to stakeholders and the Government considers that merging the two grants into one single formula grant from 2003/04 onwards would improve simplicity and transparency.
- 13.2.2 With the exception of a small number of district councils (whose RSG figure is negative when calculated on the present basis), this proposal would have no impact on the total amount of government support received.