The Institute for Fiscal Studies submission 21 August 2024

I wanted to provide some brief comments which I hope are helpful. I should highlight that my work on local government finances has focused more on England so I am less aware of some of the specifics, especially on demand and cost pressures in Scotland.

Comments from David Phillips, Associate Director at the Institute for Fiscal Studies and head of the Institute's work on devolved and local government finance. Please note, the views below are the views of the author only: the IFS has no corporate views.

My response directly addresses questions (1), (5) and (10).

1 Financial challenges

The key challenge facing local government finances is the combination of likely constrained funding and rising demands and costs for key services. Funding is likely to be constrained because of the difficult fiscal situation the UK is currently in. As highlighted in various analyses, including by the IFS, the plans inherited by the new UK government imply cuts to many areas of spending for 2025-26 onward if pledges on health, defence, overseas aid and childcare are to be met (https://ifs.org.uk/sites/default/files/2024-06/Public%20services%20in%20the%20next%20Parliament%201.pdf) The new Chancellor is likely to change these inherited plans, with history suggesting plans are more likely to be topped up rather than reduced. But given a high (by UK standards) tax burden, high debt and debt interest payments, and the more difficult starting position revealed in the Spending Audit, any increases are unlikely to allow all pain to be avoided.

While the Scottish Government's overall funding will highly likely increase in the years ahead and it is up to the Scottish Government to allocate this funding between services, it will face many pressures on its budget too. Like with the UK Government, health spending will likely need to increase by more than average, and forecasts imply further increases in funding needed for devolved social security benefits. Fully meeting increases in the demands and costs faced by local government would likely necessitate substantial cuts to some other areas of Scottish Government spending, given funding for local government is the second largest component of the Scottish Budget after the health service. The Scottish Government may therefore increase local government funding by less than required to meet spending needs. This could require some cut-backs to service provision by local government.

Our analysis for England (https://ifs.org.uk/publications/how-have-english-councils-funding-and-spending-changed-2010-2024 and https://ifs.org.uk/publications/what-outlook-english-councils-funding) has shown that growing demands and above-inflation increases in costs for key services mean that even under relatively optimistic scenarios for funding, funding would be insufficient to maintain (let alone improve) services, unless demand and cost pressures slow down. I am less familiar with the demand and cost pressures facing Scottish councils, but my sense is that pressures on housing and special education needs support are not quite as great, perhaps reflecting different operational models and legislation. The overall schools budget has been highlighted as a pressure point in Scotland though given politically salient Scottish Government pledges on teacher numbers and the relatively high levels of teacher pay in Scotland. Adult social care may be a bigger pressure point in England, especially in the longer-term, given a more rapidly ageing population and wider coverage of support due to universal (rather than means-tested) personal care. More generally, the views of councils and COSLA on key demand and cost drivers are important to elicit.

5 Severe financial distress

Turning to severe financial distress, it is important to note there is no direct equivalent to the Section 114 notices council finance chiefs can issue in England to try to force their council to take actions to improve financial viability if they feel their ability to meet financial obligations and statutory duties is at risk. The professional body CIPFA recommends Scottish councils' finance chiefs follow the same principles that guide when their English equivalents should consider issuing a Section 114 notice, in how they exercise their responsibility for sound financial management. This includes clearly notifying the council leadership of their concerns and pushing for an action plan to address them.

I am not best placed to comment on how close any Scottish council is to this sort of situation. A recent LGiU survey of Scottish councils (https://lgiu.org/wp-content/uploads/2023/12/State-of-Local-Government-Finance-in-Scotland.pdf) found that 8 councils (1 in 4 in Scotland) reported that they may be unable to meet their financial obligations and statutory duties in the current financial year (2024-25) – a situation that should prompt the issuing of a Section 114 notice in England. I would treat this with some caution: councils unsurprisingly use such surveys as vehicles to highlight the financial difficulties they face in the hope of prompting additional funding. But the analysis does suggest there is at least some risk of this in the short-to-medium term.

In the absence of a significant injection of funding, there are no easy options for reducing this risk. Some suggestions for the Scottish Government include:

- Providing councils with multi-year financial settlements, potentially from 2026-27 onwards to align with the multi-year settlements the Scottish Government will receive from the UK government.
- Enabling councils to increase council tax, to help them raise more revenues themselves, and consider providing councils with a wider array of revenue-raising options, building on tourism tax plans.
- Reducing the scope of ring-fencing and earmarking to give councils more flexibility over how they allocate funding between services. With declining pupil numbers, there may be scope to reduce the share of funding going to schools and increase the share going to other services. This would not be easy, requiring reductions in teacher numbers and potentially the closure of schools. But local areas are likely best placed to make these difficult decisions.
- Assessing the cost of existing burdens alongside assessments of the costs of new burdens, such as those related to the planned 'National Care Service'. If

new burdens are to be introduced, ensure that they are fully funded to avoid increasing financial pressures.

Scottish councils can also take a number of actions:

- Leveraging the data they individually and jointly hold, as this can be a treasure trove of information to see what does and does not work and improve value-for-money. Work with researchers and others to understand how to use this data, and to undertake proper evaluations of pilot projects.
- Be smart-sourcers. This could include pooling procurement, outsourcing where competition means that this may reduce costs and/or enable improvements in service, and in-sourcing where a lack of competition mean that current outsourced arrangements involve excess profits and/or poor services (in England, the provision of specialist children's residential care placements is an example where the latter may apply).

10 Reserves

Lastly in relation to reserves, Scottish councils' reserves increased very substantially during the pandemic – with general fund non-HRA reserves approximately doubling in cash terms between end-March 2020 and end-March 2022. The main driver of this was a substantially greater boost to funding than spending during the COVID-19 pandemic. In England, this appears to have been driven by councils overstating the total increase in spending they were facing when providing financial reports to government (they more accurately reported the losses of income they faced). In turn, this perhaps reflects the fact that they did not include areas where spending was lower (e.g. because activities couldn't take place, or service users were not presenting as usual) as a result of the pandemic.

Unlike in England, Scottish councils overall continued to pay into reserves in 2022/23, with a particularly large increase in capital reserves, which Audit Scotland believes may relate to project slippage (https://audit.scot/uploads/docs/report/2024/nr_240116_local_government_finance.pdf). It is worth noting that half of councils drew down reserves in 2022/23 though. Provisional outturns for 2023/24 and budgets for 2024/25 a drawdown of reserves, overall, last year as well as a planned drawdown in the current financial year (https://www.gov.scot/publications/local-government-2023-24-provisional-outturn-and-2024-25-budget-estimates/documents/). Note, however, that provision figures for 2022/23 showed a drawdown in reserves that was subsequently revised to a modest increase in reserves when final outturns were published (https://www.gov.scot/publications/local-government-2022-23-provisional-outturn-2023-24-budget-estimates/documents/). Provisional figures for 2023/24 and plans 2024/25 should therefore be treated cautiously.

As in England, there is a lack of transparency around savings plans, the use of reserves, and the planned future use of reserves. This makes assessing the financial sustainability and risks of Scottish councils difficult.