Passing the Bucks:
The Impact of Standard Spending Assessments on Economy, Efficiency and Effectiveness

Volume 1
The 1982 Local Government Act, which established the Audit Commission, created two separate powers to undertake studies. The first, under section 26, empowers the Commission to examine performance amongst local authorities and to make recommendations highlighting best local practice in achieving economy, efficiency and effectiveness, often described as the three Es. The second, under section 27, enables the Commission to examine the effect of statutes, regulations and directions on the ability of local government to achieve the three Es. This report is the result of a section 27 study.

Many councils face increasing difficulty in reconciling their programmes of activity with the resources which central government allows them to spend. In 1992 the local authority associations requested the Audit Commission to undertake a study of the basis upon which central government provides resources to, and regulates the spending of, councils. The Audit Commission accepted the invitation. This report is the outcome of that study, reviewing the present system of Standard Spending Assessments (SSAs).

Many in local government would wish the Commission to criticise the way central government regulates local expenditure - 'capping'. But capping is a government policy and the Audit Commission has no remit to challenge policy decisions, even though it is entitled to review their impact on the three Es. Similarly some would wish the Commission to offer views on the selection of variables and the weighting given to them by SSA formulae. Whilst such considerations may affect the fairness of the system, it is very difficult to establish their effect on the economy, efficiency and effectiveness of council spending. Consequently the report does not concentrate on the composition of the formulae, but rather on the overall performance of the SSA system in creating a framework within which local government can give proper attention to the three Es.

The report addresses how SSAs work in England. During the study the workings of the system in Wales were reviewed and a paper summarising that review is one of those listed in Appendix 8. The system in Wales works differently from that in England and has generally caused less conflict. However, many of the issues which affect the future of the system in England will also be relevant in Wales.

The report is not a full examination of the system of local government finance, and in particular does not consider the contribution of fees and charges in the financing of local government, or how Council Tax will operate, or the interaction between Council Tax and the grant system.

Chapter 1 explores what SSAs are, what government objectives they were designed to meet, how they operate and the changing circumstances which affect them. Chapter 2 considers the criticisms which they attract. Chapter 3 sets out a number of questions which must be posed and the alternative directions which could be considered if the financial relationship between central and local government is to remain appropriate for the developing circumstances of the 1990s.
The study took place between May 1992 and March 1993. The study team, under the direction of Bob Chilton, was led by Jon Vaughan Jones and comprised Paul Smith as project manager, supported by a 'technical sub-group' consisting of Glen Bramley (School for Advanced Urban Studies, University of Bristol), Mike Derbyshire (Assistant Director, Social Services, Lancashire County Council) and Trevor Sheldon (Centre for Health Economics, University of York). An advisory group drawn from the local authority associations and attended by several Commissioners met on a number of occasions during the study. Parallel consultation with the Department of the Environment (DoE) was also carried out throughout the study. The Commission is grateful for the help received, but the arguments and conclusions in this report are the sole responsibility of the Commission.

Research for the study included analyses of national data and a survey returned by almost 80% of local authorities in England and Wales, which gave rise to some individual submissions on the subject by a number of authorities and related follow-up work. KPMG Peat Marwick undertook a comparative analysis of cost and activity drivers of four services (Primary Education, Elderly Domiciliary Social Services, Refuse Collection and Leisure & Recreation) in different authorities; Peter Smith, of the University of York, undertook a theoretical and statistical analysis of the impact of SSAs on local authority budgets; Price Waterhouse carried out a study of the Capital Financing SSA; Steve Lord, an independent consultant, carried out studies of the Fire and Highways SSAs; Glen Bramley undertook an analysis of comparable funding systems in six European countries; Bob Chilton examined the Australian grants system; and Rita Hale and Associates Limited provided estimates for a study of the impact of local government re-organisation on a county's Education spending. The research also included visits to Wales and Scotland to assess the systems in operation there.

The report, Volume 1, is a brief statement of the study's findings designed to be accessible to a general audience. Much of the detailed work which supports the report is included as Volume 2, Appendices to the report. Many other background papers were prepared and a list of those which are open for public access is attached at Appendix 8.
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ANNEX
Standard Spending Assessments (SSAs) are the latest in a long line of mechanisms to distribute money from central to local government in order to equalise councils’ ability to meet needs. For that purpose they work better than any previous system.

SSAs represent the government’s view of what a local authority needs to spend to provide a standard level of service consistent with overall public spending targets and taking account of the social, demographic and geographical characteristics of the authority’s area. They are used as the basis for distributing Revenue Support Grant (RSG) to ensure a common local tax rate throughout England in respect of spending at SSA level.

However, SSAs are also being used for tasks for which they were not originally designed. Since they were developed in 1989, the proportion of local government income represented by local taxes has fallen from more than 50% to about 20% and the government has introduced universal capping of councils, with SSAs being a key part of the basis for calculating capping limits. Pressure is growing for councils to set spending for each service with reference to service SSAs even though RSG is a block grant. The developing performance culture in local government may suggest new rôles for SSAs and the re-organisation process will expose presently concealed differences between actual spending and the SSA formulae.

These new tasks have created additional pressures on the system. There is increasing discontent among local authorities. Comparing the system with a checklist of objective criteria reveals that it is deficient in several ways. The system succeeds in equalising local tax rates for spending at SSA and is partially successful in terms of data reliability and the avoidance of perverse incentives. But consultation, although extensive, is unsatisfactory. The technical performance of the system delivers a degree of fairness, which could be improved; it is not designed to provide a standard level of service, and does not do so. The system is neither simple to understand nor stable in outcome, although it improves on its predecessor in both respects; and while it meets the objective of being ‘no less fair’ than its predecessor, this objective is judged inadequate in view of the new tasks imposed on the system. Compliance with central government’s overall spending objectives is achieved, as is autonomy for local government within the overall limits, but this outcome is unpopular with local government and does not allow central government to meet its control totals in respect of individual services.

Capping is a government policy and a fact of local government life. But the manner in which SSAs are used to limit council expenditure has confused accountability for local services between central and local government. Without clear responsibility for services, the basis for improving their economy, efficiency and effectiveness (the three E’s) is weakened. Alternatives to the present SSA system are reviewed to assess whether the price paid for the benefits of capping can be reduced. In considering alternative systems, key questions are identified concerning the balance between central and local control and between political discretion and formulaic decisions.
Technical improvements to the models are considered, as is independent validation of the system's performance and reducing the pressure on the system through an element of ministerial discretion or by more use of historic expenditure as the basis for capping. None of these approaches deals with the problem of accountability. A different approach could be a two-tier system of grant distribution, which might involve London being treated separately from the rest of England or the division of all English authorities into regional clusters. Another possibility would be an independent grants commission. But similarly, none of these changes is likely to resolve the tensions in the system; nor are they likely to improve significantly the performance of the system in relation to the three E's when they fail to resolve the issue of accountability.

Accountability can be clarified in two ways, with responsibility attaching more clearly either to local or to central government. A local government option could be to increase the revenue raising powers of local government and to modify capping by requiring referenda on propositions to exceed the spending limit or to reduce spending. A central government option would be the continued removal of functions from local government or a move towards more ring-fenced specific grants. Another way of increasing central government responsibility could be for central government to enter into contracts with local government for the delivery of services such as education, social services and the law and order services. This could clarify accountability in these areas and allow local accountability to work more effectively for the remaining services. However, such an option would have significant implications for the corporate rôle of local authorities and for central government departments.

The report recommends no specific solution. Rather, in highlighting the problem and describing some possible solutions, it sets the stage for a more thorough debate between and within local and central government, to determine whether the present SSA system, or modest revisions of it, is more tolerable and realistic than the alternatives. In this debate the Audit Commission's concern is for economy, efficiency and effectiveness in the delivery of services. In the compromises which central and local government negotiate, accountability should not be sacrificed, for without it responsibility for securing economy, efficiency and effectiveness in local services will be obscured.
SSAs IN CONTEXT

1. SSAs are the current basis for the distribution of grant from central to local government. They have a long pedigree. For more than 150 years central government has been grant-aiding local authority spending. During that time the nature and purposes of the grants have varied, but government objectives have usually included the following:

— to ensure the appropriate local provision of a service of national importance;
— to reduce the burden on local authorities of providing services by making national revenues available to supplement local taxes;
— to enable local authorities with fewer resources or greater needs to provide services similar to other areas without imposing a heavier tax burden.

2. For many years, grants were given mainly for specific services, tied to particular spending levels, as the police grant continues to be. Since 1958, most grant money has been distributed on a block basis, with recipient authorities free to use it as they choose. There have been many changes since 1958 in the mechanism for calculating the block (Exhibit 1). SSAs were introduced in 1990/91, at the same time as the move from rates to Community Charge (Box A, overleaf).

3. The government defines the SSA for a local authority as ‘…the amount of revenue expenditure which it would be appropriate for an authority to incur to provide a standard level of service consistent with the Secretary of State’s view of the appropriate amount of revenue expenditure for all authorities. It takes account of each

Exhibit 1

GRANT SYSTEMS SINCE 1958
There have been many changes.

Source: Audit Commission

1 Appendix 1 sets out a brief historical perspective on systems of government grant in Britain
authority's social, demographic and geographical characteristics, and the functions for which it is responsible.¹

**NATIONAL TOTALS**

4. The government uses SSAs to distribute grant in accordance with its policy to allocate its contribution to local authorities differentially according to the taxable resources and spending needs of those authorities.

5. Each year, the Government's view of the appropriate amount of revenue expenditure for all authorities is set out in the Revenue Support Grant settlement. For 1993/94, the Government assumes that local authorities (LAs) in England will spend a national total of £41.2 billion in revenue expenditure, a figure described as Total Standard Spending (TSS). Of this, councils are

¹ Source: Department of the Environment, Standard Spending Assessments - Background and Underlying Methodology.
6. Within the national total, the government takes a view on how much should be spent on different services and on the revenue costs of capital financing. The totals for each service are called ‘control totals’. There are control totals for seven main service blocks, of which education is the largest (Exhibit 3). The control totals are drawn up on an annual basis. The Public Expenditure Survey (PES) has no projections even for one year ahead for local authority spending on services like education, personal social services or highways.

7. The government calculates the share each authority should have of the control total for each service for which it is responsible. The sum of these service assessments then becomes the total SSA for the authority. Therefore, the total SSA is built up using a figure for each service, but once the total is decided it becomes a block figure which determines a grant allocation within which the council can make its own choices on how to fund local services.
8. Currently local authority responsibilities are diminishing. Higher and further education are examples of services which have moved outside local government in recent years. In the case of further education (FE), a total of more than £2 billion of college expenditure has been transferred away from local government for 1993/94. Many local authorities claim that more money has been taken from them than they actually spent on their FE Colleges.

9. In contrast, local government has gained functions and resources in respect of Community Care. More than £500 million will be provided to local authorities in 1993/94 for this purpose. However, Community Care funding is a temporarily ring-fenced grant. It cannot be used for any other purpose and is not yet part of the SSA system. It will serve to strengthen the trend away from local discretion and local control of resources unless, as the government intends, its funding is integrated into the SSA system and the block grant in future years.

LOCAL DISTRIBUTION

10. Local circumstances dictate that different authorities have to spend different amounts to provide a similar level of service. For example, one council may have a greater percentage of elderly people than another, justifying greater central government assistance to support relevant services. The underlying principle is equalisation to meet spending needs (needs equalisation). Government also distributes RSG in order to equalise fully for differences in the ability to raise local revenue (resource equalisation). RSG makes up the difference between each authority's SSA and its estimated sources of income. There are three main sources of income for local authorities - local tax (Community Charge until 1992/93, and Council Tax from 1993/94), NNDR, and RSG. Central Government sets for each authority its total SSA, its NNDR (as a common sum per adult across England) and its assumed level of local tax (as a common sum per Band D property across England). RSG then becomes a balancing figure to make up the difference between each authority's SSA and its other sources of income (Exhibit 4):

\[
RSG = SSA - NNDR - ASSUMED LOCAL TAX AT STANDARD SPENDING
\]

Exhibit 4

HOW RSG IS DISTRIBUTED

RSG is a balancing figure to make up the difference between an authority's SSA and its other sources of income.

Thus, despite differences in revenue-raising capacity and in the cost of providing services, the government's objective for the SSA system is that it should in theory be possible for local authorities to provide a similar level of service while levying a nationally-determined standard rate of local taxation. But the level of service they actually provide is a matter for local decision.

11. SSAs are mainly based on relevant indicators of population, such as children of primary school age for primary education or elderly people for relevant parts of the personal social services assessment. For highways, miles of road are important. These client group indicators form the major part of the calculations, but they are modified for differences in social need. For example, numbers of single parent families, income support cases and people who do not speak English as a first language are measured directly or by proxy, and the spending assessment for each area is weighted to provide more resources where needs are greater.

12. There are further adjustments to allow for the different costs of providing services in particular areas. For example, there are allowances for areas with very sparsely scattered population or for areas with particularly high population densities. Higher levels of pay and other costs in London and the South-East are recognised in the Area Cost Adjustment. It is necessary to decide the extent to which these factors should affect the assessment of an area's need to spend, and statistical techniques such as regression analysis are used to help reach these decisions (Box B). In total, there are 21 separate

Box B

SSA CALCULATIONS: THE RÔLE OF REGRESSION ANALYSIS

**Background**

The calculation of SSAs requires a way of estimating how much each LA needs to spend to provide a similar standard of service. The basic approach used in the current system is to identify a number of 'indicators' which might be expected to be related to spending need and then to use a statistical technique known as regression analysis to estimate the relationship. The relationship would not be expected to explain all the variations in spending between LAs - because LAs differ in terms of both policies (e.g. the quality or the volume of service delivered) and efficiency. But differences in the need to spend would appear as an underlying trend in the data.

**Illustration**

In the graph below, a single indicator is used in a regression against historic LA spending levels for the service being studied. The fitted relationship is assumed to be the need to spend (at an average standard of service), while variations between actual spending and the line are assumed to be due to policy or efficiency differences.

In order to confirm that the relationship is a reasonable one, the statistical 'goodness of fit' would be checked and the indicator weights (in this example, the slope of the line) examined to see if they were plausible in the view of statisticians and service experts.
assessments within seven main blocks. In comparison with GREs, the number of assessments has been reduced by two thirds (Exhibit 5). The composition of each authority's SSA can be broken down into its component elements (Box C).  

Exhibit 5  
THE REDUCTION IN ASSESSMENTS BETWEEN GREs AND SSAs  
The number of assessments was reduced by about two thirds.

<table>
<thead>
<tr>
<th>GREs</th>
<th>SSAs</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Education</strong></td>
<td><strong>Education</strong></td>
</tr>
<tr>
<td>Primary</td>
<td>Primary</td>
</tr>
<tr>
<td>Secondary (above school leaving age)</td>
<td>Secondary</td>
</tr>
<tr>
<td>Secondary (below school leaving age)</td>
<td>Post-16</td>
</tr>
<tr>
<td>Careers</td>
<td>Under-5</td>
</tr>
<tr>
<td>Non-advanced FE</td>
<td>Other</td>
</tr>
<tr>
<td>Nursery</td>
<td>Children</td>
</tr>
<tr>
<td>Adult</td>
<td>Elderly (Domestic)</td>
</tr>
<tr>
<td>Higher Education</td>
<td>Elderly (Residential)</td>
</tr>
<tr>
<td>Young unemployed</td>
<td>Other</td>
</tr>
<tr>
<td>Youth and related studies</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Personal Social Services</strong></th>
<th><strong>Personal Social Services</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Children 0 - 17</td>
<td>Children</td>
</tr>
<tr>
<td>Elderly</td>
<td>Elderly (Domestic)</td>
</tr>
<tr>
<td>Other</td>
<td>Elderly (Residential)</td>
</tr>
<tr>
<td></td>
<td>Other</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Home Office</strong></th>
<th><strong>Police</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Police</td>
<td>Fire</td>
</tr>
<tr>
<td>Fire &amp; Civil Defence</td>
<td>Civil Defence</td>
</tr>
<tr>
<td></td>
<td>Highway Maintenance</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>All Other Services</strong></th>
<th><strong>District-level services</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Distribution Services</td>
<td>Rail Support</td>
</tr>
<tr>
<td>Other Services</td>
<td>Flood Defence</td>
</tr>
<tr>
<td></td>
<td>Coast Protection</td>
</tr>
<tr>
<td></td>
<td>Revenue Interest Receipts</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Capital Financing</strong></th>
<th><strong>Interest on Capital Receipts</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt Charges</td>
<td>Debt Charges</td>
</tr>
<tr>
<td>Capital Charged to Revenue</td>
<td></td>
</tr>
</tbody>
</table>

Source: DoE, Grant Related Expenditure, 1989/90, SSA Handbook, 1990/91

1 A fuller description of the way SSAs are derived is set out in Appendix 2.
**Box C**

**SSA COMPONENTS: ONE EXAMPLE - PRIMARY EDUCATION ASSESSMENT**

Example: Warwickshire (1992/93)

<table>
<thead>
<tr>
<th>Note</th>
<th>£</th>
<th>£</th>
<th>%</th>
<th>Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic cost per pupil</td>
<td></td>
<td>1372.96</td>
<td>79.7</td>
<td></td>
</tr>
<tr>
<td>Additional educational needs</td>
<td>2</td>
<td>653.52</td>
<td>x 38.9% (a)</td>
<td>254.42</td>
</tr>
<tr>
<td>Sparsity</td>
<td>3</td>
<td>205.94</td>
<td>x 39.1% (b)</td>
<td>8046</td>
</tr>
<tr>
<td>Free school meals</td>
<td>4</td>
<td>150.78</td>
<td>x 10.4% (c)</td>
<td>15.61</td>
</tr>
</tbody>
</table>

Unit cost/pupil = 1723.45 100.0%

Area cost adjustment = 1

No of pupils aged 5-10 = 33,641

SSA (£000) = 57,978

**Derivation of Indicators**

(a) Additional educational needs

<table>
<thead>
<tr>
<th>Note</th>
<th>%</th>
<th>Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>Children of lone parents (%)</td>
<td>10.8%</td>
<td>16.2%</td>
</tr>
<tr>
<td>Children of claimants of Income Support (%)</td>
<td>10.4%</td>
<td>15.5%</td>
</tr>
<tr>
<td>Children or household head born outside UK, Ireland, USA or Old Commonwealth (%)</td>
<td>7.3%</td>
<td>7.3%</td>
</tr>
</tbody>
</table>

(b) Sparsity

<table>
<thead>
<tr>
<th>Note</th>
<th>%</th>
<th>Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population in wards with 0.5 or less people/ha</td>
<td>5.3%</td>
<td>10.6%</td>
</tr>
<tr>
<td>Population in wards with 0.5 to 40 people/ha</td>
<td>28.4%</td>
<td>28.4%</td>
</tr>
</tbody>
</table>

(c) Free school meals

<table>
<thead>
<tr>
<th>Note</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Children of claimants of Income Support (%)</td>
<td>10.4%</td>
</tr>
</tbody>
</table>

**Notes**

1. The client group is pupils aged 5-10.
2. 'Additional educational needs' allows for the extra costs of special schools, pupils who require extra help in ordinary schools and external support e.g. school psychologists, uniform grants.
3. The sparsity indicator allows for the diseconomies of scale of small schools and higher home to school transport costs.
4. The free school meals indicator recognises the additional costs related to children whose parents receive Income Support.
5. The additional needs indicator was derived from regressions of measures of additional need against alternative composite indicators of available data.
6. The sparsity indicator was initially derived from regression analysis but the overall weight was judged to be too low and was accordingly increased by 50%.
7. The percentage of the total national assessment allocated via the various indicators is fixed in line with research findings at 20% (additional needs), 2.4% (sparsity) and 1.2% (free meals). These proportions vary across authorities; for Warwickshire, they are 14.8%, 4.7% and 0.9% respectively.
13. Although the definition of SSAs suggests that they are built up from individual local circumstances in each area, they are more accurately described as the result of dividing up a predetermined total of revenue spending among local authorities as equitably as possible, taking some account of the impact of local circumstances on the need for and cost of providing services. The process is essentially top-down, whereas the term 'Standard Spending Assessment' implies that it is bottom-up.

'The SSA is not a target at which they (local authorities) should aim... nor is it a level to which they are obliged to reduce if they want to spend above it. It is for local government to determine what it will spend on its services. It will be answerable to the electorate for the resulting charges.'

Rt Hon. Kenneth Clarke MP, Secretary of State for Health, Standing Committee E, National Health Service and Community Care Bill, 20 February 1990.

CONTROLLING EXPENDITURE

14. The original purpose of SSAs was as a grant distribution mechanism. In addition, they are also being used for capping, to control council spending, both collectively and individually. Authorities cannot set budgets which ministers regard as excessive in that they represent too large an increase over either their previous year's budget or their SSA. For this purpose the previous year's budget is restated as a relevant notional amount. This adjusts the previous budget for changes in responsibilities. For 1993/94 the main adjustment to budgets is an estimate of the spending no longer falling to the local authority as a result of the transfer of further education funding out of local government. The precise capping limit for an individual council depends on the relationship between the budget and the SSA (Exhibit 6). Local authorities spending well below SSA can contemplate large real increases in spending; those spending well above SSA have to make significant cuts.

Exhibit 6
CAPPING LIMITS (1993/94)
Capping limits depend on the relationship between budgets and SSA.

Source: DoE, The Limitation of Council Tax and Precepts, 1993/94
15. The government applies capping to local authority spending in order to achieve two objectives:
— to control the total of local authority spending, thus helping to meet the objective of reducing over time the share of national income taken by public spending1;
— to protect local taxpayers from bills imposed by some local authorities which it regards as excessive.
However unpopular capping may be, it is a reality with which councils are obliged to come to terms, and SSAs are used alongside historic expenditure as the core criteria. Although SSAs were not designed for this purpose it is not surprising that ministers turned to them as a key basis upon which capping would apply. SSAs are the only assessment available to government of what it expects councils to spend. But their use for such a purpose does raise questions as to whether they are either appropriate or could ever be made sufficiently precise.

EMERGING TENDENCIES - HYPOTHECATION

16. As well as capping, two tendencies involving SSAs are also emerging. The first is hypothecation. This refers to the idea that the element of the SSA calculated for each service should be dedicated entirely to that service. At present, an authority’s RSG is an unhypothecated block grant, linked to the sum of its service SSAs. Local authorities have discretion on how they use the money they receive. Therefore government decisions on priorities, as expressed in control totals, need not be carried into local practice (Exhibit 7). It would require primary legislation to give ministers the power to achieve this. However, because the total SSA is built up from separate assessments related to different service areas, there is a temptation to judge an authority’s spending

Exhibit 7
NATIONAL CONTROL TOTALS - LOCAL DISCRETION
Government decisions on priorities need not be carried into practice.

Note: Changes adjusted for average increase in SSAs
Source: Peter Smith, The Impact of SSAs on Local Authority Budgets (Background Paper 8.2)

on a particular service by reference to its SSA for that service. Such judgements are sometimes made by local pressure groups, by central government inspectorates and occasionally even by ministers and local authorities.

17. It is questionable whether using SSAs in this way is justified. There are differences of definition between authorities in the way they classify expenditure in their budgets as between central costs and direct spending on services, and there is no agreed methodology for comparing LA service budgets with service SSAs. Further, the SSA for capital financing is largely based on a notional figure for debt outstanding at 1 April 1990. Some local authorities had higher actual debt at that date than was calculated in their SSA. This means that they have no choice but to pay more to service their debts than the SSA allows, so that less of their spending power is available for other services. Conversely, other local authorities were free of debt at 1 April 1990. Their SSA for capital financing need not be spent on debt servicing and is available to increase their spending on services beyond the sum of their service SSAs. For authorities in the first category it is not possible for their spending on services to match the sum of their service SSAs if their total spending is to remain within their total SSA. Authorities in the second category are able to choose whether to spend more on services or to reduce local taxes.

18. Despite these problems, the tendency to judge local services in terms of the relevant service component of the local SSA is gaining momentum. The government has stated its intention of fixing the funding of grant maintained schools with reference to the education component of the SSA for the area. This gives local authorities which wish to retain control of their school systems a strong incentive to ensure that local authority funding of schools is not less than SSA, thereby reducing the incentive for schools to 'opt out'. As education is the largest service, the hypothecation of its SSA is likely to incline all other service budgets towards their SSA.

'It is the total SSA for an authority which is used for distributing Revenue Support Grant. Local authorities, however, retain discretion over their expenditure priorities both between and within services.'


EMERGING TENDENCIES - PERFORMANCE CULTURE

19. The second tendency is the extra emphasis on performance measurement and improvement which is developing in the culture of all public services. Some government departments are becoming less tolerant of the differences in service level which arise from local discretion. In services like fire, police, education and social services the government is increasingly prescribing the outcome of services. Outside local government, funding is already related to performance in areas such as university research or Training and Enterprise Councils. If the government's appetite for a performance culture extends further into local government it should be confident that councils are potentially capable of delivering comparable levels of performance (possess equivalent capability) and that definitions of service standards (whether inputs, outputs or outcomes) are clear and comprehensible.

20. It would not be possible to operate fairly a system which required equivalent capability as a precondition, if there were inadequacies in the calculation of SSAs which prevented
equivalent capability being achieved through the operation of the grant system. Moreover, significant differences in historic service provision in different areas would raise questions about such an approach. For example, if nursery education is included as part of the standard service level, an authority will be advantaged if it has already carried out the necessary investment in premises to meet required standards. But if nursery education is not part of the standard service level, an authority which has invested in such premises will be disadvantaged because it will have to meet costs of servicing past capital expenditure on a service which it will no longer be funded to provide. Meeting these unfunded costs would cause underfunding of other areas of service.

21. The trend to a performance culture and the necessary pre-conditions to establish one, all throw the spotlight on SSAs. Service standards are not defined in the SSA system, despite the reference in their definition to a 'standard level of service'. The meaning of 'level of service' is not defined for most local authority services and so it is impossible to identify any particular level as the standard. This is deliberate. The Department of Environment (DoE) has seen such a process of defining standards as too difficult to achieve in practice. Moreover, SSAs take no account of the history of service provision or the value of the asset base. Whether they form an adequate basis for funding services to standards of performance which will then be compared is therefore open to question.

A NEW CHALLENGE

22. Another significant challenge for the system is the impact on SSAs of local government re-organisation. If, as is possible, new unitary authorities are created which are smaller than present counties, SSAs for present county services will have to be recalculated for each of the new authorities. There could be material changes in SSA per head. These need not match current county council spending patterns. For example, in education, an analysis based on data calculated for Berkshire suggests that counties tend to equalise services across their areas despite variations in spending need which are identified when disaggregated SSAs are calculated. If Berkshire had six unitary authorities, based on present districts, patterns of SSAs and spending could change (Exhibit 8, overleaf). Re-organisation could expose the contrast between actual spending and the level of spending assumed by SSAs. This could lead to big changes in local taxes and/or service levels. Another complication is that re-organisation is taking place in different areas at different times. If the government ignored these changes, and allowed the present SSA system to operate without amendment for the new authorities, then it would risk triggering significant levels of public protest. A question is therefore raised as to how SSAs should be adjusted to cope with the immediate effects of re-organisation.

CONCLUSION

23. The SSA system is at the heart of the financial relationship between central and local government. That it has a profound effect on local government is indisputable. But it does more than affect relationships between two tiers of government. Even though efficiency improvements

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1 'Phoenix Rising' (Audit Commission Occasional Paper No 19, forthcoming) - In New Zealand, similar problems arose because of the merging of previous districts and the equalising of their tax rates. The new Conservative Government in New Zealand felt obliged to provide aggrieved communities with the means of seceding from their new authorities.
are always possible, the absolute level of resources underpins the ability of any tier of government to deliver services to the public. SSAs may be a remote concept when considering the numbers of pupils per teacher in schools, the extent to which home helps are available to the elderly, the frequency with which potholes in the road are repaired and the availability of new books in the library, to name just a few examples, but all of these services compete for money locally from a budget which is constrained by the SSA system. Directly or indirectly SSAs affect everyone.

24. Fluctuations in SSAs over time can result in the urgent curtailment of valued services or, in some places, in an unexpected increase in resources providing additional services. They also affect local tax levels. It is not surprising, therefore, that councils, on behalf of their local electorates, are very concerned about the SSA system.

25. As a system for distributing a limited amount of grant, the intentions and overall architecture of the SSA system seem unobjectionable. The system builds on lessons learned through the operation of many previous systems. As long as local needs and resources vary and local government is unable to fund all its services entirely from local taxation, a scheme of assistance from central government is necessary. That central government should direct its assistance where needs are greatest or resources least has been part of a wide political consensus for many years. That councils, individually or in groups, seek to complain and readjust the formulae in their own favour is predictable. That the system could never be perfect was acknowledged. Imperfections were tolerable, if controversial, when more than half of local expenditure was covered by local taxation, enabling councils to ‘paper over the cracks’ of the SSA system using local taxes. But the increase of grants to 80% of expenditure, capping, the tendencies
to hypothecation and a performance culture and the issue of re-organisation all raise questions about the capability of the SSA system. The next chapter examines whether it can meet the challenge.
2. Assessing Criticisms of the System

LOCAL AUTHORITY VIEWS

26. In view of the ways in which SSAs are increasingly being used, it is not surprising that criticisms of the system from local government are becoming more vociferous. As part of the study, the Commission undertook a survey of local authority views of SSAs. Only 8% of authorities surveyed thought that SSAs were a suitable basis for capping, but more than 40% of authorities said they were acceptable as a basis for grant distribution.

27. Additionally, the survey revealed how capping limits have grown in importance for budget setting. These are now far more important than estimates of spending to meet desired service levels and local tax rates for all classes of authority. And uncertainty about SSAs and capping limits were judged to be the most important factors in inhibiting long-term planning. No more authorities claim to plan more than one year ahead than did so five years ago. The survey also gave authorities the opportunity to give their views more generally on SSAs (Box D, overleaf). A wide range of opinions was expressed. Many respondents cited reasons why their authority's local circumstances were not properly taken into account, and there were many criticisms of the SSA methodology and of particular assessments.

28. The hundreds of different criticisms of the SSA system may be summarised into two criticisms of principle and two of practice. In principle, many authorities expressed opposition to capping, and to the use of SSAs as a way of judging spending on individual services. The objections of practice may be summarised as a view that there was not enough money in the system; and that the system provided an inadequate share for a particular authority, or group of authorities.

29. These points are not surprising. As SSAs distribute a fixed sum of money, a bigger share for one authority means less for others. There is a deadlock in reaching a collective local government view of how SSAs work. The only point which can command agreement across all authorities is the need for more money in the system. But the deadlock which prevents collective views emerging does not inhibit individual councils from arguing how the formulae should be adjusted in their own favour without regard for the effect on other councils.

30. That local councils criticise the system from a point of view of its immediate impact on their ability to provide local services is also not surprising. They face the immediacy of reconciling resources with local needs. But sitting behind their direct criticisms are the influences described previously, which are placing on the SSA system tasks which it was not designed to discharge.

31. As a result of the pressures in the system, local authorities and the associations scrutinise the calculations ever more closely to see if it is possible to gain any advantage within the system.

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1 The Audit Commission survey is described further in Appendix 3.
### Box D
**The Commission's Survey - Local Authority Views of SSAs**

<table>
<thead>
<tr>
<th>Issues</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Local Issues which were felt to advantage or disadvantage certain LAs</strong></td>
<td></td>
</tr>
<tr>
<td>Economic</td>
<td>Unemployment, homelessness, trading income, Large Scale Voluntary Transfers</td>
</tr>
<tr>
<td>Environmental</td>
<td>Reclamation of ex-mining land, Green Belt planning enforcement</td>
</tr>
<tr>
<td>Demographic</td>
<td>Population decline/growth, needs of elderly</td>
</tr>
<tr>
<td>Geographical</td>
<td>Regional centres, travel costs related to geography</td>
</tr>
<tr>
<td>Financial</td>
<td>Revenue costs of capital projects, transfer of new town assets, staff turnover, high debt</td>
</tr>
<tr>
<td>Costs arising from local facilities or amenities</td>
<td>Army bases, airports, ports, heavy industry</td>
</tr>
<tr>
<td>Local initiatives</td>
<td>HMOs, recycling, response to 'Pin-down' report</td>
</tr>
<tr>
<td><strong>The impact of SSAs on Budgeting and Financial Planning</strong></td>
<td></td>
</tr>
<tr>
<td>Constraints on LA actions</td>
<td>Gearing too high, SSAs now de-facto target, service cuts now likely</td>
</tr>
<tr>
<td>Accountability</td>
<td>Local accountability diminished</td>
</tr>
<tr>
<td>Impact on planning</td>
<td>SSAs too unstable, November too late for planning, system encourages short-termism</td>
</tr>
<tr>
<td>Interpretation of SSAs</td>
<td>Service-level SSAs of increasing importance, most members and officers don't understand</td>
</tr>
<tr>
<td><strong>Problems with the SSA Methodology</strong></td>
<td></td>
</tr>
<tr>
<td>Allocation methods</td>
<td>Insensitive to local circumstances, out-of-date, need to allow for true drivers of cost</td>
</tr>
<tr>
<td>Indicators</td>
<td>Too much weight on social indicators, too little on economic conditions, better data required</td>
</tr>
<tr>
<td>Specific assessments</td>
<td>(All assessments criticised by one or more LAs)</td>
</tr>
<tr>
<td>Consultation process</td>
<td>Lone voices ignored, better dialogue needed</td>
</tr>
<tr>
<td>Control Totals</td>
<td>Inadequate account of costs of new duties, loss of income due to recession</td>
</tr>
<tr>
<td>What SSAs should take into account</td>
<td>Parish precepts too variable for capping, more use of specific grants/actuals</td>
</tr>
<tr>
<td>General issues</td>
<td>Aims of system need clarification, no means of validation</td>
</tr>
<tr>
<td><strong>Capping</strong></td>
<td></td>
</tr>
<tr>
<td>Acceptability</td>
<td>SSAs need to be more accurate to be acceptable, capping unnecessary with high gearing, capping criteria should be planned well ahead, bigger tolerance needed</td>
</tr>
<tr>
<td>Capping mechanisms</td>
<td>Rely more on historic spending, use Performance Indicators</td>
</tr>
<tr>
<td>Differential approaches</td>
<td>More flexibility where problems can be proved, restore £15m threshold, improve flexibility for small LAs, separate London</td>
</tr>
<tr>
<td>Who should do it?</td>
<td>Use an independent body, involve Local Authority Associations, use local referenda</td>
</tr>
<tr>
<td>Need for more fundamental change</td>
<td>Accountability should be clarified e.g. by changing the funding method for some services</td>
</tr>
</tbody>
</table>
There were 89 delegations to ministers concerning the 1993/94 settlement. At one point 5 DoE ministers separately and simultaneously were meeting delegations from local authorities. This level of use for what is, in effect, the appeal of last resort suggests that there are real strains within the system.

32. Some in local government allege political bias by ministers. One example cited is the decision in 1991 to allow the weighting for visitor nights to be doubled. It is alleged that this decision was made in order to favour a particular local authority and provided evidence of bias in the use of SSAs by ministers. However, such allegations are not easy to demonstrate convincingly.

33. The use of formulae offers some safeguard against capricious ministerial behaviour but does not extinguish its possibility. Indeed, formulae, because they are little understood, can draw a disguising veil across the values which lie behind them. No formulation is value free, but formulae can disguise what those values are. For example, SSAs for councils in Wales are calculated on different formulae from SSAs for English councils. The two methods give different results. Different approaches between the two sets of formulae in relation to issues like sparsity and socio-economic deprivation lead to different outcomes (Exhibit 9). This report does not argue that the Welsh method is better or worse than the English. But it demonstrates that the formulae are based on different values and produce different outcomes.

Exhibit 9
THE IMPACT OF DIFFERENT METHODS OF CALCULATING SSAs
Calculating SSAs for Welsh Districts by the English method gives different results.

Source: Audit Commission

JUDGING GRANT SYSTEMS - DEVELOPING A CHECKLIST
34. No allocation system can be perfect. The greater the number of objectives, the more likely it is that some will be met imperfectly and that different objectives will conflict with each other. For example, it is desirable to keep the method as simple as possible, so that it is easily understood by anyone with an interest in it; but the simpler a system becomes, the less sensitive, and less fair, it is likely to be. Stability of the results over time is also a desirable aim, but this can lead to a system which does not change fast enough to reflect changes in circumstances. A system based on data which is incapable of being manipulated by local authorities is likely to be more
objective. But the further the data sources are removed from local authority activities, the less suitable they are likely to be in determining expected standards of service. So compromise is inevitable.

‘I am not so complacent as to believe that SSAs are perfect, or, indeed, that perfection is achievable in such a complex field under which the ground is ever shifting.’

35. To assess whether the SSA system can meet both its original and its additional objectives and whether local government’s criticisms of the system are justified, an analytical framework is valuable. An amalgam of the objectives set by the Government for the SSA system and Council of Europe Recommendation No. R(91) 4, adopted by the Committee of Ministers on 22 March 1991 and set out in full in the Annex to this report, can be used as criteria to assess SSAs, or any alternative system (Box E). The British government supports the Council of Europe (CE) objectives.

**Box E**

**CHECKLIST FOR JUDGING GRANT SYSTEMS**

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td>(a)</td>
<td>Simplicity</td>
</tr>
<tr>
<td>(b)</td>
<td>Stability</td>
</tr>
<tr>
<td>(c)</td>
<td>Data reliability</td>
</tr>
<tr>
<td>(d)</td>
<td>Avoidance of perverse incentives</td>
</tr>
<tr>
<td>(e)</td>
<td>Exclusion of efficiency differences from need calculations</td>
</tr>
<tr>
<td>(f)</td>
<td>Consultation between central and local government</td>
</tr>
<tr>
<td>(g)</td>
<td>Similar rate of local tax</td>
</tr>
<tr>
<td>(h)</td>
<td>Similar (European term) or Standard (UK term) level of service</td>
</tr>
<tr>
<td>(i)</td>
<td>Fairness</td>
</tr>
<tr>
<td>(j)</td>
<td>Protection of local autonomy</td>
</tr>
<tr>
<td>(k)</td>
<td>Consistency with government spending policies</td>
</tr>
<tr>
<td>(l)</td>
<td>Clear accountability</td>
</tr>
</tbody>
</table>

(a) **SIMPLICITY**

36. At first sight, SSAs seem impenetrably complicated. But this view is not entirely fair. The determination of SSAs, being wholly formula-based, is explicit and open to scrutiny. The components of the formulae (client groups, unit costs) generally have a simple structure, consisting of a small number of indicators, each multiplied by an appropriate weighting. And the volume of documentation is much lower than for GREs since the number of assessments has been reduced to about a third of the original number. SSAs may fairly be described as more simple than GREs, although they still appear a mystery to most elected members, let alone members of the public. Overall they might be classified as transparent but not simple.

(b) **STABILITY**

37. An improvement in the stability of assessments over time was one of the principal design criteria for the grant system, of which SSAs form an important part. Improvements have been
made. The level of grant does not now change as a result of spending within the year and changes in the assessment methodology have deliberately been kept to a minimum. Although some minor changes have been made in response to complaints about particular issues, the methodology has been consistent over the last three years. However, this in itself does not guarantee that the SSAs for particular authorities are stable.

38. For the system to work well as a control system, to limit expenditure, it needs to be reasonably stable over time, so that year on year changes at the level of the individual authority reflect a balance of changes in the government’s view of appropriate overall spending levels and of changes in local circumstances. However, the extent of changes which do take place from year to year make rational planning difficult. The bulk of the instability derives from changes in national control totals between services (Exhibit 10). However, ministers cannot be confident of achieving the desired outcome from changed control totals because of the unhypothecated nature of the block grant. The instability is not capricious, but is caused by rational central decisions. However, at the receiving end, the result seems unpredictable.

Exhibit 10
SSA INSTABILITY
There is instability in SSAs...

...which is mainly caused by changes in control totals.

Reasons for national SSA changes

(c) DATA RELIABILITY

39. With fewer indicators, SSAs place fewer demands on the data base than GREs. Much of the data is based on the census, which has its own procedures for validation. Questions have been raised about some of the 1991 Census population figures, particularly concerning the methods proposed by the Office of Population Censuses and Surveys to tackle the shortcomings. However, some measures of population are inevitable and it is difficult to envisage any more reliable source. The reliability of data sources was an important consideration in the choice of indicators. Some data sources, such as the number of people accepted as homeless, which might have been useful indicators were rejected because of fears about data reliability and because there were fears that local authorities might be able to manipulate the data to improve their grant.

40. Most of the other indicators are relatively easy to check and are generally held to be reliable, although there are some exceptions. For example, the number of people in an area who claim income support is an indicator in several assessments. The data used is collected by the Department of Social Security (DSS), on the basis of a 1% sample, collected manually. The results have been challenged. For example, there are variations between areas in the proportion of eligible people who claim the benefit. DSS offices do not cover areas coterminous with local authority boundaries. Even postcode data does not always succeed in allocating claimants to the right local authority area. So authorities sometimes question the validity of the information even though great efforts are made to ensure its accuracy.

41. Another consequence of the reduction in assessments and range of indicators is that the system is cheap to administer. The use of readily available sources of data obviates the need for expensive specialist data collection exercises. The administration is carried out centrally by a small team at DoE headquarters, which is possible because of the decision, for reasons of stability, to keep the methodology essentially the same over a number of years. Given the amount of money being controlled through SSAs (over £40 bn), the total administrative overhead is very low in comparison with other funding systems e.g. Urban Programme, City Challenge etc. The question arises whether more should be spent on the operation of the system, for example by sponsoring targeted items of research to test how far the indicators used reflect real differences in need to spend.

(d) AVOIDANCE OF PERVERSE INCENTIVES

42. The DoE has recognised that indicators which relate directly to service activities can provide undesirable incentives for local authorities to act in a particular way. For example, an indicator relating to the number of children in special schools might be considered a suitable indicator of additional educational needs, but it would be rejected on the grounds that it would encourage local authorities to place children with special needs in special schools rather than integrate them into ordinary schools. This accounts for the attractiveness of proxy indicators based on census data - local authorities cannot affect them in order to improve their financial position.

43. However, a few examples of perverse incentives do exist. For example, a Fire Authority reviewed the risk gradings in its area. By downgrading some areas from A risk to B risk it saved £100,000 a year in operating costs, but then lost more than £1,000,000 in its SSA. Investment in fire prevention can lead to a reduction in fire calls and consequent loss of SSA. The police
SSA is based on the establishment of police officers approved by the Home Secretary and so authorities have an incentive to seek approval for more police officers rather than pressing for greater use of civilian staff in the police force. However, such perverse incentives are the exception.

(e) EXCLUSION OF EFFICIENCY VARIATIONS FROM NEED CALCULATIONS

44. The SSA system makes much use of regression analysis, based on past expenditure. It assumes that the regression line represents need to spend, with efficiency and policy differences tending to account for random variations from the underlying trend. This assumption is open to challenge from the Commission's own experience of measuring efficiency differences between authorities, from research carried out for this study and from statistical analysis. Taking into account the relevant precepts, the maximum variation in SSAs per head is almost 3.4:1, between Forest Heath and Tower Hamlets. The variation in SSA reflects historic variations in expenditure and is assumed to show different levels of need. It may well do so. But the variation could also reflect different levels of past efficiency between authorities like those serving Tower Hamlets and Forest Heath. If that were so, then some of Tower Hamlets' extra SSA could be a reward for past inefficiency in similar authorities rather than a recognition of need.

45. In its studies of local government services, the Audit Commission typically finds efficiency variations between local authorities of the order of 3:1. The work done for this study does not make it possible to estimate confidently how far the differences in spending between different authorities reflect need, efficiency or local political choice. But it does lead towards questioning the assumption that need is necessarily a more significant determinant of spending than efficiency or local political choice. The Commission's experience suggests that spending differences reflect need, efficiency and policy choices in ways which are less predictable than the assumptions within the SSA system.

(f) CONSULTATION BETWEEN CENTRAL AND LOCAL GOVERNMENT

46. There is extensive consultation between central and local government through the Consultative Council on Local Government Finance (CCLGF). Many meetings take place each year. Technical issues are considered in detail. However, many in local government argue that central government refuses to enter into serious discussion on key issues like total spending and the assessment of changing demands on services. This is said to reduce the consultation process to a charade. In addition, conflicts of interest within and between the local authority associations reduce the effectiveness of the consultation mechanism. The Council of Europe recommends the purpose of consultation as being to identify and test the value judgements used within the system. In practice, despite the diligent efforts of all parties to the discussions, reactions to consultation focus more on identifying winners and losers through the exemplification of proposed changes.

1 This issue is discussed more fully in Appendix 4.
(g) SIMILAR RATE OF LOCAL TAX

47. An objective of the system is to equalise the local tax consequences if authorities spend at SSA. Under Community Charge this was expressed in terms of a Standard Community Charge per Adult. With Council Tax the currency of the system is Council Tax per Band D property and taxes paid per head across different authorities will vary in line with differences in average property values. Anywhere in England, the Council Tax for property in any particular Band will be the same in respect of spending at SSA. Therefore, the system is successful in producing a similar rate of local tax for spending at SSA. However, small differences between different authorities in spending levels will lead to large differences in local tax levels because local tax is the balancing figure in matching revenue to spending, even though local tax covers only about 20% of total expenditure.

(h) SIMILAR (EUROPEAN TERM) OR STANDARD (UK TERM) LEVEL OF SERVICE

48. The term Standard Spending Assessment implies a standard level of service. This is not defined. The DoE prefers to describe the objective as being a common level of service. This will appear to be better resourced in areas assessed as having higher needs. So standard spending per head varies sharply between authorities. On the ground, the level of services delivered to the public also varies. At first sight the SSA does not provide for a similar or standard level of service. Assessing whether a common level of service is achieved in the DoE's terms depends on whether the system is fair in its assessment of needs between areas. It may be that by allowing for the particular demographic, geographic and social characteristics of each area it can achieve a level of fairness. However, it does not meet the Council of Europe requirement of also allowing for different economic characteristics between areas. The system's ability to deliver fairness is discussed in the paragraphs below.

(i) FAIRNESS

49. Fairness is an imprecise concept. It depends on values not statistics. Is it fair for example, that Cambridge has a higher SSA per head for district services than Hartlepool, as a result of being defined as more deprived in terms of the All Ages Social Index (Exhibit 11)? Or that Manchester has an SSA per head 28% greater than neighbouring Salford? Other questions of fairness may arise. For example, is it fair or unfair that:

— the range of SSAs per head is 3.4:1 in England, or should the gap be wider or narrower?

— some authorities receive grant and spending power for services they do not provide?

— high previous spending should be taken as a proxy for need in the regression calculations, without full allowance for efficiency or choice?

— capital financing SSAs should be based on notional rather than actual debt? Do they reward wealth and penalise need? Or do they reward prudence and penalise extravagance?

These questions require political answers. They cannot be resolved by statistics alone.

50. However, the Government's objective is that SSAs should be 'no less fair' than GREs despite being simpler and more stable. There is no definition of fairness. Like GREs, SSAs were designed to distribute grant representing about 50% or less of local authorities' income. When
they were introduced, most authorities were not capped. Those which were capped were allowed to spend at least 12.5% above their SSA - a margin defined under the original rate capping rules in 1984. SSAs now control the distribution of about 80% of local authorities' income. All authorities are effectively capped, many to their SSA with no margin above it. SSAs must do more than GREs; saying they should be 'no less fair' than GREs is not enough.

51. The fairness of the system depends on the quality of the data, methodology and models used in the system and on how far the values it promotes meet the values of society as expressed by elected representatives. A model cannot create fairness. It can only interpret values which are conducive to fairness. The values in the SSA system are not clear. And there are serious questions as to whether the sophistication of the models is adequate for the policy purposes to which they are put.

52. There are technical problems in the methodology and models used within the system (Exhibit 12, overleaf). And, however sophisticated the assessment model, there will always be special local circumstances which any practical model cannot take into account. Where these are minor, it is reasonable to ignore them. However, there is evidence that for certain authorities, the costs of meeting peculiar local circumstances can represent a significant part of their budgets. SSAs possess no mechanism for recognising unique or subtle variations in local needs and costs.

53. Many authorities cited the lack of sensitivity as their major concern with the system, when responding to the Commission's survey. Many different reasons were given in support of these views: economic, environmental, demographic, geographical, financial and relating to specific local amenities. For example, a number of authorities felt that deteriorating economic conditions affected them adversely, through a lower capacity to generate income and higher

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1. Although the concept of a 12.5% margin is still recognised, authorities are capped within that margin through the second criterion of the capping system, which is the size of year on year budget increases.
Note: Further details are given in Appendix 4

demand for services. The cost of supporting homeless households is a particular problem for some authorities. High levels of debt were a problem for others, especially former new towns. Coalfield communities sometimes had high levels of environmental costs relating to reclamation; for others, such costs arose because of a high concentration of heavy industry. Some pointed to the costs of planning enforcement in the Green Belt. Specific facilities or amenities such as ports, airports or army bases could also be a burden. And local authorities servicing regional centres also claimed that they carried some of the costs of supporting neighbouring areas.

54. Conversely, some authorities benefit from particular local circumstances. One council makes such high profits from rental income on industrial estates and interest on capital receipts that it can offer Council Tax payers a discount of over 40% on the county precept. While it would be wrong to stifle initiative by depriving local authorities of the benefits of good management, it is difficult to argue that the potential for such opportunities is equal among authorities.

(j) PROTECTION OF LOCAL AUTONOMY

55. This is an objective contained in the CE Recommendation. With a system based mainly on block rather than specific grants, English authorities are free to allocate their resources between services, subject to statutory and regulatory constraints, and they are free to spend below their capping limit or SSA. If they are designated for capping, they may appeal to ministers for a higher capping limit than the formula would provide. They are not free to spend above their capping limit. Many in local government argue that this undermines local autonomy, which in respect of total spending is true. But in the case of spending within their total limit, they enjoy considerable autonomy. They have scope to improve their operations to deliver better economy,
efficiency and effectiveness. Achieving better value for money can increase their freedom of choice in terms of improving local services or reducing local taxes.

(k) CONSISTENCY WITH GOVERNMENT SPENDING POLICIES

56. Through capping, the present system is reconciled with central government policies in terms of total spending. There is a conflict between local autonomy and the meeting of central objectives, which is currently resolved in favour of meeting central objectives. But the achievement of central government spending priorities for particular services is limited because of the local discretion arising from a system based on block grants.

(l) CLEAR ACCOUNTABILITY

57. Clear accountability is at the heart of the Citizen's Charter. It is an objective with which all would agree, even if its achievement is hindered by ambiguity in the workings of the partnership between central and local government. Central and local government in Britain and the CE Recommendation all accept accountability as an important objective. Clear accountability is an essential precondition of achieving the three Es of economy, efficiency and effectiveness.

58. Without accountability, nobody accepts responsibility for the achievement of value for money. Consumers can be left at best bemused, or sometimes exasperated. For example, a parent of a child with special educational needs may be told at the school that those needs cannot be met because of a shortage of resources. The school refers the parent to the local education authority (LEA). The LEA blames the government for providing an inadequate SSA to resource all the demands falling upon it. The government disputes this, affirming that the LEA has discretion to spend its funds as it sees fit and that it could provide the necessary special needs support. The LEA makes similar points about the school's discretion over its locally managed budget. The buck is passed. The parent is left perplexed. Similar circumstances can arise where a branch library is closed or its opening hours are reduced. The local consumer may complain to the local authority, which might blame the cuts on an inadequate SSA. Taking up the issue with the minister could again obtain the reply that the authority is free to use its resources as it chooses. Once more, the consumer experiences the loss of a service while two tiers of government put the blame on each other. Whilst each party accepts some responsibility for achieving value for money with the resource available, the system weakens that sense of responsibility by allowing each to blame the other. There is a risk that the last ounce of efficiency improvement will be ignored in favour of service closure, holding another party responsible for the consequences. Unequivocal accountability is the only counter to these problems.

59. With locally determined taxes funding only about 20% of the cost of local services, it is increasingly difficult to claim that local authorities can be wholly accountable for the service levels they provide in their areas. In the absence of capping, the option would still exist for them to spend above the level set by central government if their local population were willing to pay higher local taxes. But when local tax covers only a fifth of total spending, each one per cent of marginal spending which is locally funded costs the local taxpayer five times as much as one per cent of spending which attracts government grant. In some areas the apparent cost to local taxpayers of marginal spending is even greater. The higher an authority's SSA, the higher the impact of spending above SSA on local taxes. This is known as the gearing effect (Exhibit 13, overleaf)
and it should exert a strong deterrent against councils spending more than the government is willing to support through grant.

60. In an environment of universal capping, even the limited freedom of action possible under a high gearing regime disappears. SSAs and local government spending are converging. SSAs have moved closer to historic spending patterns (Exhibit 14); and local authority budgets are moving closer to SSAs (Exhibit 15). Authorities previously spending above SSA levels are bringing their expenditure down to those levels, largely because of the capping limit; and authorities previously spending below SSA level are increasing their expenditure towards their SSA (Exhibit 16). It is not possible to judge whether capping has increased the spending of ‘underspending’ local authorities more than it has decreased the spending of ‘overspending’ local authorities, but it is clear that it has influenced the spending decisions of most local authorities.

61. A confusion of accountability between levels of government is emerging. Central government often seems content to let councils accept a cosmetic accountability for services, for it obviates government responsibility, even if in practice ministerial decisions on resources are pre-eminent in shaping the character of the service which the public experiences. Councils appear to accept this partly because the law positions them to do so, but also because they are reluctant to admit to their loss of discretion over policy and resources. The consequence is a system in which councils assume a degree of accountability out of proportion to their ability to control services. Central government chastises local government when local activity deviates from the models' predictions; local government plays the same game and negotiates with central government over...
the models’ characteristics. Central government avoids responsibility for its own effects on local services by pleading the models; local government likewise blames SSAs for local changes in services. The public is presented with the conclusion that neither tier is accountable but that the models are the all powerful cause of changes in services. SSAs should not be a substitute for political accountability but rather should be an aid to it.

CONCLUSION

62. Performance of the English SSA system against the checklist criteria is mixed (Box F). There is nothing intrinsically wrong with the present SSA system in terms of its original objectives. It is capable of development and refinement, but if its objective is to distribute available funds in a fashion which recognises some link between need and historic funding patterns it provides a rough approximation. It is a more sophisticated system for equalising needs than any overseas system examined in this study and it is an improvement on its predecessor in many respects. But there is also nothing indisputably right about the present SSA system. Its basis is simply a set of imperfect statistical models. It possesses no special insights into what ought to be spent on particular services in different places. And yet, immense authority is invested by the public in the models’ conclusions. Central government avoids responsibility for its own effects on local services by pleading the models; local government likewise blames SSAs for local changes in services. The public is presented with the conclusion that neither tier is accountable but that the models are the all powerful cause of changes in services. SSAs should not be a substitute for political accountability but rather should be an aid to it.

Box F

PERFORMANCE OF SSA SYSTEM AGAINST CHECKLIST FOR JUDGEMENT

<table>
<thead>
<tr>
<th>CRITERION</th>
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</thead>
<tbody>
<tr>
<td>(a) Simplicity</td>
</tr>
<tr>
<td>(b) Stability</td>
</tr>
<tr>
<td>(c) Data Reliability</td>
</tr>
<tr>
<td>(d) Avoidance of perverse incentives</td>
</tr>
<tr>
<td>(e) Exclusion of efficiency differences</td>
</tr>
<tr>
<td>(f) Consultation between central and local government</td>
</tr>
<tr>
<td>(g) Similar rate of local tax</td>
</tr>
<tr>
<td>(h) Similar or Standard level of service</td>
</tr>
<tr>
<td>(i) Fairness</td>
</tr>
<tr>
<td>(j) Protection of local autonomy</td>
</tr>
<tr>
<td>(k) Consistency with government spending policies</td>
</tr>
<tr>
<td>(l) Clear accountability</td>
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</tbody>
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<table>
<thead>
<tr>
<th>RATING</th>
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<tbody>
<tr>
<td>m</td>
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<tr>
<td>x</td>
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<tr>
<td>?</td>
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</table>

<table>
<thead>
<tr>
<th>COMMENT</th>
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<tbody>
<tr>
<td>Simpler than GREs but generally not understood</td>
</tr>
<tr>
<td>Stable methodology but some unstable outcomes</td>
</tr>
<tr>
<td>Despite problems, better data difficult to find</td>
</tr>
<tr>
<td>Not perfect, but substantially successful</td>
</tr>
<tr>
<td>No clear view possible</td>
</tr>
<tr>
<td>Consultation exists but is not entirely fruitful</td>
</tr>
<tr>
<td>System meets its design objectives</td>
</tr>
<tr>
<td>No Standard level of service defined or achieved</td>
</tr>
<tr>
<td>Statistics suggest imperfect methodology and models</td>
</tr>
<tr>
<td>Objective set aside for totals, but met within total</td>
</tr>
<tr>
<td>Capping gives success for total, but not for individual services</td>
</tr>
<tr>
<td>Accountability is confused</td>
</tr>
</tbody>
</table>

These ratings represent one judgement of the system’s performance. Other judgements may be different.

1 Variations on a Theme (Appendix 6), Fair Dinkum (Appendix 7).
government in the current SSA formula. Some of the system's objectives are contradictory whilst the extension of its uses renders inadequate an original objective such as 'no less fair than GREs'.

63. Even the best system based on statistical processes will contain within it margins of error.\(^1\) If the methodology, models or data are less than perfect, then the margins of error become greater. The SSA system falls short of perfection. It is doubtful whether all who use the system make full allowance for its imperfections and inherent approximations. Chapter 3 considers whether improvements can be made to the system to improve its performance and reduce its disadvantages, or whether it is the best practicable system available, the problems of which should be tolerated.

\(^1\) For further details, see Appendix 4.
3. The Future of SSAs

Chapter 2 considered the present system of SSAs and the uses to which they are put against a set of criteria drawn from government and Council of Europe statements. The system fails or is only partially successful on a number of criteria. But, at the same time, SSAs are as good as or better than their predecessors or equivalent foreign systems. It was noted that all statistical models create approximations and require compromises and SSAs are no exception. An assessment of the system in terms of its impact on economy, efficiency and effectiveness shows that some of its main disadvantages are linked to the confusion of accountability (Box G, overleaf). A key question is whether SSAs are tolerable either in their existing state or with some improvement, or whether significantly different alternatives should be contemplated. This chapter considers possible changes to the system which might improve its performance. These have been identified during the study partly as a result of examining other funding systems in the UK (Appendix 5) and overseas (Appendices 6 and 7) and partly through the consultative process carried out during the study. The chapter also considers some more significant reformulations of the relationship between local and central government, the advantages and disadvantages of which can be compared with the strengths and weaknesses of the current SSA system.

KEY QUESTIONS

The task of reinventing SSAs, should be approached with modest expectations. There is no single ‘right’ approach to the distribution of resources between tiers of government. Value judgements and political decisions are critical. Elected members in different tiers or with different political views will reach different conclusions. In this context, it would be wrong for the Audit Commission to propose a solution. How politicians choose between the present system and any alternative financial relationship between local and central government will be informed by their answers to two key questions (Exhibit 17, overleaf):

1. How far should financial and policy discretion be vested in central or local government?
2. How far should resources be distributed by formulae or by political discretion?

Some possible solutions which give a variety of answers to these questions are considered below.

COULD SSAs BE MADE FAIRER?

Changes in the demands placed on the system have outpaced its ability to meet those demands. This has led to allegations of unfairness in the operation of SSAs. That sense of unfairness distracts members in some councils from the task of using available resources to best advantage, diverting energy into attempts to change the SSA system. To address the issue of fairness, methodology and models could be improved (Exhibit 18, page 36). There is no shortage of possible improvements to the present system. Whether they will improve the overall operation of the process or simply redistribute grievances about it will depend on the assessor's perspective. Despite this report's criticisms of SSAs, they do possess some strengths and should not lightly be set aside. Any alternative to SSAs should be compared carefully with them to ensure that the remedy is not worse than the disease.
66. Capital poses particular problems for the system. There have been inconclusive debates on the extent to which inherited debt should be treated on a notional or an actual basis; scope exists to revisit those issues. Additionally, British local authorities account only for the costs of financing capital expenditure instead of recognising the value of assets in their balance sheets and depreciating them over time. Current proposals for changes in the system of capital accounting are welcome. A review of the impact of capital on the SSA system is also required. Both should be done together. A requirement on the authorities created by reorganisation to create and maintain proper asset registers would be another useful step forward.

67. Both the present system and any changes to it should be kept under continuous evaluation with regular monitoring or validity checking, using targeted items of research to test how far particular indicators reflect real differences in need to spend. At present there is a lack of systematic monitoring of the validity of a system which controls the distribution of more than

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| Box G | AN ASSESSMENT OF THE ADVANTAGES AND DISADVANTAGES FOR THE THREE Es OF THE PRESENT SYSTEM OF SSAs AS USED FOR GRANT DISTRIBUTION AND EXPENDITURE CONTROL |
|-------|-------------------------------------------------------------------------------------------------
| **Economy** | **Advantages** | **Disadvantages** |
| | 1. Capping rules promote economy in LAs spending above SSA | 1. Capping rules create no incentive for economy in authorities spending below SSA |
| | 2. The gearing effect encourages economy through accountability to local taxpayers in LAs spending below SSA and not tightly constrained by capping limits | 2. Capping, based in part on SSAs with perceived imperfections, encourages expensive challenges to the system through consultants and academics |
| **Efficiency** | 1. General absence of perverse incentives | 1. Instability from year to year for individual authorities excuses lack of forward planning |
| | 2. Capping limits encourage efficiency within the cap | 2. If SSAs are too high the pressure for efficiency is reduced |
| **Effectiveness** | 1. System highlights difference between an LA’s spending and its ‘Standard’ assessment | 1. If SSAs are too low, necessary services can be affected adversely |
| | 2. Misuse of the word ‘Standard’ causes confusion | 2. Confused accountability and lack of ownership of spending limits reduces pressure for efficiency |
| | 3. Confused accountability obscures responsibility for service standards |
Exhibit 17
CENTRAL OR LOCAL, FORMULA OR POLITICAL DISCRETION?
There are two key questions.
**Exhibit 18**

**ADDRESSING THE ISSUE OF FAIRNESS**

Methodology and models could be improved.

<table>
<thead>
<tr>
<th>PROBLEM TYPE</th>
<th>PROBLEM</th>
<th>POTENTIAL IMPROVEMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>METHODOLOGY</td>
<td>Indicator weightings derived from regression analysis may be distorted by policy or efficiency factors</td>
<td>Rely less on regression analysis by: (a) using primary needs indicators alone (as in Scotland or Wales), where appropriate, to define assessments (N.B. generally requires models to be disaggregated) (b) making use of more fundamental research into cost and activity drivers, especially where assessments are most contentious e.g. Education, Social Services</td>
</tr>
<tr>
<td></td>
<td>LA budgets which increasingly reflect SSAs will 'feed back' the original answers, and not allow the assessments to be properly updated</td>
<td>Disaggregate assessments to minimise the effect - especially the two Other Services assessments</td>
</tr>
<tr>
<td></td>
<td>Some assessments show evidence of (a) non-uniform variance and (b) correlated indicator variables</td>
<td>(a) Transform variables to remove the problem (b) Check whether collinearity is likely to produce unreliable coefficients and take action to minimise the effects</td>
</tr>
<tr>
<td>MODELS</td>
<td>The indicators suffer from being: (a) too narrow to properly characterise spending patterns (b) too reliant on outdated census data (c) constructed without following recommended guidelines (composite indicators)</td>
<td>(a) Increase the range and breadth of indicators, in particular attempting to identify suitable measures of economic activity and poor health Make timeliness a more important criterion when choosing indicators (b) Re-create such indicators in line with guidelines</td>
</tr>
<tr>
<td></td>
<td>Some assessments are too highly aggregated to allow for differences in LA circumstances</td>
<td>Use more disaggregated assessments</td>
</tr>
<tr>
<td></td>
<td>Some models are not suitable for the wide range of LAs for which they are used</td>
<td>(a) Identify problems by analysis of regression residuals, Analysis of Covariance etc (b) Apply models to groups of LAs only where it can be established that the model is valid for the entire group</td>
</tr>
<tr>
<td></td>
<td>Some models may be of the wrong form and may disadvantage certain LAs</td>
<td>Examine alternative approaches for these assessments, using any relevant research already carried out</td>
</tr>
</tbody>
</table>

*Note: Further details are given in Appendix 4*
£40 billion a year of public expenditure. Feedback on technical issues from local authorities is constrained and partial because of the conflicts within and between the Associations, and the need for any possible changes to be exemplified to assess who gains or loses, and by how much. As well as the existing consultation process between central and local government, independent validation is necessary. Such an evaluation will not be easy. It would be necessary to define expected standards for the services under review. For example, work on assessments such as highway maintenance could be carried out to identify factors which affect bottom-up costs in specific councils, especially those which are untypically high or low spenders in particular areas of activity.

68. Even if the system became fairer as a result of technical improvements, the strains within it could not be entirely removed. The impact of confused accountability on the three E's would remain. Fairer assessments imply changes in the distribution of grant and spending power. There would be winners and losers. Even with better models, inherent margins of error would still exist. That issue could be tackled in different ways, involving a move away from a completely formulaic approach.

COULD THE DEMANDS ON SSAs BE REDUCED?

69. It is the use of SSAs for controlling expenditure which causes most of the criticism they attract. SSAs were designed to distribute grant. They use formulae to help in equalisation. Control mechanisms such as capping could be based more on past expenditure. Attempts to shift resources could be at the margin, as seen in the 'core and margin' systems now in use in higher education. It would be possible to keep SSAs as a mechanism to distribute grant while using historic spending as the only basis for capping. This could reduce instability and cushion the adverse impact on local services of budgets being forced down from historic levels to an SSA of uncertain accuracy.

70. Such a possibility carries risks and disadvantages. In the Commission's 1984 report into Block Grant\(^1\), the existence of the two systems of Targets and GREs was identified as a source of confusion, instability and perverse incentives. Further, the use of historic expenditure as the only basis for capping could perpetuate existing inequalities and would tend to penalise previously low spending authorities in order to ease pressure on high spenders. However, the recent convergence between historic spending and SSAs for most authorities has reduced the opportunity to apply the suggested approach. It could also be evidence that two separate systems are no longer required if continuing convergence makes spending and SSAs more closely equivalent.

71. As capping is currently based to a large extent on SSAs, caps could be related to the potential accuracy and precision of SSA estimates for particular services or classes of authority. For example, greater freedom could be allowed for classes of authority such as shire districts where the imprecision of SSAs is greater\(^2\) and the main component of the SSA is simply a single aggregated block. This suggestion would also involve slightly tighter rules for other classes of

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2. It is argued in Appendix 4 (paras 36 - 44) that the statistical confidence limits around SSAs for Shire Districts could well be twice the size of those for multi-purpose authorities.
authority if the overall benefits of capping were to be retained. It is not clear that such a change would be more acceptable to local government generally than the present arrangements for making appeals to ministers in order to seek a more generous capping limit. In any case, if unitary authorities become the norm, the suggestion will be overtaken by events.

72. No formula can allow for all local differences in circumstances. It might be possible to improve sensitivity to local circumstances by allowing part of an authority's SSA to be set by means other than statistical formulae. This would probably mean allowing ministerial discretion to be used for part of the assessment. If there were an element of ministerial discretion, there would also need to be a process through which local authorities could bid to persuade ministers of their needs. Making and reviewing bids would involve extra administrative effort both locally and centrally; it would thus be more expensive to run than the present system.

73. Giving ministers power to allocate part of councils' spending power independently of the formulae would make political decisions more explicit. Such power might make it possible for the system to be more responsive to particular local circumstances. However, the apparent objectivity of the present system would be reduced. There could be a risk that aggrieved authorities might complain even more than they do now, although it could also be argued that authorities might put less effort into challenging unpopular ministerial decisions than they do now into querying supposedly objective calculations.

74. These three methods of reducing the demands on SSAs - basing caps more on historic spending, applying capping rules to different classes of authority in different ways, or introducing more ministerial discretion into the process - are unlikely to lead to a coherent improvement in accountability. They could offer only limited value in improving the impact of the system on the three E's. And many might conclude that their consequences would be worse than the present system. Another possibility could be to change the structures within which the statistical models work.

COULD TWO-TIER DISTRIBUTION BE HELPFUL?

75. There would be a better fit of the statistical models if London's circumstances were modelled separately. Ministers could make an initial judgement on the resources to be allocated to London and the rest of England before carrying out separate calculations of the appropriate SSAs. This report expresses no opinion on whether that crucial judgement should give London a higher, lower or unchanged share of resources in comparison with the rest of England. But dealing separately with London would have two benefits. It would improve the technical workings of the statistical models by reducing the impact of London's circumstances on authorities outside London. As much controversy has arisen from actions to tackle particular problems in London, it should also assist the decision making process by making political decisions explicit instead of allowing them to be obscured by formulae.

76. As a development from a two stage process for London, it would be possible to allow more flexibility for local circumstances by developing such a process for the rest of England. An initial decision by ministers, which could be discretionary or based on a formula, on the distribution of grant between clusters of authorities based on regions or classes would cascade into separate SSA calculations for authorities within each cluster. Authorities within each cluster
might meet to agree on the distribution of grant, using the SSA calculations as a starting point. This would enable a greater degree of sensitivity to particular circumstances, without affecting total spending. It would also enable central government to change the distribution of grant between groups of authorities without having to adjust the overall system in ways which can create unexpected and ongoing distortions.

77. But these ideas have intrinsic disadvantages. If grant were allocated by authority class (Shire Counties, Metropolitan Districts, Shire Districts), the increase in local sensitivity would be limited as each class would cover a wide geographical area. Existing disagreements between the Associations could well lead to more attention being paid to distribution between classes than to fairness within them.

78. Additionally, there is little agreement in England on the existence of natural regions. Little regional machinery exists at present; and it could be necessary for ministers to keep a referee rôle if local authorities in a region failed to agree. This could encourage some authorities to be uncooperative with neighbours.

79. A two tier distribution on a geographical basis, whether for London alone or the whole of England, involves radical change and uncertainty over impact. It would increase the political element in decision making at the expense of the formulaic, because of the need for the initial ministerial decision on allocation between clusters. It would also increase the potential for local control because of the rôle of the local authority clusters in deciding how grant and spending power should be divided. However, it would not resolve the problem of accountability and so would not significantly improve the system's impact on the three E's. Further, it suffers the defect of increasing the complexity of the process. So it may be worthwhile to examine means of increasing the transparency of the process.

COULD IT HELP TO USE AN INDEPENDENT GRANTS COMMISSION?

80. A further change which might increase the confidence of local government and service users in the system could be to introduce an independent and non-partisan body such as a grants commission to allocate grants once central government had taken an initial decision on the total amount of available resources. The remit for such a commission would need to be open and explicit. Ministers would decide the remit, but would not then be able to affect the details of how the commission fulfilled it. The system could become more transparent. Such a change would involve a greater degree of formulaic rather than political decision making. However, one risk of such systems is that they can become even more complex as experts try to take ever more factors into account. It may be considered unlikely that either central or local government would be willing to hand over such sensitive decisions to a non-elected body. Moreover, experience from abroad, particularly from Australia, does not suggest that such an approach resolves the political issues which inevitably surround decisions on public spending and taxation. The objective use of statistics cannot be isolated from the value judgements and compromises inherent in political decisions.

81. It is possible that improvements to the three E’s might arise from changes in the technical performance, structures or processes of the SSA system. However, such changes would not address
the problems created for achieving the three E's as a result of confused accountability. The changes so far discussed could redirect the grievances rather than resolve them. Central and local government must either suffer the present system or some derivative of it, or else must contemplate different changes, which would more directly address the need for clearer accountability in the system.

**HOW COULD ACCOUNTABILITY BE CLARIFIED?**

82. Accountability could be clarified in two directions. Central government could increase the discretion and the revenue raising power of local government. Many in local government would wish to see the return of NNDR to local control. But central government shows no inclination to do this. Moreover, although the consultation paper on replacing the Community Charge suggested the creation of new revenue raising powers for local government, no further action in this direction has been proposed. If local government could raise more of its own revenue, it would be less dependent on central subsidy and more accountable locally. It is possible that the new Council Tax may prove capable of bearing a greater financial burden than the Community Charge. Domestic rates carried a heavy financial load before their abolition, and, once established, Council Tax may permit a readjustment in the balance of funding back to local government. A reduction in the overall level of central finance coupled with a change in the capping rules to enable councils to hold local referenda on propositions to exceed capping limits or reduce spending would give clearer accountability back to local government, and would reduce the pressure on the statistical models.

83. Local accountability would improve, but the use of local referenda to exceed capping limits has a chequered legislative history and could put at risk central government's objectives in terms of total public spending. Such changes do not seem to be on the agenda of central government, which seems unwilling to put its own objectives at risk.

84. Accountability could be clarified by moving responsibility towards the centre. With a combination of capping and present high levels of gearing, accountability is already moving to central government as it takes more responsibility in respect of local services. Duties such as further education are leaving local government and Care in the Community is initially to be provided on a specific grant basis. Removing duties from local government requires the creation of new agencies like the Further Education Funding Council or the Funding Agency for Schools to deliver services locally.

85. Such trends impose new burdens at the centre and risk a loss of sensitivity to local circumstances. Accountability would be clear, but its discharge by a limited number of ministers could be problematic.

86. A third method of clarifying accountability, which would extrapolate from current trends whilst keeping some rôle for local government, could be a system of contracts between central and local government. Such a system could be applied for services such as education, social services and the law and order services. The appropriate central government department could contract with councils to provide a specified national service with a specified level of resource. The

accountability for the specification and local resourcing of the national service would rest with central government. Accountability for the performance of the contract would rest with the council. Hypothecation would be clear and unequivocal.

87. It would follow from a contract culture that central government would not be obliged to contract with local councils if their performance were inadequate; nor would councils be obliged to accept contracts if resources were judged inadequate. The government could then use other agencies - typically non-elected - to achieve its national objectives. But in so doing it would achieve a competitive system in which it could compare the performance of councils with agencies. In the absence of such competition, agencies could enjoy monopolistic power with no scope for central government to compare their performance.

88. For other services, locally specified and locally funded, the system of local democratic accountability could operate effectively. Local aspirations would not become entangled in machinations over the funding of national services as happens at the moment. Central government might still wish to cap expenditure in these categories, but the sums involved are small enough to allow a more flexible regime.

89. Experience in the National Health Service suggests that although a contract culture could improve accountability, it has disadvantages. For example, setting the appropriate level of resources for a service in each local area would be difficult. Service level SSAs would not be an adequate basis of resourcing - a more detailed central assessment of spending needs would be unavoidable. There would be extra administrative costs in terms of managing the contracts, and in the transitional costs of revising the present system. Because contracting would create a direct relationship between local authority service departments like education and social services and their sponsoring Whitehall departments, the rôles of the local corporate centre and of the DoE would be greatly reduced.

90. Clarifying accountability in the direction of central government, whether through an increase in duties at the centre or by using contracts to change the relationship between central and local government, would be a step towards more centralisation of power and would be unpopular with local government. Moving accountability in the direction of local government would be a step towards more decentralisation of power and would be popular with local government but does not seem to be acceptable to central government. Allowing accountability to remain confused and unclear damages the interests of taxpayers and service users because it hinders the achievement of better economy, efficiency and effectiveness.

CONCLUSION

91. This report has identified the implications for economy, efficiency and effectiveness of the SSA system, and the adverse consequences for the three E’s which arise from the imperfections of the SSA calculations and from the confusion of accountability between central and local government. The report has also spelt out a range of options which imply different answers to the two key questions on central or local control and political or formulaic decisions (Exhibit 19, overleaf). None of the options is perfect. Each has advantages and disadvantages. This is not surprising - with 150 years experience in Britain and reference to many resource allocation systems overseas, it is likely that if a perfect system existed it would have become evident before now.
92. The questions and possible solutions in this chapter may help local government to select a stance on the future of SSAs. SSAs are the target of a great deal of criticism from local government. In part that criticism is understandable special pleading to improve the benefits to a particular authority; but in large measure, the criticisms flow from local government's objection to the use of SSAs for capping. Local government must first ask itself whether it is the nature of SSAs to which it objects or the uses to which they are put, or both?

93. If one assumes that central government's policy on controlling expenditure is 'given', the debate moves on to the question of whether SSAs are fit for all of the purposes for which they are used. This report argues that whilst they are, on balance, better than previous systems, they do have deficiencies, which have an adverse impact on the three E's. This leads to the further question of whether they could be improved. The report makes a number of suggestions both to the statistical basis of SSAs and to the structure in which they operate — rehearsing possibilities such as a two tier system or more ministerial discretion. Once one countenances such possibilities two under-pinning questions must be addressed:
   — the extent to which decisions should be made centrally or locally; and,
   — the extent to which decisions should be dictated by formulae or explicit political choice.

The answers to these questions lead to more polarised solutions. Very centralised models such as a contracting culture between central and local government appear, as do localised models of councils regaining greater tax raising and spending freedom. Additionally 'expert' approaches like a grants commission also enter the debate.

94. Whilst greater local freedom for councils will be very attractive to them, the contracting model would appeal only as an option which might be less bad than losing services entirely. In considering its stance on SSAs local government must contemplate whether the present SSA system, or minor improvements to it, is less bad than the alternatives. Local government may feel that the cures identified could well be worse than the disease.

95. The report has described a number of ways in which SSAs and their use can be revised. Local and central government need to debate these and other possibilities. The Audit Commission has an interest in this debate. Its proper position is a concern for economy, efficiency and effectiveness in the delivery of services. This report has expressed concern at the way in which the use of SSAs obscures accountability. In any change to the system accountability for decisions on local services and taxes should be clearly established. At the very least some of the imprecise terminology of SSAs such as the word 'Standard' should be revised and clarity of rôles between central and local government more precisely defined. Each tier of government should be clearly seen to assume proper accountability for the duties for which it is responsible. In the compromises which central and local government negotiate, accountability should not be sacrificed, for without it responsibility for securing economy, efficiency and effectiveness in local services will be obscured. It must be clear where the buck stops.

'We must build a new accountability fit for the 21st century - a new accountability that goes directly from those who run public services to those who use them.'

Exhibit 19
POSSIBLE OPTIONS FOR IMPROVEMENT
The options imply different answers to the two key questions.
COUNCIL OF EUROPE RECOMMENDATION ON THE EQUALISATION OF RESOURCES BETWEEN LOCAL AUTHORITIES
(Recommendation R (91)4, adopted by the Committee of Ministers on 22 March 1991 at the 455th meeting of the Ministers' Deputies)

The Committee of Ministers, under the terms of Article 15.b of the Statute of the Council of Europe.

Considering that the aim of the Council of Europe is to achieve a greater unity between its members for the purpose of safeguarding and realising the ideals and principles which are their common heritage and facilitating their economic and social progress, and that this aim can be pursued, inter alia, by common action in economic, social, legal and administrative matters;

Having regard to Resolution No 2 adopted by the 8th Conference of European Ministers responsible for Local Government, on ways and means of reducing regional and local imbalances by promoting greater equalisation of resources;

Considering that the equalisation, at an adequate level, of the financial capacity of local authorities is one of the principal conditions for achieving better balance in the distribution and quality of local public services;

Recommends the governments of member states:

1. to establish financial systems which equalise the local tax burden so as to enable local authorities, if they wish, to provide a broadly similar range and level of services while levying similar rates of local taxation;

2. to ensure that such equalisation of financial capacity does not undermine local autonomy by inducing local authorities in practice to provide the same level of service or apply the same rate of tax;

3. to design equalisation arrangements to cover as much of local government activity as possible and, where there is more than one tier of local government, to envisage the possibility of applying equalisation objectives to the totality of local services and tax rates in a given area;

4. when assessing the expenditure needs of local authorities, to take into account as far as possible the demographic, geographical, social and economic characteristics which lead to disparities in their costs;

5. to ensure, however, that the calculation of differential expenditure needs does not make allowance for differences in efficiency;

6. to base needs assessment systems on objective criteria over which individual local authorities have no direct control;

7. to bear in mind that, for the sake of the transparency of the equalisation process, an attempt should be made to relate the weighting given to the individual indicators of need to objective evidence about unit costs;

Annex

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7. to bear in mind that, for the sake of the transparency of the equalisation process, an attempt should be made to relate the weighting given to the individual indicators of need to objective evidence about unit costs;
8. in as much as needs assessments nevertheless involve value judgements as to weight to be given to different indicators of need, to identify and test such judgements in consultation with representatives of the local authorities concerned or their associations;

9. while taking due account of the above requirements, to seek to keep needs assessment models as simple as possible, so as to promote understanding and accountability;

10. to ensure that assessments of need remain as stable as possible, both by restricting changes in the data used within a single year and by avoiding modification of the method of assessment from one year to another, so that changes in assessed needs reflect real changes in the situation of local authorities;

11. to bear in mind that equalisation by means of grants is less likely to create ill-feeling between local communities but, where local taxable capacity varies so greatly that full equalisation of resources is too costly to achieve by means of government grants to consider having recourse to resource-sharing arrangements by which part of the tax revenues of the wealthy authorities is transferred to the less wealthy;

12. where there is more than one local tax, to recognise the need for each tax to be equalised, unless a single tax is dominant and local authorities have little discretion about the balance between their various taxes;

13. to recognise, on the one hand, the imperfection, as instruments of equalisation, of specific grants allocated as a fixed percentage of the costs of a particular service and, on the other hand, the threat to local policy discretion constituted by differential specific grants adapted to the expenditure needs of individual authorities (except where local government has to perform an agency function prescribed by central government which could not be financed by general grants);

14. consequently, without neglecting the contribution which specific grants can make, to give preference in most circumstances to general grants on account of their more comprehensive approach to equalisation and the greater flexibility which they allow;

15. in general, to design equalisation arrangements, as far as possible, so as not to create unintended incentives to particular courses of action or to conflict with the objectives of local accountability and efficiency in the provision of services.
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