

Agenda Item 10

SOUTH EAST ENGLAND REGIONAL ASSEMBLY EXECUTIVE COMMITTEE

Date: 9 June 2000

Subject: **Area Cost Adjustment**

Report of: Chief Executive, Hertfordshire C.C.

Recommendations

1. That the Assembly endorses the steps already taken, namely setting up the Treasurers Group of South East local authorities, and establishing closer links with the Association of London Government with a view to identifying common ground on Area Cost Adjustment.
2. That representatives of county, unitary and district councils in the region, plus Hertfordshire, Bedfordshire and Essex, be invited to convene in due course under the auspices of the Assembly in order to agree a collective South East local authority strategy on Area Cost Adjustment.
3. That the Assembly's response to the second technical consultation paper on Post-16 Funding draws attention in particular to the extensive historical evidence of additional cost pressures in the South East.

1. Background

- 1.1 This report considers the future of the area cost adjustment (ACA) in the light of the forthcoming Green Paper on Local Government Finance and the creation of Learning and Skills Councils (LSCs) for post-16 education. The Green Paper will be informed by the review of revenue grant distribution which the DETR and LGA has been carrying out during the last 14 months. In addition a second consultation paper on LSC funding has just been published.

- 1.2 The ACA distributes £1.6bn in to London and the South East, of which £550m goes to counties, districts, unitaries and Police Authorities outside London. It has long been a contentious area and has frequently been reviewed, most recently in 1996 and 1998. The 1996 review, carried out by independent academics, concluded that the ACA insufficiently recompensed the South East and was regarded as impossible to implement for this reason. The 1998 review attempted to find a more acceptable basis for the ACA, but no consensus could be reached and ministers decided to retain the status quo.
- 1.3 Loss or reduction of the ACA would have a huge impact on the finances of South East authorities forcing a choice between very large service cuts or increases in council tax. Clearly it is important that all authorities affected by the latest proposals should organise and plan to resist detrimental changes.

2. Review of Revenue Grant Distribution

- 2.1 A joint report by the Department of Environment Transport and the Regions (DETR) and the Local Government Association (LGA) suggests that the next Green Paper on local government finance might reflect the preferred LGA solution that funds continue to be distributed by formula. An alternative, not explicitly endorsed by the DETR (but believed to be their preferred option) is for distribution based on authorities' service plans. A mixture of these options is also a possibility.
- 2.2 Although local government in general prefers a formula-based approach, there is no consensus on the shape such a formula would take. This is no surprise given the annual debates on Standard Spending Assessment (SSA) in the years up to 1998 where groups of authorities sought changes to the formula for their benefit at the expense of others. The review conducted an opinion survey into the SSA process last year and uncovered widespread dissatisfaction. Advocates of the SSA system would argue that this was inevitable given the way in which the survey questions were constructed. One criticism of the system is that it is seen as "too complicated", but it is interesting to note that the report whether it is possible to design a formula which is very much simpler than SSA".
- 2.3 Funding distributed in whole or in part by plans would rely explicitly on ministerial judgement in allocating resources. Details on how such a system would work have not yet been determined so it is difficult to assess the practicalities of such an approach, beyond the observation that it would be administratively extremely complex.

- 2.4 The role of area cost differentials is scarcely acknowledged in the report. However a number of informed commentators are already suggesting that the ACA will not continue. If a formula approach were adopted, it would be likely to be regression-based (i.e. correlating historical spending data with current demographic information) in the manner of the present SSA system. The report suggests “a formula with three or four variables (client population, a pay cost adjustment, plus a measure to reflect urban and rural deprivation) can account for a great deal of the variation between authorities”. While it is unclear whether a “pay cost adjustment” is the same as an ACA, it is clear that such a formula could certainly be adjusted to reflect regional cost differences. In so far as this system is an evolution of the present one, its implications for ACA might be seen as relatively encouraging. However previous research and experience shows that pure pay differentials significantly understate the additional costs of providing similar levels of service in the South East to the cost of similar services elsewhere.
- 2.5 A section of the report looking at formula approaches also considers non-regression formulae. The most worrying of these is a separate formula – and ring-fenced allocation – for each class of authority. This would allow government to target resources at particular categories of authority while reining back those seen as over-funded. Shire counties would be unlikely to benefit from this approach. It would also make it easier in political terms to remove the ACA: much of the reason for its survival is the additional resources it pumps into London. Creation of a separate control total for London would remove this political justification.
- 2.6 It is unclear to what extent plan-based funding would take into account area cost issues. There is certainly no reason why an authority, in putting together its plan, could not draw attention to higher unit costs it faced by reason of its location. The concern is that, with area cost differences not built explicitly into the system, ministers would find it easy to reject such arguments.
- 2.7 An approach which combined formula and plans would include all the weaknesses of the latter. If we imagine a regime in which 80% of funding was distributed by formula with 20% held back as ministerial top-up, the problem becomes apparent. If an authority were perceived as getting an unduly generous settlement as a result of an area cost adjustment, ministers would be able to “claw back” funding by awarding a disproportionately low plan-funded element.

3. Learning and Skills Councils

3.1 The consultation paper on LSCs (for which responses are required by 3 July) says:-

“a geographical element should be included [in the funding formula] - initially applying only to London where the case is supported by strong evidence of unavoidable additional cost.”

The paper also proposes to give the National LSC and Employment Service the power to add other areas in future if this is justified by evidence.

3.2 In drawing a distinction between London and the rest of the South East it is possible to see the thin end of a wedge. Also any new basis of allocation based on factors which could produce a significantly lower ACA would be highly problematic. An important argument for us in the last review was that a recent report restated the application of a labour market approach for NHS funding. The argument for making such a distinction is exceptionally poor: the continued existence of ACA despite extreme reviews is surely proof that authorities in the South East do face additional cost pressures.

4. Next steps

4.1 It is apparent that there is still very much to play for; it is important that the South East should be seen to speak with one voice on this issue. To this end the South East Treasurers' Group has been reconvened and has had its first meeting. This group contains representatives of all tiers of authority, most of whom have been involved in the 1996 and 1998 reviews. A meeting at officer level has also taken place with the Association of London Government. This meeting established the considerable areas of common ground and agreed to do more work to generate evidence of higher costs in the South East. The axis of the South East and the ALG has been a powerful force in previous reviews and it is considered very important that a strong relationship is maintained.

4.2 There are further steps which can be taken. During the 1998 review the South East Regional Forum set up a small group of members with responsibility for giving political leadership. This group co-ordinated research and lobbying (including meetings with South East MPs) and enabled a united front to be presented throughout the review. It is considered that this group had a major influence in retaining the status quo in 1998. With this in mind members might want to consider convening a meeting of elected representatives from county, unitary and district local authorities in order to shape strategy and steer tactics. Because it is important that such a group

should be as representative as possible, it would be reasonable to invite members from ACA authorities outside of the Assembly's region, such as Essex, Hertfordshire and Bedfordshire. It is suggested that representation should be by Chair of Finance or equivalent from each county and unitary authority, plus one district councillor from each two-tier county area.

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