TONY BLAIR INSTITUTE FOR GLOBAL CHANGE

Fixing the Plumbing: Resetting the Framework of Local Government Funding

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Executive Summary

The Covid-19 pandemic has highlighted the dysfunctional relationship between central and local government. An excessively centralised approach to contact tracing flies in the face of the approach taken in other countries more successful at controlling the virus. Meanwhile the broader policy failure to contain the virus loads costs onto already depleted local government budgets, undermining the sector's ability to serve its citizens.

But this is not a new dynamic. A vicious cycle of constrained autonomy and reduced resources for local government has, for many years, undermined local government's capacity to respond to emerging policy challenges. As a result, policy formulation becomes "central by default", further exacerbating the problem. Policy outcomes for citizens and taxpayers deteriorate.

How local government is funded lies at the heart of the problem. Beyond simply a distribution of resources, the funding framework underlies the entire relationship between central and local government, but also between local government and its citizens.

Local government has two roles: the delivery of centrally prescribed services locally; and, as a local democratic body, responding to citizen needs and aspirations. The funding framework erodes the second role through its prioritisation of the first.

Over the past decade, central government grants have significantly reduced such that locally retained taxation makes up the vast majority of local government revenue. However, central government prescription of what local government delivers has not declined. As a result, locally retained taxes are the primary source of funding, but central prescription dominates the use of those funds. Local discretionary activity has been crowded out.

What discretion there is belongs to central government. Its ability to open up new, often ringfenced, funding streams is the only way for local government to access further funding. Their pursuit of this funding distorts local government focus and creates a dynamic in which local government's primary "customer" is Westminster, rather than its own citizens. Short-term funding arrangements from Whitehall exacerbate the problem, undermining local service delivery know-how and strategic planning.

The mirage of local government autonomy does not end there. While local government has limited power over its spending, it also has limited power over its revenue. The localisation of revenue sources has not equated to the localisation of authority over them. Local government is a recipient rather than a setter of taxes, a passive position which undermines local accountability.

The inevitable result of this perverse financial plumbing is a disempowered local government, underserved citizens and wasted public money. The lack of autonomy and accountability not only damages practical outcomes, it also creates communities who feel they have no power. That the need to "level up" is a national responsibility is in part a feature of how disempowered local government is to invest in place.

Too often the debate about local government focuses on the need for more funding. The need is clear, but the source of the problem is more fundamental than something that can be solved simply through a slightly more generous funding round for townhalls.

Instead, the sustainable solution lies in fixing the plumbing of local government finance. This means clearly distinguishing between the two roles of local government and reforming funding to drive accountability and autonomy. Two principles are key to achieving this goal:

1. Local government should be fully funded by central government to deliver the services that central government requires it to provide.
2. Local government should be given broad scope to raise revenue from its own tax base along with autonomy over how that money is spent, accountable to its own citizens for its decisions.

These principles should be applied together to ensure that local government is both able to deliver the services that central government demands and fulfil its role as an empowered place-maker – building the local economy and shaping the identity of a place. More local revenue or powers in the abstract will never resolve the blurring of central government requirements with local taxation, which lies behind the drift towards centralisation by default.

Introduction

In a crisis, leadership is vital. Through the uncertainties, complexities and anxieties of Covid-19, people have looked to civic institutions for that leadership. Central government's voice has, naturally, been dominant, but the more place-based and community-connected leadership of local government has also been strong. Yet there is a stark absence of effective collaboration between those two layers of government. Local government has two roles: to be the delivery arm of central government at the local level and, as a responsive local body, to listen to, support and empower its communities. Both require collaboration and partnership between central and local government.

In its relationship with citizens, Covid-19 has highlighted the best of local government's capacity to collaborate. Local government has rapidly adapted its services and developed new ones, but it has also shown strength beyond a service delivery role in the way it has convened local partnerships and worked on the ground to support citizens and help them to support one another. Communities up and down the country are dotted with powerful examples of collaborative partnerships where local authorities have worked hand in hand with citizens to ensure that food, medicine and emotional support are provided to those most at risk. This is not the story everywhere, but where the relationship has worked, it has been to enormous benefit.

The pandemic has also highlighted fundamental tensions in local government's relationship with central government. The bickering has played out on a larger stage than normal as the general public have witnessed regular breakdowns in communication between central and local government over data and local restrictions. Media attention on how local government will pay for the increased costs associated with the pandemic has publicly exposed a longstanding debate between central and local government about the financing of local delivery. Local government has been vocal about the extra strain being placed on its already stretched finances. The situation is undoubtedly undermining effective delivery on the ground and frustrating the ability of government, at both levels, to deliver what its citizens need in a time of acute crisis.

These are extraordinary times, but the cracks in the local-central government relationship were well established before the pandemic struck and are, in large part, a function of the mess that is local government financing. Covid-19 has amplified immediate cash pressures, but local government finances were already stretched, with many councils having almost no room for discretionary spending once statutory services are paid for. As a result, a host of local authorities are now warning that they may need to issue section 114 notices, stating that they are unable to balance their in-year budgets.

This is not simply a financial risk. The poor plumbing of local government finance has real implications for the ability of local government to fulfil its role, with knock-on consequences for citizens and central government alike. Reduced resources undermine local government's capacity to deliver services that are essential for many people's well-being (housing, care, social services). But more fundamentally, the current financial framework puts local government at the service of central government and crowds out the space to focus on its relationship with its citizens. This arrangement disempowers local government, eroding its accountability and undermining its capacity to be responsive to citizens and the challenges within the locality, let alone be a proactive place-maker and facilitator of partnerships that support and empower citizens.

An undermined local government, without the bandwidth to act, feeds the perception that it is incapable of addressing emerging policy challenges. This leads to a vicious cycle of policies that should be locally led, where both the levers and the intelligence are locally held, being centrally driven by default. These policies tend to be remedial, addressing problems where the consequences of inaction have been deemed too substantial. This creates an inefficient system, with high human costs.

Nowhere has the costly impact of this dynamic been more clearly exemplified than in the failing centralised public-health approach to Covid-19. Lacking confidence in the capacity of local government to deliver in a crisis, Whitehall's response has been to lead from the centre, with a Test and Trace programme that is more centralised than its equivalents in countries that have been more successful in keeping the virus under control.

As well as disempowerment, the squeeze on discretionary spending has contributed to a deterioration in the public realm, fuelling the perception in many local areas that their part of the country has been left behind. Perversely, the resulting policy debate becomes one about what central government should do to address the problem rather than freeing local government to use its own resources – currently co-opted to pay for statutory requirements – to that end.

Fixing the financial plumbing is a foundational step to improving the relationship between central and local government. Without doing so, the framework will continue to prioritise central government decision-making, eroding local government autonomy and accountability and undermining it as a partner to central government.

Part I: Where Are We and How Did We Get Here?

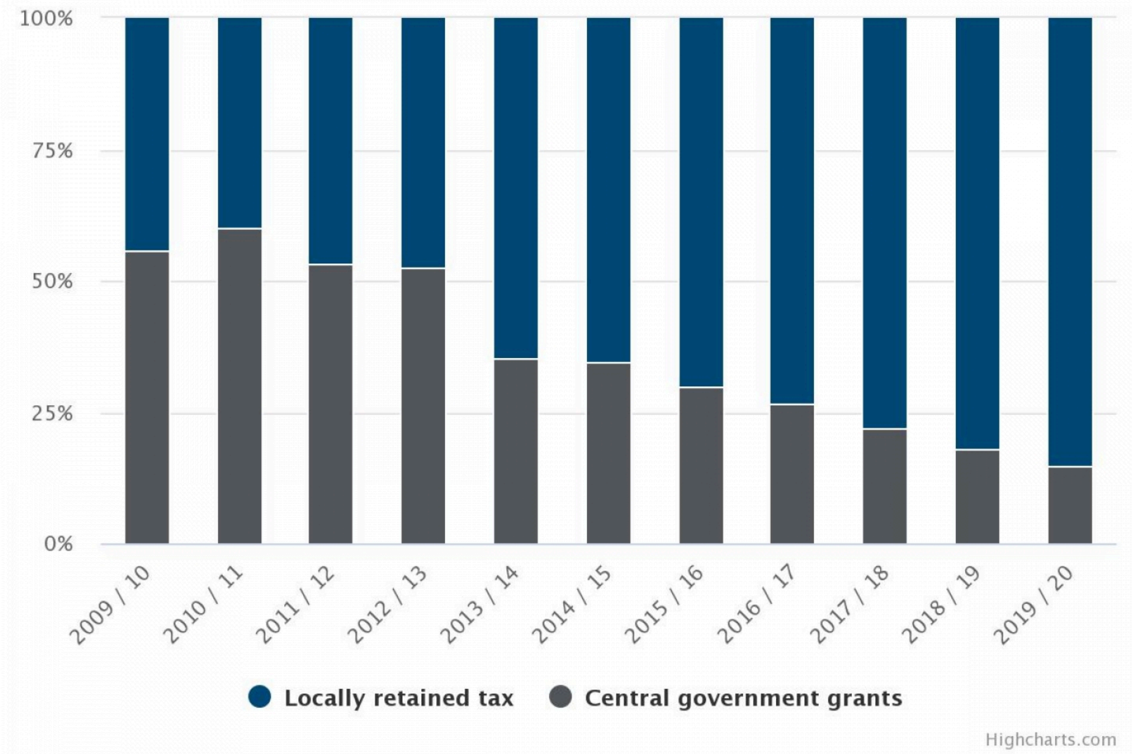
The Lyons Inquiry, in 2007, set the stage for reform to the local government funding system. Lyons depicted a sector that lacked autonomy and clarity of responsibility, arguing that "local government has become dependent on central government not only financially, but in many cases also for guidance, encouragement, and permission to innovate, across a wide range of fields."[1] The description was of a sector dependent on central government funding and undermined by central government prescription, with high volumes of ring-fenced funding and low levels of accountability to local populations or business communities. Lyons argued for reforms to the local tax base to provide greater fiscal autonomy to local government and to increase incentives for local government to promote economic growth.

Though the specifics of his recommendations were considered too contentious to implement (such as removing caps on council tax increases and revaluation of property prices), the underlying intention of boosting local government autonomy and incentivising it to drive economic growth had cross-party support and was received well in both central and local government. It was the details of how to do that which were disputed.

Local Government's Sources of Revenue Have Changed

Against this backdrop and under the banner of localism, the Coalition Government introduced several reforms that shifted funding away from a reliance on central government grants and towards locally retained taxation. Figure 1 shows that, in comparison with 56 per cent a decade earlier, by 2019/20, only 15 per cent of local government revenues were received in the form of central government grants.[2] In the main, this shift has been the result of the reclassification of business rates (non-domestic property tax) as a locally retained revenue stream. Previously, business rates were centrally aggregated and redistributed as grant funding, however a new Business Rates Retention Scheme was introduced in 2013. For the majority, this meant the retention of 50 per cent of business rates collected in their locality as well as 50 per cent of the growth in business rates over a set period. In recognition that business rates are by no means generated equally across the country, this shift was accompanied by a mechanism of tariffs and top-ups to retain some degree of redistribution between more- and less-well-off areas. In addition, several different pilot schemes are trialling higher rates of retention.

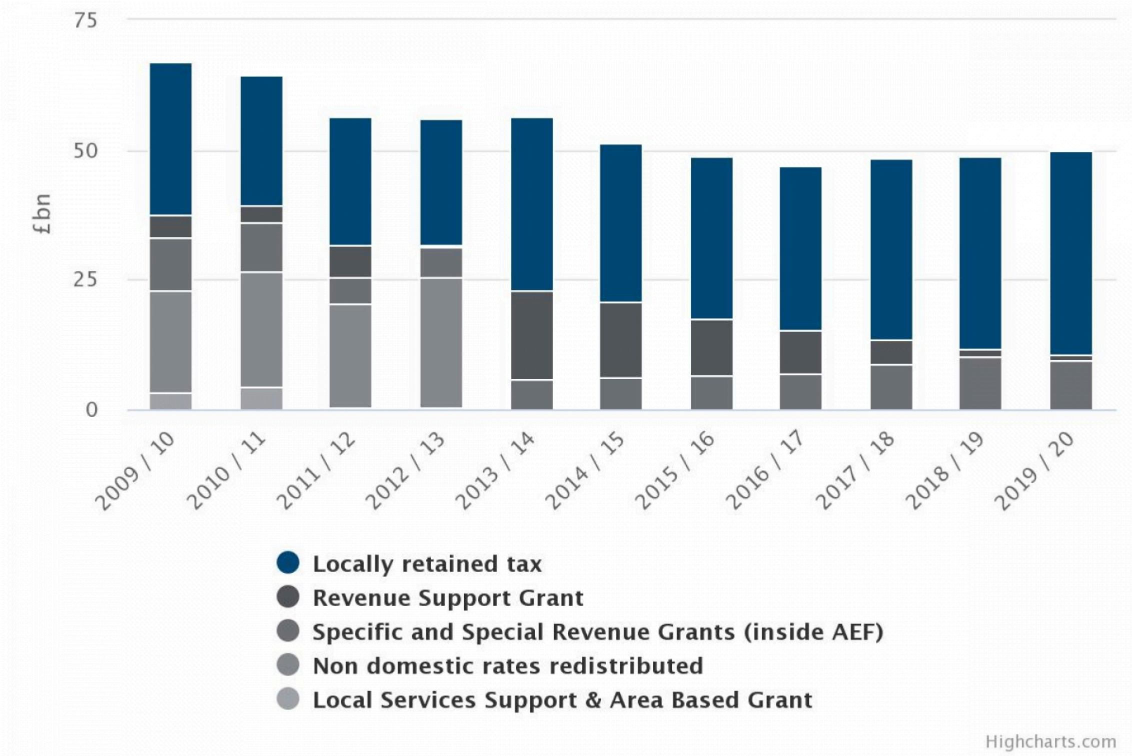
Figure 1 – Share of central government grants relative to locally retained tax



Source: Authors' calculations using 2009-2020 local authority revenue expenditure and financing data from the Ministry of Housing, Communities & Local Government, https://www.gov.uk/government/collections/local-authority-revenue-expenditure-and-financing#2010-to-2011. Figures are adjusted for inflation using CPIH. Delay in submitting revenue outturn due to pandemic means that the data used for 2019/20 is forecast rather than outturn. This is the case throughout the paper.

As a consequence, the balance between the two core sources of local government revenue looks very different now to when Lyons was reporting. Central government grants have been significantly reduced, falling in real terms from £37.5 billion in 2009/10 to £6.9 billion in 2019/20, and locally retained taxation now makes up the bulk of local government revenue. These grants have encompassed a general revenue grant (a non-ring-fenced grant that funds core services known as the Revenue Support Grant), and Specific and Special Revenue Grants, which are typically more targeted pots to fund specified agendas or projects. The Better Care Fund and the Flexible Homelessness Support Fund are examples of this type of grant. Central government announced that the Revenue Support Grant would be eradicated by 2019/20. Although it has not yet been fully withdrawn, in recognition that business rates are not yet fully retained, the implication is that central government grants will eventually make no contribution to core local government budgets. While some redistribution of business rates remains through tariffs and top-ups, pressure to fund core local government services rests largely, if not yet entirely, on the shoulders of locally retained tax revenues.

Figure 2 – Total revenue from central government grants and locally retained tax



Source: Authors' calculations using 2009-2020 local authority revenue expenditure and financing data from the Ministry of Housing, Communities & Local Government, https://www.gov.uk/government/collections/local-authority-revenue-expenditure-and-financing#2010-to-2011. The redistribution of non-domestic rates is included as a central government grant until 2013/14 with the implementation of the Business Rate Retention Scheme (BRRS). The BRRS introduced a universal 50% retention (classified above as locally retained taxation); the remaining 50% (previously categorised as redistributed non-domestic rates) was reallocated via the Revenue Support Grant. This accounts for the large uplift in the Revenue Support Grant in 2013/14.

The reclassification of business rates, since 2013, as locally retained taxation means this revenue stream has grown, but not to the extent that it has offset the reduction in central government grants. As Figure 2 shows, the combination of business rates, (whether centrally distributed or locally retained) central government grants and council tax has declined by £17 billion since 2009/10, from £67 billion to £50 billion. Across these two sources, that's a 25 per cent reduction in local government revenue in ten years. The effect of this profound shift has been felt far more strongly in lower-income areas than more affluent ones. In the most deprived local authorities in the country, the net spend per head has reduced by more than £400 per year compared to closer to a £100 reduction in the least deprived local authorities. [3] The detail of the varied experience of these changes across the country is beyond the scope of this paper but clearly an important aspect of the new context.

Today, local government is also far more reliant on additional income from commercial activity than it was at the time of the Lyons Inquiry. Since 2003, local government has been able to generate revenue through the levying of fees and charges on services that it has the power, but not a duty, to deliver, such as charging for parking. However, this income must be reinvested directly back into the service it has been raised from. While it can therefore be used to offset costs in some core services, its flexibility to support discretionary spend is highly limited.

Despite efforts by some of the country's more inventive authorities, growth in locally driven commercial incomes that might help to take the strain remains relatively small. Since 2011/12 the total income accrued across the sector by sales, fees and charges has remained at a steady £10 billion to £11 billion annually. Nonetheless, as central government grants reduce, the importance of these income streams has increased. However, these commercial revenue streams have taken a significant hit during the pandemic as the economy has contracted. Their reduced contribution to revenue is an important component of the widening funding gap in the present moment.

Categorisation aside, the picture of local government funding over the past ten years is therefore one of new reliance on locally retained taxation and increased incentives to search for commercial income streams. What remains of central government grants is predominantly special and specific grants which are typically, although not universally, earmarked for specific services. That means locally retained taxes have become the primary source of funding for core services.

Locally Retained Revenue Has Not Meant Local Control

The natural response from local government has been to look to sources of finance within its control to make up some of the gap, but the funding framework means it has almost no room for manoeuvre. It has little power to affect its declining revenues because, despite the localism rhetoric, "locally retained" or "locally funded" does not mean "locally controlled". While the sources of revenue have been localised, generated from the local tax base and retained for use by local government, the real powers to increase those revenues have not. While local government has exercised the one power that it has to annually increase council tax, any further control that it has over its own local tax base is negligible.

Neither council tax nor business rates can properly be described as locally controlled revenue streams. There is a distinct difference between being the administrating authority, and even the recipient of a tax, and being in genuine control of it. In the case of council tax, central government has the power to set the ratio between bands, trigger revaluation of properties, establish appropriate easements, introduce ring-fenced precepts and control an effective cap on the rate. Correspondingly, the only power local government holds is to consider overall rate changes within highly controlled parameters. Despite business rates being recategorised as a local revenue stream, local government control over these rates is even more limited. Central government continues to set business-rate multipliers and their reliefs, determine when revaluation takes place (or doesn't) and to drag its feet on previous commitments about higher rates of retention. The extent of local control is the tangential capacity to grow commercial floor space with the intended consequence of increasing the size of the tax base. [4]

There Is a Difference Between Prescribed and Discretionary Activity

Even if local government could raise revenues locally more easily, it has little control over its costs, which further increases financial pressures. As local government budgets have shrunk, the cost of delivering the services prescribed by central government has gone up sharply. This has particularly been the case in the two pillars of adult and children's social care.

Central government prescription over local government services comes in two forms. Local government delivers a huge number of statutory services, which they have a legal requirement to provide. The degree of autonomy they have in determining how these services are delivered varies based on the other mechanism: service standards.

In certain service areas, there is an expectation of uniform provision and precise standards. For example, there is no appetite for a postcode lottery around the provision of child protection services, or the quality of social care provided to the elderly. The terms of these services are debated, negotiated and promised nationally and the standards of their implementation are monitored and judged by national regulators. Delivery arrangements and details are flexed to be locally appropriate, but it is central government that has committed to and outlined the service that each citizen can expect. As such, these services are examples of those that are heavily prescribed by central government.

Just as it is appropriate that central government will guarantee provision and prescribe services in some policy areas, there are also services where decision-making and accountability should sit at a local level. These include those areas that have traditionally sat with the portfolio of discretionary spend for local authorities, such as public-realm management, leisure services and facilities, cultural and heritage provision, and support for local economic development. In these areas, even where there may be some statutory duties, the prescription from central government is low and local government exercises a high degree of discretion.

The categories against which local government finance is reported mean it is not easy to disaggregate statutory and discretionary activity, let alone those with high or low levels of prescription, but as indicated above, looking at the spend in different service areas is indicative.

Discretionary Spend Has Borne the Brunt of Cuts

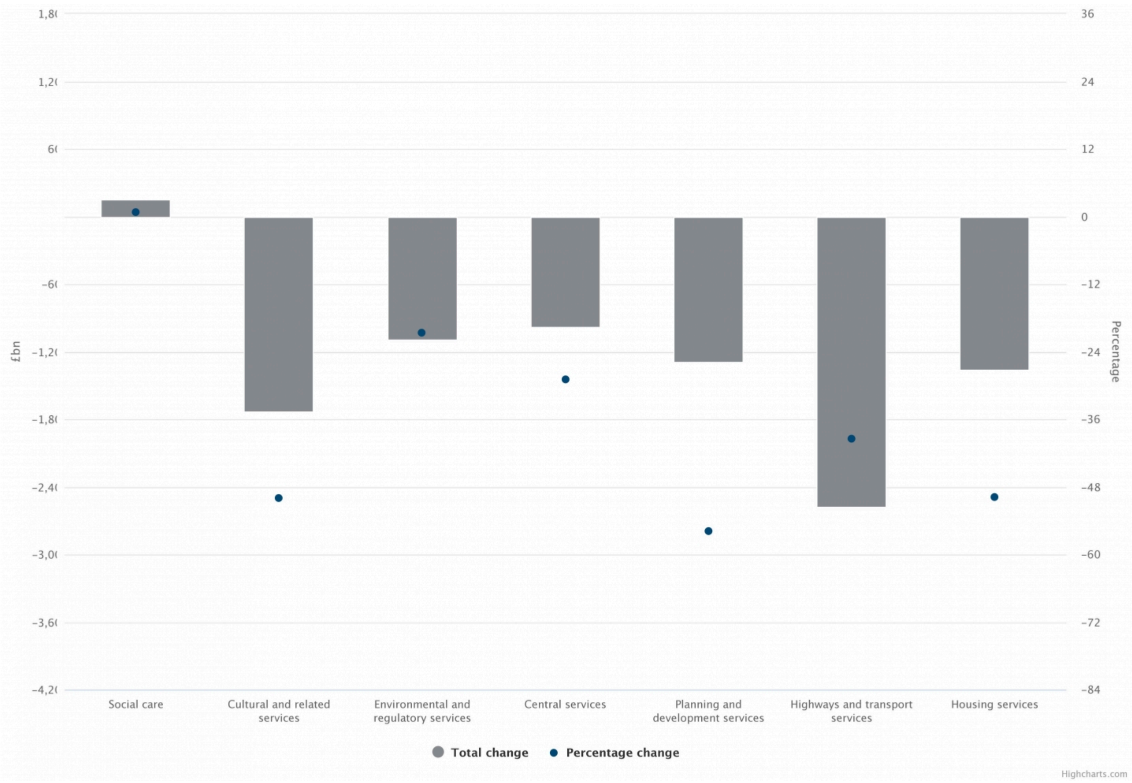
In adult social care, an increase in demand has been driven by the changing demographics of an ageing society but has also been shaped by the prescriptions from central government contained in the 2014 Care Act, for example on who is eligible for care. In children's services, cuts to preventative services, shifting attitudes to risk and a growing range of statutory responsibilities for local authorities has increased the use of demand-led, high-cost services. [5] This is demonstrated by the fact that there are 28 per cent more children in care than there were in 2010. [6] The combination of smaller budgets and higher costs in these sectors means that more than half of local government revenue is spent on these two core services. This has risen from 47 per cent in 2009/10 to 55 per cent in 2019/20.

Current funding arrangements protect budgets for some services more than others. For example, funding for education is almost entirely protected. Similarly, the effective ring-fencing of public health spend means that even as social care cost rise, that budget cannot be eroded. As a result, when costs in one service area increase, it is the subset of discretionary initiatives and services that bears the brunt.

The overall consequence of these trends has been that the proportion of local government revenue spent on centrally prescribed services has increased, and this has come at the cost of local discretionary spending. Despite a shift away from central government grants to far greater reliance on locally retained taxes, this localised revenue base is therefore actually being used more than ever to pay for nationally determined priorities.

Once statutory services are paid for, the scope for local government discretion is incredibly limited. A small number of service and social infrastructure areas have experienced deep cuts as statutory services were protected. Figure 3 shows both the total change in spend but also the proportional change in spend on different service areas over the past decade. It is evident from this data that social care services have been protected while the brunt of budget reductions are felt elsewhere. [7] Spending on planning and development services has fallen by 56 per cent; on cultural and related services and housing services, it has reduced by 50 per cent; and on transport, spending is down by 39 per cent since 2010. While not visible in the data used here, a report commissioned by Boris Johnson's government by Conservative MP Danny Kruger points out the heavy toll on youth services, which have experienced a 70 per cent reduction in funding between 2010 and 2020. [8]

Figure 3 – 2019/20 real spending in different service areas relative to 2009/10



Source: Authors' calculations using 2009-2020 local authority revenue expenditure and financing data from the Ministry of Housing, Communities & Local Government, [*https://www.gov.uk/government/collections/local-authority-revenue-expenditure-and-financing#2010-to-2011*](https://www.gov.uk/government/collections/local-authority-revenue-expenditure-and-financing#2010-to-2011)

This is the core failing of the existing framework. Belt-tightening in Whitehall, without any reduction in local government's statutory responsibilities, inevitably focuses deep cuts on discretionary local services.

From a starting point, in narrative at least, of increasing local government autonomy, the picture of the past ten years is in fact the opposite. The sources of local government revenue have shifted, but control over them has not. The demands from central government in terms of service provision have not reduced, but revenues have been cut deeply, and so local government finds itself with squeezed budgets, funding centrally prescribed services. In the balance of its two roles, local government as a delivery arm of central government services is squeezing out its capacity for discretion and responsiveness to local need. Overall, despite some efforts to enhance it, over the past decade local government autonomy has been eroded rather than increased.

Part II: Why This Matters for Central Government, Local Government and Citizens

The character of local government in a given era is defined by the balance it strikes between the two extremes of being locally controlled and centrally directed. At one end is a locally funded and locally focused tier of government, responsive to citizens' needs and held to account by them. At the other is a centrally directed, centrally funded delivery arm, which enables central government to guarantee uniformity of services for citizens and to ensure local policy does not interfere with or undermine its national approach. [9]

That one extreme informs central government's perspective was implicitly acknowledged during Covid-19, when the communities secretary, Robert Jenrick MP, stated that central government would only reimburse local government for costs associated with delivering the additional services it had specifically asked of them during the pandemic. [10] The past decade, however, has mainly been characterised by the steady collapse of any such balance. Jenrick's statement failed to acknowledge that the majority of local government costs are also driven by services that central government requires it to deliver but no longer provides funding for. This inconsistency is putting local government finance under severe strain. It undermines the relationship between central and local government, the ability of local government to deliver services to the public, and its capacity to be a dynamic, democratic leader of place. It needs to be addressed.

Service Provision Is Undermined

Central and local government share the goal of strong service delivery, but the current funding framework undermines their ability to achieve it. Central government is hugely reliant on local government for the delivery of many public services. That reliance drives much of what we see in central government behaviour, such as the issuing of detailed guidelines on service standards, implementing heavy monitoring and reporting requirements, and putting in place strong cost controls. But none of these measures are sufficient to override the damage done by a funding system that creates persistent uncertainty; indeed, this funding system undermines local government as an efficient and effective service delivery partner and creates a distracted sector looking to Whitehall for clarity rather than being responsive to its citizens.

Local government lacks confidence that its annual settlement provides it with what is required to deliver for its citizens. Surveyed at the start of 2020, one in ten councils said that they are in danger of being unable to fulfil their statutory duties this year. [11] Funding is topped up with in-year grants, however because these grants are time-bound, they lead to short-termism, undermining the essentials of service quality and affecting the staff retention that is essential to tacit knowledge, client relationships and organisational capital built up within the workforce over time. Significant financial injections into tackling rough sleeping provide a strong example of how in-year grants can undermine strategic decision-making: Without the lead-in time to develop and evolve strategic approaches, significant amounts of money with very short time horizons for spending have ensured the provision of "more of the same" remedial services rather than targeted solutions to tackle the long-term, underlying causes of rough sleeping. Uncertainty over funding also hinders attempts to join up services around users' lives (for example, by integrating provision for drug misuse, housing and rehabilitation), which contributes to the creation of institutional silos.

A lack of financial stability also draws significant energy from local government, which could otherwise be spent on delivering services. This energy is directed at the (currently annual) task of lobbying central government to secure a suitable funding settlement, including attempts to influence the latest policy decisions, such as the evolution of the business rates retention scheme and Fair Funding Review.

There Is a Lack of Accountability

The current funding framework undermines the ability of local government to act as a responsive and accountable body to its citizens. The mechanisms of local tax retention introduced over the past decade have not equipped local government with financial autonomy. As a result, they have failed to strengthen accountability both between local government and its residents, and between local government and its business community. With so much of its resources, even when they are raised locally, diverted to national-level priorities, local government is unable to respond to local need and demand. Its limited control over even its own tax base represents a missed opportunity to build greater accountability and democratic engagement. The tool of local elections is a weak democratic mechanism if those whom it holds to account do not have the opportunity to affect how most local taxes are raised or spent.

The 2011 Localism Bill introduced a requirement for local referenda on "excessive" council tax rises, which the government claimed would increase accountability. Instead this has had the effect of capping council tax rises, imposing yet another limit on local government's revenue-raising capability by central government. The same lack of local accountability occurs with business rates, where local retention has done little to tie local government to its business community because all the levers remain with central government. That the business community continues to lobby central government on business rates is indicative of the primary relationship the tax establishes. Central government also recognises its responsibility here; at each announcement to introduce business-rate relief since the retention scheme began, it has simultaneously committed to reimburse local government for lost revenue as a result of the relief. While this is appropriate in relation to local government revenue, it underlines the fact that despite localising this revenue stream, the policy change has not established any dynamic or accountable relationship between local government revenue and business rates.

Local government's role is not simply to account for its spending to its residents. At least in some areas, its relationship with its communities has also adapted and matured in the past decade. The experience of Covid-19 has further renewed enthusiasm about the power of partnership between citizens and the local state in delivering services more quickly and efficiently, and in supporting and empowering people to play an active role in their neighbourhoods. [12] Local government has a role in rebuilding a sense of belonging and fostering agency after Brexit, in developing connections and social capital at the community level, and as a convenor and enabler of an active civil society. These functions require that it have the ability to both raise and spend funds in partnership with its communities. Strengthening local government as a democratic institution embedded in place requires dynamic and engaged local institutions able to listen to and represent citizens.

The effect of the current funding framework, however, is to constrain rather than enable local government to act in response to its citizens. This has implications for local economic growth and the "levelling up" agenda, in which action is required as much at a local level as by the centre. Research with low-income voters in deprived areas shows that they consistently prioritise issues that require local leadership and action, such as the presence of community spaces, activities for young people and investment in the appearance of their local area. [13] These local issues drive discontent and become writ large in national conversations about places being "left behind". Where local government's hands are tied, this becomes a problem for central government.

Central Government Short-Term Grants Distort Local Government Priorities

As total budgets have been reduced, and locally retained funds are increasingly required to pay for centrally prescribed activity, the power of the remaining central government grants to dictate local priorities has increased. Rather than supporting local government to develop a collaborative and responsive relationship with its citizens, the funding framework instead drives a system where decision-making becomes centralised by default. This approach is then characterised by central government attempting to cure problems that have arisen rather than proactively preventing them. The rough sleeping example given above is emblematic of this.

One practice that central government has reduced, but by no means ended, is ring-fencing funding. The Coalition Government explicitly described this reduction in ring-fencing as a means to reduce central government control over local government activity. However, in the context of smaller budgets, with locally retained taxation largely focused on core service costs, any funding to be used outside of those parameters has a disproportionate ability to inflict new priorities upon local government activity.

Therefore, where central government does invoke the power to ring-fence budgets, the effect on distorting local government focus is profound.

Regardless of the debate about whether local government is best placed to drive economic development, it lacks the funds to do so. With all the breathing space for discretionary spend on items such as economic development squeezed out by statutory delivery, and in the absence of local tax controls that would enable it to raise more funds for local priorities, local government looks to the centre for funds to fulfil that function. This position reinforces central government's perception of local government's failure to drive this agenda and fuels its opinion of the need to do so itself. Additional grant money provided by central government for priorities such as this, while providing welcome resource to tackle key issues, accentuates the ability of central government to direct local government's activities, making them less able to respond to local circumstances and citizens' needs and ambitions.

The Towns Fund is a clear example of how central government influences the priorities local government can pursue, undermining its autonomy to respond to local circumstances. In pursuit of its "levelling up" agenda, in 2019 the government launched the fund to inject £3.6 billion into 100 towns across England. Its goal was to "increase economic growth with a focus on regeneration, improved transport, better broadband connectivity, skills and culture", a clear sign that it did not feel local government was adequately delivering against this agenda. [14] While the Towns Fund represents an injection of new money into local government, the criteria determining where and how that money is spent is controlled by central government. The upshot is that central government judgement weighs more heavily than local decision-making in those spending decisions. Despite increasing requirements for plans to be co-designed with communities, funds of this nature continue to operate within a scope rigidly defined and assessed by central government. This ignores the fact that it is local authorities who are more likely than officials in Whitehall to understand the complex challenge of rejuvenating their local areas and the broader ecosystem in which they operate.

Central government steps in with additional, remedial, funding where local government has been ill equipped to act. With central government waiting for a situation to become unacceptable before it intervenes, the funding framework is necessarily creating a model of state intervention that is last-minute and inefficient. That is not to mention the human cost borne by citizens as outcomes deteriorate to the point of requiring intervention.

Desire for Financial Autonomy Is Also Driving Demands for Devolution

While much of the debate on local government funding sounds like repeated demands for more funds, this hides a much more principles-based problem with local government financing. Ongoing calls for reform are really the search by local government for revenue that generates autonomy. They revolve around identifying ways that local government can draw more revenue from its tax base, becoming less reliant on central government funding.

This quest misses the point that the limitations of the current system are not just the lack of resource, but also the lack of control over costs. Many in local government have continued to support the slow progress towards rolling out higher proportions of business-rate retention in search of that greater revenue. There are also pockets of support for the retention of other taxes such as income tax or cooperation tax or the introduction of localised taxes such as a tourist tax, over which local government might have more genuine revenue-raising control. [15]

However, reform founded in either of these two approaches – more rate retention or new taxes – neglects to address the failings of the present system. Securing new revenue streams without a broader shift away from using that to fund centrally determined activity will secure neither greater autonomy for local government in its decision-making nor greater freedom from central government's ability to prioritise local governments focus. It fails to recognise and address the fundamental disempowerment of the sector which is set to undermine its ability to fulfil its basic functions. Establishing a funding system by which local government can flourish, and deliver for its citizens and central government alike, requires a more fundamental rethink of the principles behind local government funding.

Rather than build a platform for a mature collaborative relationship, the current framework has created a battleground over resources and autonomy. As the funding framework squeezes autonomous decision-making, local government is seeking other avenues to gain authority over issues affecting its residents, hence growing demands for the broader devolution of power. There are many reasons why it may or may not be appropriate to devolve power to different levels of government, but it should not be the solution to a funding framework that is disempowering and insufficient in facilitating central and local government working together.

Just as devolution should not be seen as a solution to a failing funding framework, a new framework should not determine devolution. The current framework means that every time some element of devolution is agreed, new funding arrangements have to be negotiated alongside it. As outlined, many argue for more localised tax capability as a route to support more local power, but it is imperative that funding for powers that central government devolves do not depend on locally generated revenue. Having control over certain services must not be the preserve of places with a big enough local tax base. In order to facilitate the continued experimentation and evolution of where decision-making lies between central and local government for a given place, the financial settlement should allow funding to respond to, rather than determine, devolution.

Part III: Principles for Reform

As the previous sections have illustrated, local government's capacity to act is hindered not only by the level of local government funding, but also by the mechanisms through which it is funded: the financial plumbing. Funding has become a bargaining chip between the two tiers of government. The promise of funding has become a tool through which central government directs local government action, while demands for funding are a constant refrain from local government asked to take on more responsibilities. At the same time, the current arrangements mean central government imposes indirect cuts to local government discretionary spending lines and central priorities come to dominate local budgets. This damages the partnership required between the two tiers of government.

The principles set out below assume that it is possible and necessary for local government both to be a dynamic local democratic body and to serve a delivery function for central government. That means being equipped as a local leader of place, convening partnerships and empowering citizens, and being responsive and accountable to residents. It also means being integrated into place and able to deliver services, negotiated for the nation as a whole, at a local level. To do so requires a new combination of central government grants and locally generated resources, establishing stronger links between the sources of revenue and the decision-makers of policy. It means fair resourcing of centrally dictated activities and having the autonomy to spend on locally determined priorities. In contrast to a system that is centralised by default, this should set the stage for collaboration, bringing to bear the best of both central and local government for citizens' benefit.

- **Central government should directly fund the services it mandates.**

Central government should provide the resources necessary to fund services that it requires local government to deliver, securing more effective and efficient service delivery. The existing situation, whereby local government faces a growing challenge to secure enough revenue to cover the costs of its statutory obligations, will only increase over time as the costs of providing social care services are projected to increase faster than the growth in revenue from council tax and business rates. [16]

The practical application of this principle would create some complexity, for example in determining what those services cost to deliver (including how both the cost of delivery and scale of need varies geographically), and how central government keeps cost controls in place to ensure value for money for citizens. These are inherent challenges where central government funding is involved, and the search for an appropriate funding formula is neither an unexplored nor a resolved challenge. However, the current alternative of locally funded but centrally prescribed services fails to acknowledge that local government is delivering on central government's behalf and should be appropriately funded to do so. This needs rectifying.

Implementing this principle alone would go a long way towards addressing the current imbalance in authority and accountability between central and local government. It tackles the main failure of the status quo: the crowding out of local discretion. However, to create a genuinely empowered tier of local government, it needs to be accompanied by the capability of local government to raise its own revenue, for its own purposes.

- **Local government should have the powers to raise and spend money, accountable to residents.**

Local government should have the power to levy its local tax base *and* determine how that revenue is spent. These taxes should be designed in a way that creates accountability for local government to its taxpayers. It would require some intervention from central government to equalise revenue-raising power, but this can be achieved without damaging that local accountability.

The argument that locally raised revenue plays an important role in liberating local government to act is made by both central and local government. However, unless local government is able to determine how that revenue is spent, its discretion will continue to be crowded out and its accountability undermined. A local tax base must be carved out for which local government has complete discretion to determine whether and how that tax is levied. Doing so would both provide resource exclusively for locally determined activity and strengthen local accountability.

Which taxes are amenable to local control should partly be determined by identifying ones that do not create harmful economic distortions or zero-sum tax competition between areas. For example, there is a far stronger case for devolving control over council tax, tourism-related levies or congestion charges than income, consumption or corporation taxes, which might encourage companies, workers and consumers to unnecessarily shift behaviours across geographies in response. [17] Nevertheless, it is clear that there are numerous tax bases that local government could assume more control of without hampering economic efficiency. Local autonomy would also be significantly enhanced by control over more than one tax. This would remove the imperative to simply maximise revenue through a single available source and instead equips local government with the discretion to vary the tax burden on different parties across its tax base.

There is inevitably geographic variation in revenue-raising potential. Clearly the taxable capacity of residential property for the average London borough will exceed that for more rural authorities. This creates the need for a degree of redistribution between local authorities without undermining accountability and autonomy. Such a system could be achieved so long as top-up funding to less well-endowed areas was linked to their appetite to raise revenue locally.

Conclusion

How local government is funded has far-reaching implications for its efficacy and viability. It is important for local government and its citizens that the funding framework is reformed, but it also matters for central government. As the tier of government with the powers to make necessary changes, the lead in doing so must come from central government.

This paper proposes a way to fix the plumbing of local government funding to end the crowding out of local government discretion. The principles set out here do not purport to provide the technical answers required to reform the framework, but they show that unless local revenue-raising capability and spending discretion are protected, local government will be unable to function as much more than a delivery arm of central government. Simply allowing local areas to retain or raise more revenue *or* take more powers will never resolve the underlying causes of local government's weakness.

Applying these two principles would mean that central government gives local government the resources necessary to deliver what it prescribes, and local government has the autonomy to raise and, crucially, to spend local tax revenue. Applied together, these two principles would create the capacity for local government to pursue the activities it and its electorate deem important, while also providing the services central government prescribes to the appropriate standard.

Fixing the financial plumbing of local government is not just about resourcing a sector to fulfil its obligations as a service provider, but also to empower it to play a meaningful role in democratic life at the local level. It would acknowledge the shared responsibility of central and local government to deliver effective public services and good democracy, setting the foundations for a more mature, properly resourced, collaborative relationship that is fit for delivery in a post-Brexit and post-pandemic world.

Footnotes

1. ^ Sir Michael Lyons, Lyons Inquiry Into Local Government: Place-shaping: A Shared Ambition for the Future of Local Government (The Stationary Office, March 2007), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/243601/9780119898545.pdf
2. ^ Central government grants include the Revenue Support Grant, the Local Services Support Grant, the Area-Based Support Grant, some Specific and Special Revenue Grants and non-domestic rates redistributed. Specific and Special Revenue Grants are categorised as inside and outside Aggregate External Finance (AEF). We have included the former but not the latter as this is funding which passes directly through local government to other bodies. It is therefore neither spent against local government priorities nor available as local government revenue. Within AEF, we have also excluded items related to police, fire and rescue, and National Parks, as these are the responsibilities of specific authorities rather than the broader network of councils. These grants also include funding for more bespoke regional service provision, such as the Greater London Authority Transport Grant. As these don't contribute to the overall spending power of local government, they have been excluded. We have also excluded education, due to the academisation of the education system and ring-fencing of funding which removes both funding discretion and much of the delivery from local government. Finally, we have also omitted funding on public health as this was a new responsibility obtained during the period, and the funding level for public health is dictated in such a way that it does not contribute to the overall spending decisions in local government. Locally retained revenue includes the council tax requirement and the retained revenue from the Business Rate Retention Scheme.
3. ^ For a more detailed analysis of the distribution across different authorities, see Tom Harris, Louis Hodge & David Phillips, English Local Government Funding Trends and Challenges in 2019 and Beyond (Institute for Fiscal Studies, November 2019), https://www.ifs.org.uk/publications/14563
4. ^ Centre for Cities research casts even this in doubt by showing that in areas where demand for commercial floor space is already low, increasing availability reduced the value of existing property and reduced the returns via business rates. Hugo Bessis, Business Rates: Maximising the Growth Incentive Across the Country, (Centre for Cities, December 2017), https://www.centreforcities.org/publication/business-rates-maximising-growth-incentive-across-country/
5. ^ Institute for Government, Children's Social Care, Performance Tracker, 2019, https://www.instituteforgovernment.org.uk/publication/performance-tracker-2019/children-social-care
6. ^ Local Government Association, "Number of Children in Care Reaches 10-year high", 8 January 2020, https://www.local.gov.uk/number-children-care-reaches-10-year-high
7. ^ Social care includes both adult and children's social care as these were categorised as one service area prior to 2011/12
8. ^ Danny Kruger MP, Levelling Up Our Communities: Proposals for a New Social Covenant (September 2020), https://www.dannykruger.org.uk/sites/www.dannykruger.org.uk/files/2020-09/Kruger%202.0%20Levelling%20Up%20Our%20Communities.pdf
9. ^ Tony Travers and Lorena Esposito, The Decline and Fall of Local Democracy: A History of Local Government Finance, (Policy Exchange, 2003), https://www.localis.org.uk/wp-content/uploads/2003/08/Travers-T-Esposito-L.-The-Decline-and-Fall-of-Local-Democracy.-A-History-of-Local-Government-Finance.pdf
10. ^ Secretary of State for Housing, Communities and Local Government giving oral evidence at the Select Committee for Housing, Communities and Local Government on Work of the Department. 04 May 2020, https://committees.parliament.uk/event/921/formal-meeting-oral-evidence-session/
11. ^ State of Local Government Finance Survey 2020, (The MJ; Local Government Information Unit, February 2020), https://lgiu.org/publication/lgiu-mj-state-of-local-government-finance-survey-2020/
12. ^ Danny Kruger MP, Levelling Up Our Communities: Proposals for a New Social Covenant (September 2020),

https://www.dannykruger.org.uk/sites/www.dannykruger.org.uk/files/2020-09/Kruger%202.0%20Levelling%20Up%20Our%20Communities.pdf

13. ^ Matthew Bevington, Anand Menon, Mike Hawking and Katie Schmuecker, Briefing: Post-Brexit Priorities for Low-Income Voters in Deprived Areas (Joseph Rowntree Foundation, July 2019), https://www.jrf.org.uk/report/post-brexit-priorities-low-income-voters-deprived-areas

14. ^ Ministry for Housing, Communities and Local Government, Towns Fund Prospectus, (November 2019), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/886737/20191031_Towns_Fund_prospectus.pdf

15. ^ State of Local Government Finance Survey 2020, (The MJ; Local Government Information Unit, February 2020), https://lgiu.org/publication/lgiu-mj-state-of-local-government-finance-survey-2020/

16. ^ Neil Amin-Smith, Tom Harris and David Phillips, Taking Control: Which Taxes Could Be Devolved to English Local Government? (Institute for Fiscal Studies, March 2019), https://www.ifs.org.uk/publications/13991

17. ^ The IFS has made a valuable contribution to this. Neil Amin-Smith, Tom Harris and David Phillips, Taking Control: Which Taxes Could Be Devolved to English Local Government? (Institute for Fiscal Studies, March 2019), https://www.ifs.org.uk/publications/13991

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