Interim Report

Public money, local choice

INDEPENDENT COMMISSION
ON LOCAL GOVERNMENT FINANCE

Public money, local choice

Foreword *by Darra Singh OBE*

The Independent Commission on Local Government Finance was set up because the local government funding system is in urgent need of reform. The Local Government Association (LGA) and the Chartered Institute of Public Finance and Accountancy (CIPFA) has asked the Commission to recommend changes to the system which will allow local government to meet the needs of its citizens, and in particular support the delivery of five key national policy objectives: grow the economy, increase the housing supply, integrate health and social care, promote work while protecting the vulnerable, and support families and children through early intervention.

I would like to thank all the Commissioners for the work they have done so far in shaping the direction of the Commission's work as set out in this report. Our call for submissions over the summer secured over 70 responses from inside and outside local government. We were impressed by the rigour of the analysis and the breadth of ideas, with a clear focus on policy objectives such as stimulating growth. We are grateful to all those who contributed.

This interim report explains the themes and ideas that have been presented to the Commission, outlines our emerging thinking, and seeks feedback on how these ideas can be developed. The Commission's purpose is not to lobby for extra money but to propose a finance system that enables local communities to determine a level of funding to meet local decisions on service provision. The sustained cuts to councils' central Government grant gives reform a new imperative — in an age of austerity we need to ensure that public sector funding is used effectively and creatively to support local and national ambition.

Reform of the local government finance system goes to the heart of our ability to grow local economies, improve the well-being of our communities and spend every public pound well. Liberating our towns, counties and cities to develop skills, build houses, improve transport, reduce welfare dependency and support the vulnerable is essential to our national future. Local leaders are concerned that excessive central control is holding back success.

Previous reviews of local government finance have foundered. This time the nature of the challenge and the prize have never been clearer. If the current system is left unaltered, a combination of rising demand and reducing resources will make the services people value unsustainable, undermining our prosperity and quality of life. Reform of the local government finance system is central to developing new ways of delivering public services. But to make progress a change in mind-set is required. The debate about devolving further substantial powers to Scotland has created a unique opportunity to address the excessive centralisation of power within England. For the first time in many decades, the issue of empowering towns and cities to meet the needs of their citizens is at the heart of political debate. There is now near-universal acceptance that power is best exercised close to the people whose lives it affects. The issue now is not just about voting at Westminster but a devolution settlement for the whole country. All the main political parties have expressed strong support for devolution within England; they should seize this chance to act.

This is not a short-term fix or a way of managing decline, but a new economic model for delivering national policy objectives in an era of much lower public spending. The proposals this Commission is developing are realistic and an imperative for the next Parliament. We believe the next government can institute changes which will win public support while laying the foundations for a local government funding system which is stable and effective for the long term. While there are risks associated with any policy change, the greatest risk is in doing nothing.

This interim report asks a number of searching questions. We look to local government, its partners and experts in the field to help us develop these ideas before our final report in the New Year.

Darra Singh OBE

Chair

Independent Commission on Local Government Finance

The Commission

Darra Singh, OBE — Chair
This is an independent report produced on behalf of the Local Government Association and CIPFA. My role as Chair of the Commission is carried out in my personal capacity only and not in my capacity as a member of Ernst & Young LLP (EY). The report does not represent the views or opinions of EY.

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The Commission would like to thank Richard Vize for his work on this report.
All Commissioners are members of the Commission in a personal capacity.

“Faced with the long term cut in local government funding, councils and their partners could be far more efficient, effective and creative in their use of the totality of public money if they had the freedom.”

Executive summary

Key messages to the Commission

In submissions and meetings the Commission has been told repeatedly that the local government finance system is broken. It undermines councils' accountability to their local communities; is virtually impossible to understand; holds back economic growth; promotes fragmentation of services instead of integration; inhibits sound management of public finances; and encourages a sense of dependency among councils instead of self-reliance and ambition.

While the system has needed change for many years, we heard that two developments have given reform a new urgency. Faced with the long term cut in local government funding, councils and their partners could be far more efficient, effective and creative in their use of the totality of public money if they had the freedom. Meanwhile, the debate over more powers for Scotland, and the near universal acceptance that decisions are best taken as close to the citizen as possible, has created a rare opportunity to secure devolution within England.

There is growing interest in local government becoming self-sufficient. By 2018/19 business rates and council tax revenues will exceed local government's projected funding. This will come about as a result of further reductions in government funding which will see total public sector funding fall to around 37 percent of National Income. However, this could provide the foundations for a financially self-sufficient local government. The City Growth Commission's Final Report, 'Unleashing Metro Growth' acknowledges that cities need both the decision-making powers and the financial flexibility to make them self-sufficient. Local flexibility over council tax bands and valuations would help break the logjam over reforming it.

It is clear that a reformed finance system will still need an element of equalisation — redistribution of money between areas to reflect differences in wealth — but it should also provide incentives for economic growth, such as retaining additional business rates, and promote a clearer relationship between where money is raised and where it is spent. In addition, councils should have stable and independent sources of income.

The business rates retention system has hints of self-sufficiency, but the overall package is too limited to be effective. On housing, we have been told the crisis in supply will not abate until local government has a revitalised role in local housing markets. Local authorities should be able to borrow to invest in social housing which provides a return, under the same rules as registered social landlords and without any artificial limits.

> *“Meanwhile, the debate over more powers for Scotland, and the near universal acceptance that decisions are best taken as close to the citizen as possible, has created a rare opportunity to secure devolution within England.”*

The need for effective long term financial planning was highlighted, with calls for the government to announce five year funding plans for local government at the beginning of each Parliament.

The health and social care system is under extreme pressure. The NHS Five Year Forward View talks about an annual shortfall of around £8 billion and we know that the gap in social care funding is over £700 million a year.

We have been told that the ability to pool resources locally and take a multi-agency approach is crucial for early intervention

The Commission's early views

The Commission believes the need for reform is urgent, and sees an opportunity to establish a funding system for local government which is largely self-sufficient. This should include powers to set council tax bands locally, revalue properties regularly and raise additional revenues. These are key to ensuring public services are sustainable in an age of austerity.

It is clear that councils have an important role to play in addressing the chronic shortage of housing, and should be able to borrow to invest in social housing. Reforming the powers and funding of local government would support national policy objectives such as growing the economy and integrating public services. For example, policy around housing, welfare support skills and training

> *The Commission believes the need for reform is urgent, and sees an opportunity to establish a funding system for local government which is largely self-sufficient.*

could be developed as a single coherent framework, while giving councils and local businesses more control over skills development would be a major advantage for the UK economy. Addressing the fragmentation in funding and control of services around children and families would save money and improve life chances.

We agree that Government needs to support effective financial planning by announcing multi-year funding settlements. There has been much debate about local choice and national standards. The time is now right for a conversation between comparable outcomes ad local decision making.

Moves towards early intervention and prevention are essential. One way that has been proposed to achieve effective pooling for early intervention is to create a central fund which offers to match-fund any local partnership contributions. In Northern Ireland and in Scotland central funds for early action have been created. We will be looking at these and other approaches in the next stages of our work.

Councils and the NHS are committed to breaking down the barriers in how care is commissioned and delivered. Given the scale of the resources involved this is immensely important. The evidence for financial tools such as pooled budgets delivering integrated care is limited. Approaches such as the Better Care Fund are a start. However the scale of the challenge needs a bigger ambition and lager investment in transformation.

Why reform is needed now

The Commission was established to examine the strengths and weaknesses of the current local government finance structure, and propose reforms to deliver a system which is fair, understandable and sustainable.

We are testing the options for reform against five key challenges facing the country and local communities:

- promoting economic growth and investing in infrastructure;
- ensuring a sufficient supply of housing in every part of the country;
- providing a welfare system that promotes work while protecting the vulnerable;
- integrating health and social care to promote independent living and efficient use of resources;
- supporting families and children through early intervention.

In the responses to the Commission we received a clear message that there are serious and damaging weaknesses in the existing local government finance system. We heard that it fails every test of an effective, sustainable funding regime: it lacks accountability to the communities it serves; it is virtually impossible for the public or indeed ministers to understand; it is unfair; it promotes fragmentation of services instead of integration; and it encourages a sense of dependency and entitlement among councils instead of self-reliance and ambition. The grant system has been made so complicated and been altered so many times that it no longer provides a rational basis for allocating funds. Over the years, complexity has compounded complexity as the system has evolved under successive governments. The distribution of government grant to councils cannot be arbitrary; it needs to be intelligible and rational. The arguments that have been presented for reform stress that there have been four major changes in the political and economic landscape since the current system, built around the council tax, was introduced.

First, the need to bring an end to the public sector deficit has put local government funding into reverse, with many areas experiencing a cut in central government grant of 30–40 per cent during this Parliament. This has disproportionately affected the areas with the highest need, because historically they have been the ones with the greatest proportion of their income derived from government grant.

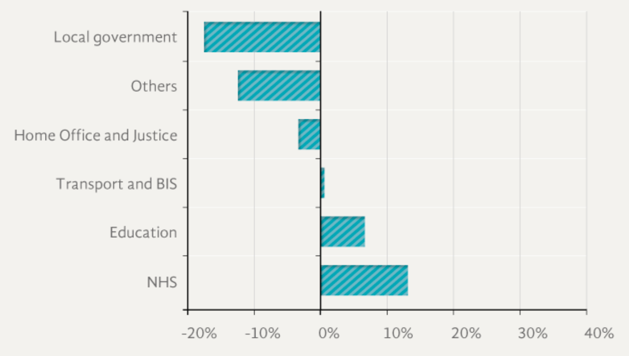
Second, the creation of the Parliament for Scotland and the assemblies for Wales and Northern Ireland mark a profound change in the UK system of government. The Commission has heard that there is now virtually universal support for the principle that power is best exercised as close as possible to the citizen. The prospect of further devolution to Scotland provides the opportunity to explore how local areas in England can take greater control of their own affairs.

Third, the surge in London and south-east property prices since homes were valued for council tax in 1991 means that, for many homeowners, the tax they pay bears little relation to the value of their home. This exacerbates the inherent unfairness of council tax — the number and levels of the bands make it a 'regressive' tax, costing people with lower value homes proportionally more than those in higher value ones.

Finally — and crucially — the current system of central control was constructed before this century's resurgence in the quality and confidence of local government. Local authorities now match a relentless focus on basic services with a resolve to build the local economy in partnership with business. There is determination to create jobs, improve training, reduce welfare dependency and intervene early with troubled families.

The responses to the Commission spelt out how the constraints of the current system were inhibiting progress on all five of the key policy areas. Weak incentives and excessive borrowing constraints are undermining growth. The marginalisation of local government in the supply of housing means the chronic undersupply of new homes — particularly for households on low incomes — will never be overcome. The lack of local direction over the management of welfare and skills programmes exacerbates dependency on benefits and inhibits businesses from finding the staff they need. Excessive rules around health and social care spending are obstructing moves to integrate services around the needs of individuals. Moves towards prevention and early intervention have been championed through initiatives such as the Troubled Families programme, but progress is being slowed by the difficulty of resourcing it alongside growing demand for statutory services. Local authorities have faced some of the largest reductions in public funding since 2010, and the sector has managed the reductions well. Paradoxically, it is this highly effective financial management that has led to it enduring the deepest cuts of any part of the public sector. Ministers have imposed these knowing they will be handled without a crisis.

Local government has borne some of the largest reductions in funding since 2010/11



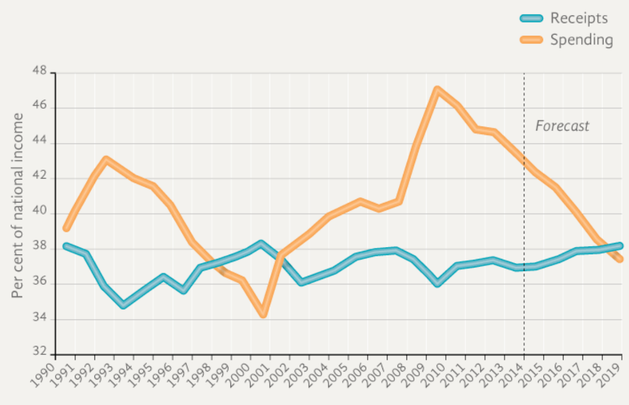
Source: HM Treasury; LGA: 2010-11 baseline as estimated in SR2010 and compares it to estimated spending in 2015/16 as per SR2013

Local government is expecting further deep cuts in the next Parliament. But despite this there has been no let-up in the public's expectation of increasingly effective and efficient public services. The submissions to us make clear that the pressure is being felt most acutely in adult social care, which will consume around 40 per cent of local government spending by 2020. So local government is caught between increasing demand and falling funding, while the lack of genuine local freedoms prevents it from taking the necessary action.

The limits of Localism

Submissions to the Commission spoke of frustration with both the limited benefits of the government's localism approach and the immense difficulties of bringing together disparate government funding streams — each overseen by a particular government department with its own reporting requirements — into a coherent local strategy. City Deals have been welcomed as a move in the right direction, but it is felt that major European cities should not have to spend months negotiating relatively modest concessions from ministers which fall a long way short of councils' ambition to drive their economies and improve their communities and services. The bidding process and drawn-out negotiations contrast sharply with the speed, breadth and ambition of the cross-party devolution offer to Scotland.

Public spending is set to fall to 37 per cent of national income by 2018/19



Source: ONS, OBR

We have heard that the Local Growth Fund is another example of a central government initiative intended to empower local government but which ultimately secured little change. The £2 billion a year fund was described by the All Party Parliamentary Group on local growth as *"a disappointment to many"*. Ministers are firmly in control and government departments are unwilling to engage in making it a success.

The consensus for empowering local government

The submissions the Commission received highlight the near universal consensus on the need for change. The leaders of all three main parties have called for devolution in England. Prime Minister David Cameron believes there is now a political consensus around the need to devolve power and money from Whitehall, arguing: "*The debate now is about how far and fast it can go.*" Labour leader Ed Miliband has backed the devolution of powers covering housing, transport and skills, while Liberal Democrat leader Nick Clegg wants local authorities to have the legal right to demand powers.

> *"The leaders of all three main parties have called for devolution in England."*

Reports from respected political figures for the government and Labour have argued for devolving power and money to councils. In 2012 Lord Heseltine, in his report for the Government No Stone Unturned, called for the creation of a locally controlled, single funding pot worth £50 billion to stimulate economic growth, alongside a reorganisation of Whitehall so that it focussed on strategic issues rather than managing narrow funding streams. This year, Lord Adonis called for cities and counties to be given major responsibilities for planning and delivering infrastructure.

In August the city regions of Leeds, Liverpool, Manchester, Newcastle and Sheffield demonstrated the ambition of local government by proposing, in their One North plan, £15 billion of infrastructure investment to connect the northern cities. They received support from Chancellor George Osborne. The drive of cities is matched by the counties, who represent a population of 23 million.

The County Councils Network recently called for powers to bring together skills, training and investment in line with local economic priorities, alongside fiscal devolution. The District Councils' Network is pushing for districts to be the default provider of universal credit, to allow them to integrate benefits with support services, and for greater freedom to borrow to invest in housing and other infrastructure. There have been four decades of reports for government calling for greater local financial autonomy, including the Layfield Committee (1974–1976), the Balance of Funding Review (2003–2004) and the Lyons Inquiry (2004–2007). Recommendations by Sir Michael Lyons included fewer ring-fenced grants, greater local control over business rates, council tax reform and greater incentives for local authorities to promote economic growth.

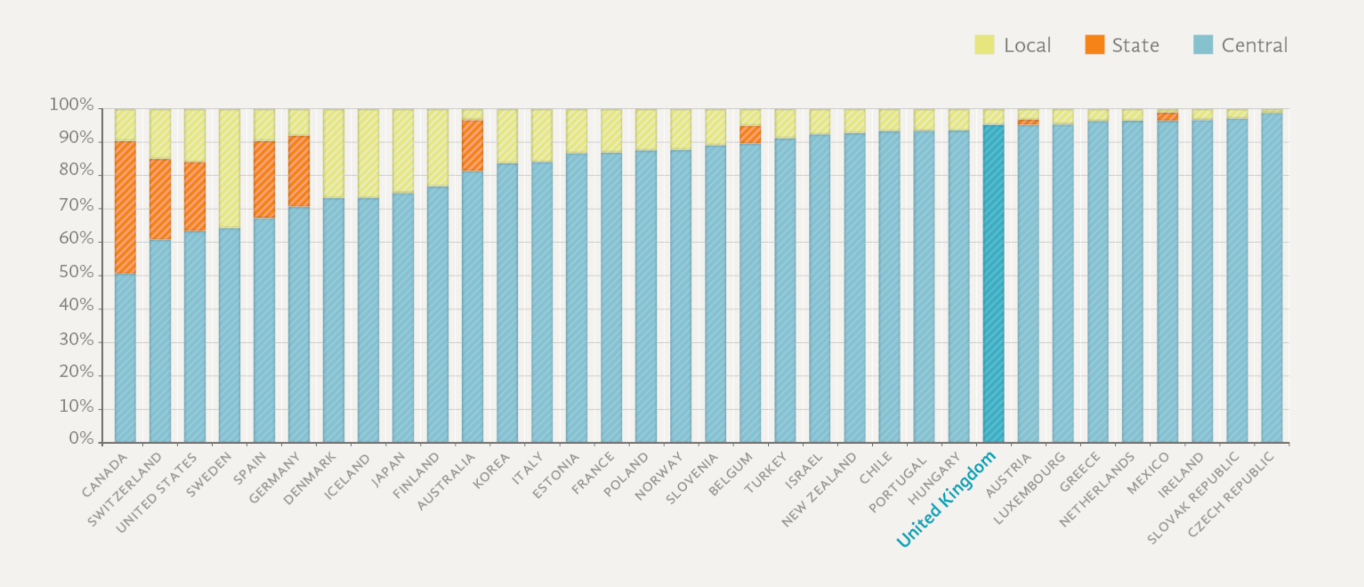
Among numerous other reports, in 2013 the London Finance Commission set up by Mayor Boris Johnson called for the capital to have more freedom to invest in its infrastructure and control over the full range of property taxes, including stamp duty. IPPR North has called for a decade of decentralisation encompassing 40 key administrative, fiscal and political functions of government. Devolution is supported by reports from the Cities Commission[1], and ResRepublica has recently published a report calling for "*devo-max*" for Manchester.[2]

In June the Communities and Local Government Select Committee published its report Devolution in England: the case for local government, which pressed for substantial devolution of powers to raise and spend money. There is striking alignment between the ideas being developed by the Commission and those which have been championed by everyone from local authorities to the Prime Minister. In particular, there is the recognition that devolving power to local government would strengthen economic growth.

1 IPPR North, "*Decentralisation decade: A plan for economic prosperity, public service transformation and democratic renewal in England*", September 2014.

2 ResRepublica, "*Devo Max — Devo Manc: Place-based public services*", September 2014.

Tax revenue by tier as a percentage of total tax revenue in OECD countries 2011



Source: OECD

International comparisons

The point has been made repeatedly over the last four decades that we live in one of the most centralised countries in the OECD. Local taxes — which are largely capped by central government — account for barely 5 per cent of total tax receipts in the UK. In Europe, the figure is typically around 12 to 16 per cent, with far less central control.

In its report on fiscal devolution, the Communities and Local Government Select Committee highlighted local government's excessive dependence on state financing compared with other European countries. For example, Madrid looks to the state for 37 per cent of its funding, New York 31 per cent, Berlin 25 per cent and Tokyo around 8 per cent; London is 74 per cent. European countries commonly use some form of equalisation to ensure different areas have roughly comparable spending power, but nobody goes as far as the UK in trying to even out funding.

It is instructive to look at Germany's approach to local government. The autonomy of towns, municipalities and districts is a key element of the constitution, guaranteed in Article 28 of the Basic Law and the constitutions of the regional Lander. The guarantee of local autonomy prohibits Federal and Land legislation from removing the rights of local authorities to manage their own affairs.

Other countries manage to operate property taxes with regular revaluations. For example, Ireland levies a tax of 0.18 per cent of the property's market value. The first valuation took place in 2013 and the next is scheduled for 2016. New York City operates an annual revaluation, with the increase in the assessed value limited to 6 per cent in any one year and 20 per cent over five years. In the state of South Australia properties are valued annually, based on analysis of house sales during the year.

UK central government exerts an unusual level of control over the spending and borrowing of local government. This is generally justified by reference to the fact that local government spending forms part of general government spending, so under international accounting standards it contributes to public sector deficit and debt. However, the same is true in other countries, who find it perfectly feasible to run fiscal policy without the same central constraints. In federal countries such as the US, Canada and Switzerland there is no central control, so local governments are free to borrow and spend. In countries such as Spain and Germany there are fiscal rules for sub-national governments, often based around the 'golden rule' of only borrowing for capital spending.

There is no evidence that much tighter controls in the UK model improve fiscal discipline over the long run. Indeed, IMF research concluded the opposite: "*Although administrative procedures may provide the central government with even tighter control over sub-national government fiscal outcomes (compared with both fiscal rules and cooperative arrangements), the implicit guarantee of subnational debt related to these controls seems to undermine fiscal discipline in the long run.*" [3]

The new constitutional settlement — devolution to Scotland, Wales and Northern Ireland

Submissions to the Commission stress that the widely welcomed march towards devolution in Scotland, Wales and Northern Ireland provides a rare opportunity for change throughout the UK, with all the major political parties prepared to make bold moves to devolve power. While there has long been a consensus about the need to devolve power to local government, this does not get translated into action. Politicians on all sides now have the chance to deliver the reforms they have been discussing for so long. While the Commission's work is focussed primarily on local government in England, we believe that giving local communities the power and autonomy to manage their own affairs should be embraced everywhere — devolution must not stop at the Scottish Parliament or the assemblies for Wales and Northern Ireland.

The Commission's vision

The Commission's vision is to build a local government finance system that: promotes self-reliance and self-sufficiency; encourages entrepreneurialism and innovation; promotes local decision-making on service delivery; is transparent in how it works and in the division of responsibilities between central and local government; and maintains support for the most vulnerable.

3 Alexander Plekhanov and Raju Singh, "*How Should Subnational Government Borrowing Be Regulated? Some Cross-Country Empirical Evidence*", IMF Staff Papers Vol. 53, No. 3 © 2007 International Monetary Fund.

“Local authorities are best placed to understand the service needs of the communities they serve, to prioritise resources to meet those needs and to react to changes in local needs and priorities as they arise.”

What we were told and our emerging solutions

While some of the submissions addressed the issue of overall funding and ways of improving the existing system, a significant number proposed radical changes built around the principle of local autonomy. A number of potential solutions have emerged from the information presented to the Commission, which we believe could form the basis of a practical, politically deliverable reform programme for the next Parliament. These ideas are at an early stage. We are keen to hear responses from as many organisations and individuals as possible before we take these forward in our final report early next year. We have posed some questions to stimulate thinking, but would welcome views and evidence on any aspect of the system.

It's time to change

The dominant theme in the responses to the Commission was that the existing funding model is no longer sustainable; the public is being let down by the ineffective way in which "*precious public resources*" are being allocated and managed. The plea was for a system fit for an era of much lower funding and rising, more complex, demand: "*Local authorities are best placed to understand the service needs of the communities they serve, to prioritise resources to meet those needs and to react to changes in local needs and priorities as they arise.*"

Weaknesses identified in the current system were numerous, including poor incentives for growth, short-term decision-making, rushed ministerial announcements, excessive central control of individual funding streams, capping undermining local services and democracy, poor understanding in Whitehall of local government's priorities and pressures, and a failure to make timely adjustments to grant allocations to reflect population changes.

There was overwhelming demand for councils to be given greater freedom from central government in raising and spending money, with the ability to set taxes to meet local needs. There was a strong desire for more long-term certainty in funding levels to improve planning and financial management, and calls for local government to have some constitutional protection. There were many complaints about the structure and oversight of government programmes. There were pleased for government departments to collaborate more effectively at a local level by coordinating funding and oversight. The ring-fencing of central government grants "*prevents their application in creative and innovative ways*".

The Commission heard that one of the main tensions in the current system is that, despite sporadic moves to reduce ring-fencing and allow a more joined-up approach to spending public money in local areas, problems arise because each government department is accountable to Parliament for ensuring that funds for a particular scheme are spent in a particular way. This point was highlighted in the recent report by the Public Accounts Committee on assurance to Parliament for local government funding. For devolution to work effectively, the issue of accountability mechanisms in Whitehall needs to be addressed.

There was frustration with the relentless use of pilot schemes; one response called for Community Budget pilots to be taken to their logical conclusion — rolled out across the country and each area allowed to have one local funding pot.

> *"For devolution to work effectively, the issue of accountability mechanisms in Whitehall needs to be addressed."*

In the same spirit as the 'Community Right to Challenge' — which gives local people the right to take over local government community assets such as a village hall — there was a call for a 'right to devolve'. The idea is that if local government could demonstrate it could "*better coordinate specific growth related budgets and deliver better outcomes, it should have the power to challenge central government to devolve [them] to local growth partnerships*".

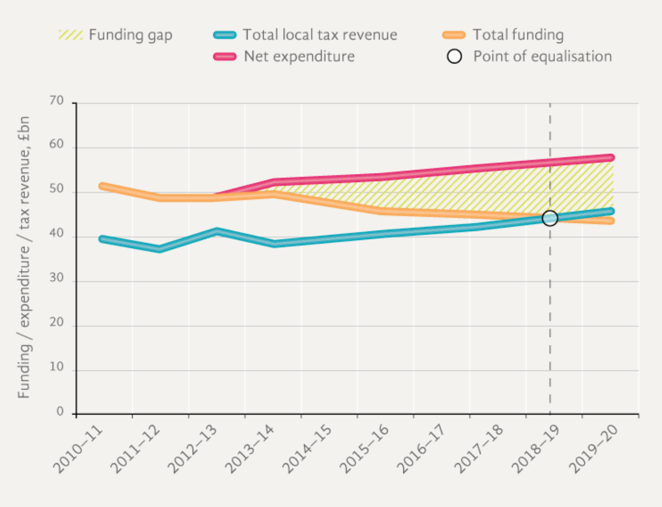
While there were eloquent arguments for stronger incentives to grow the local economy, there were also forceful demands for "*equality*" and "*a fair deal*" which recognised different capacities to generate growth. This is an inherent tension in the local government finance system, and one that arouses strong views. The commission will address this in its final report.

Local government's potential for self-sufficiency

The idea of local government becoming largely self-sufficient financially, by retaining and redistributing between each other the taxes which councils collect, is attractive to some and one which the Commission will explore further.

LGA data indicates that, by 2018/19, there is scope for local government to become self-sufficient if it retains all its business rates. By that year, council tax and business rate revenue will overtake local government's projected funding. To achieve this public spending will have declined sharply, to 37 per cent of national income. The data shows that around 106 councils would be in deficit — in other words, local taxes would not cover the costs of local services.

Total council tax and business rate revenue will surpass total local government funding in 2018–19



Source: LGA

There was support for the idea that a self-funding system would promote a confident, sustainable and constitutionally independent system of local government. The emphasis would be on self-reliance — councils and their communities looking to their own resources and ingenuity to create the additional income to meet local needs rather than pressing Whitehall for more government cash.

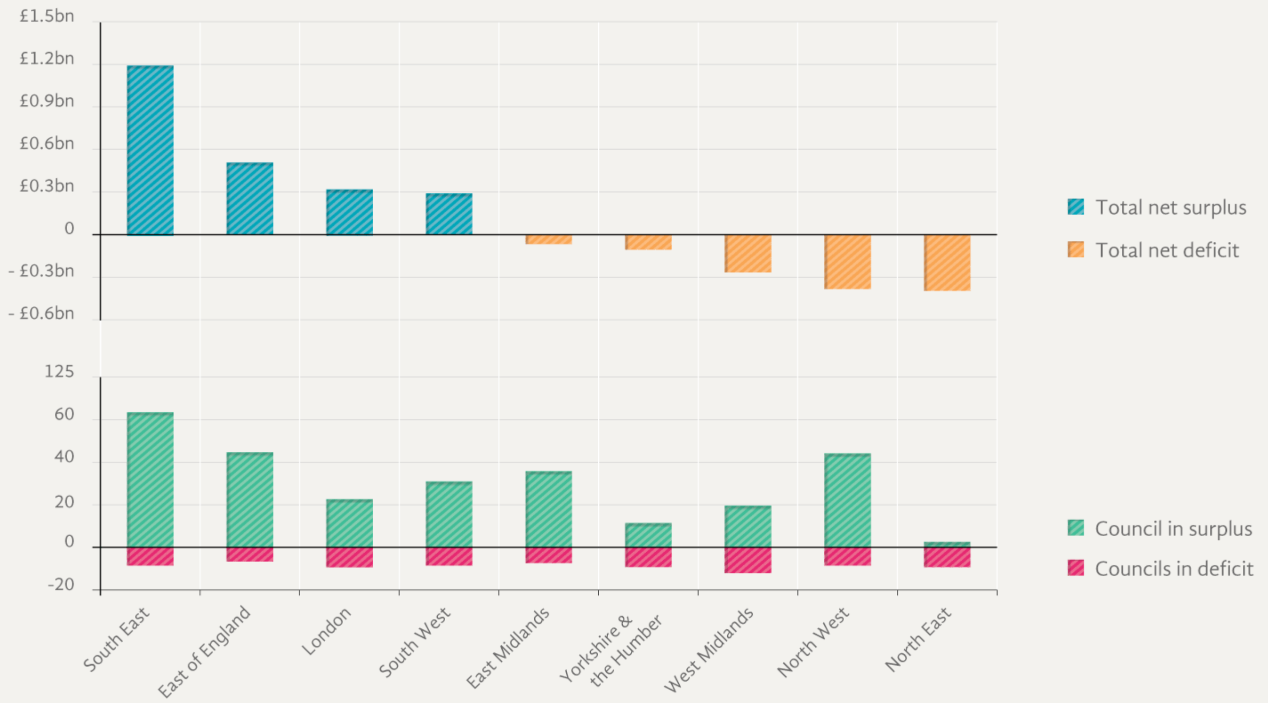
Self-sufficiency — the Commission's view

There are four advantages for central government arising in local self-sufficiency: it would be exempted from the ceaseless lobbying from special interest groups for more money; it would provide a powerful incentive for local authorities to take the lead in meeting key national objectives such as growing the economy and reducing welfare dependency; it would stimulate the ambition and entrepreneurialism of local government; and it would provide stable and predictable funding for local authorities.

Of course, self-sufficiency would require an element of equalisation. A key question would be how a self-sufficient funding scheme would manage this.

One approach would be for equalisation to operate at two levels. First, there would be equalisation within a unit such as a combined authority, for example Greater Manchester. There would then be equalisation between areas. There is less disparity in wealth between the different parts of the country than is often assumed. On the 2018/19 projections, self-sufficiency would require 247 councils to 'top up' 106 councils. Most of this could be managed through transfers between councils in the same area.

Self-sustainability in 2018/19 — a regional comparison



Source: LGA

Equalisation within an area could have a number of advantages over the current system. It would be simpler and more transparent; it could encourage strategic working between authorities; and it could lead to a more transparent discussion between local and central government on how to address on-going economic and social challenges. Under this type of model, the legislative requirements on local government do not change; the only thing that changes is the agent who pays the money. Councils would still be obliged to carry out the instructions of Parliament. We have been told that while the business rate retention scheme is not ideal, there are elements in the approach which point to how a system which strives to be both fair and provide incentives could work. The Communities and Local Government Select Committee, in its report Devolution in England: the case for local government, argues that the business rates scheme provides a useful signpost for further fiscal devolution.

Q1 *Is self-sufficiency the best way forward for the local government finance system? What are the alternatives?*

Q2 *How could an equalisation system work?*

Q3 *What are the potential drawbacks of a self-sufficient system? Could these be overcome?*

The tension between equalisation and incentives to grow

One of the toughest issues to resolve is the extent to which the ability of different parts of the country to meet need is equalised through a system of funding redistribution. At one extreme, equalisation removes the incentive to grow the local economy because any additional income through new businesses or other revenue sources would be shared out with areas that are struggling to grow. At the other extreme, the absence of any equalisation would leave areas of high deprivation unable to provide basic services.

The range of views around the appropriate balance between fairness and incentives to grow reflected the difficulties in this area. While some responses stressed the need for equalisation, there were strong demands for councils to have greater incentives to grow their local economies by retaining a much higher proportion of business rates.

> *“Reset gives areas with the lowest economic growth a chance to catch up, but the more frequent the reset the less the incentive to grow.”*

Among those pushing for equity, one argued that some of the most affluent areas see their business rates revenue grow with little action required by the council, while in more deprived areas councils have to work hard to secure even minimal increases. The logic of the business rate retention scheme *“is that, over time, those that need the most receive the least and those that need the least receive the most”*.

Under the business rate retention scheme, the Government decided it would be reset in 2020, which means the benefits accrued by the fastest-growing areas will end at that point and be redistributed under a new funding calculation, and everyone has to start again. Reset gives areas with the lowest economic growth a chance to catch up, but the more frequent the reset the less the incentive to grow.

Equalisation and incentives to grow — the Commission’s view:

In a country with wide disparities in wealth and deprivation and an expectation among voters of broadly equal access to basic services, some form of equalisation is essential. But an integral part of local autonomy is accepting greater responsibility for one’s own destiny. You are given the tools, and it is largely up to you to do the job. It has been argued that local authorities which succeed in growing their local economy should be entitled to retain a substantial portion of the revenue generated.

Q4 *What is the appropriate balance between equalisation and incentives to grow the local economy?*

Q5 *Under an incentive scheme for retaining business rates, what is the appropriate proportion of additional rates that a local authority should be allowed to retain?*

Q6 *Should any incentive scheme include a ‘reset’, to allow less prosperous areas to catch up, or should more successful areas be allowed to continue to accrue benefits from their growth without interruption?*

Q7 *Should the method by which we seek to equalise between areas be separate from the system of distributing local government finance?*

Council tax

Council tax was identified as one of the major obstacles to efficient and effective local government. The failure to revalue properties means the tax in England is now levied on the basis of values in 1991. The system has decayed to the point where it lacks credibility with policy-makers and the public.

One proposal to break the impasse over property revaluation was to devolve to individual authorities, or groups of authorities, the power to determine the council tax bands and when properties are revalued. This would enable, for example, London boroughs which have seen many homes exceed £1 million to revalue their properties and set the bands accordingly. Eventually local revaluations could lead to changes to the equalisation mechanism between authorities to reflect changes in the tax yield, but that could be managed in such a way as to avoid the big national storm which is assumed to be inevitable if the entire country were to be revalued simultaneously.

Suggestions along these lines reflected the call made in the finance review of the government of London, Raising the Capital, for the power to hold periodic revaluations and determine the number and ratio of bands. Those who are championing these options see them in terms of fairness between taxpayers and retaining trust in the overall system.

Some suggested a more wholesale reform that would see council tax and potentially other property taxes, such as stamp duty, replaced with a progressive tax on property values levied, collected and mostly kept by local government. Such an approach would still require local revaluation, but, it is argued, would support the move to self-sufficient local government.

The capping regime was a particular target for criticism. It was felt that the current requirement to hold a referendum for tax increases of 2 per cent or more undermines local democracy, discourages local communities from taking a rounded view of local needs and priorities and unfairly penalises councils with historically low tax levels. It was also pointed out that since the Government routinely announces the coming year's grant just weeks before the beginning of the financial year, the opportunity for an informed referendum debate is lost.

Council tax — Wiltshire Council

Wiltshire Council has its council tax revenue reduced every year by £21 million because of the Single Person Discount.

Since 2010 its net government grant funding has fallen by £22 million. If the council had the freedom to determine who should get discounts, it estimates it could gain £14 million by reducing the discounts awarded to single working age householders and means-tested pensioners, enabling the council to invest in services that are now at risk while still protecting the vulnerable.

We were told that the 2 per cent limit is arbitrary, and referendums waste money. The freedom for councils to set the bands and manage council tax discounts and benefits was seen as key, both in terms of fairness and in managing the supply of housing, including rental accommodation.

The council tax freeze grant — the system whereby government rewards councils for freezing the tax — was opposed by some. One authority pointed out it *"rewards high tax-base authorities at the expense of low tax-base authorities"*. The policy was seen as the antithesis of localism, and there were calls for it to be scrapped. The idea of an independent body to assess local government's funding need had some support; the suggestion was that it would agree with government what services council should provide and the funding required to do so. This would aid transparency.

Council tax — the Commission's view

A property tax is an important component of a fair and effective local government finance system. We endorse the arguments put forward by Sir Michael Lyons in 2007, that a local property tax provides a strong connection between the tax people pay and their residence in the area. It reflects their financial stake in the community and its prosperity and their interest in local services and investment — which will themselves affect the desirability of local property.

A local tax needs to work locally. The system of national bands, operating uniformly from Hull to Kensington & Chelsea, fails to reflect local variations in property prices, often resulting in properties crowding into one or two bands. The original design of the council tax had a focus on limiting variations between bills. It is time to rethink this approach.

There is a paradox in central government's approach to local government finance. It reserves to itself powers to set the council tax bands and revalue the properties, but does not exercise them. In contrast, it is clear from the submissions we received that many local authorities would like the ability to set tax bands to suit local circumstances.

Property taxes have a role in managing house prices. As Lyons pointed out, the purpose of taxes is both to raise revenue and to affect behaviour. There is great concern that persistent price inflation is making housing unaffordable to many. If local authorities were allowed to determine the position of the bands and the levels of the taxes, they could help take some local heat out of the housing market. Conversely, a nationally set system exacerbates housing problems by distorting the housing market — forcing local authorities to levy taxes which are disproportionately low in some areas and disproportionately high in others.

Successive governments have chosen not to revalue properties or reform the way council tax works, making the problem more intractable still for the next administration. The different mix of property values in different parts of the country, with many areas containing a much higher proportion of lower rated Band A and B homes, severely affects the ability of individual councils to raise tax revenues. Like the poll tax and domestic rates before it, the council tax system is heading for collapse. The one way government can avoid the pain of again having to invent a new local tax system is to devolve control of council tax to local areas.

Q8 *Should councils have the power to revalue properties and set council tax bands? How might this work?*

Q9 *Should councils have the freedom to increase the overall tax revenue after a revaluation?*

Raising additional revenue

The freedom to ensure a high proportion of services are paid for through local resources is a long-standing local government demand. A number of the submissions have suggested that additional taxes could be an integral part of a new finance system, on the basis that it would moderate the burden on domestic tax and encourage investment in infrastructure and other priorities to support the growth of the local economy. The restrictions on council tax and other forms of local taxation have pushed many councils towards raising money through charging for services. According to the Audit Commission, councils raise around £10 billion a year through service charges — approaching half the revenue raised through council tax. As local government funding continues to decrease, charging for certain services is an important local power both to raise revenue and manage demand. However, there needs to be more open debate and transparency around their use.

Additional revenue — the Commission's view

The rationale for the power to raise additional revenues is that communities are best placed to decide if additional levies would benefit the local area by enabling investment in, for example, transport links or high street infrastructure. Business Improvement Districts (BIDs), where a ballot of local businesses approves a levy on the local business rates, shows how this can work. Raising additional revenue is an important aspect of a sustainable finance system geared towards economic prosperity and community well-being. We will explore this further, recognising the principle of *'no taxation without representation'* — those who are taxed must have a voice in deciding how taxes are set and used.

Q10 *What additional streams of income for local government would benefit their communities?*

Q11 *How would people affected by new local revenue sources be given a voice in deciding how it is raised and spent?*

Q12 *Should an additional tax be permitted to become a permanent source of revenue, or should they be time limited?*

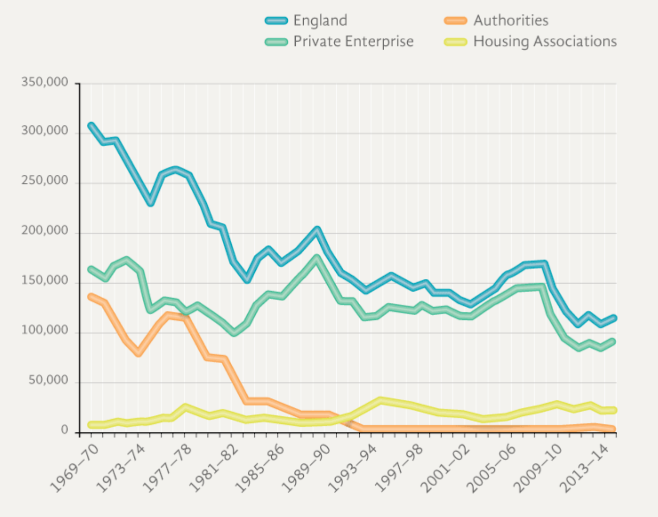
Q13 *What sort of limits, if any, should be imposed on the levels of such taxes?*

Meeting the country's housing needs

Over half the submissions addressed housing. The key issues for housing were increasing the supply — fewer than 110,000 homes were built in 2013 compared with an annual increase in the number of households of around 230,000 — and providing far more affordable housing. There are 1.7 million households on waiting lists for affordable homes across England. Any solution to the housing crisis needs to meet the specific needs of local areas, as there are huge variations in demand and supply.

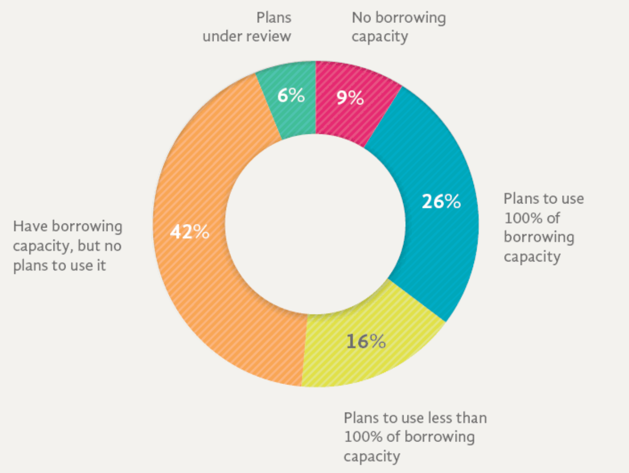
There was a widespread belief that the housing crisis will not abate until local government again plays a leading role in the supply of social housing. The submission from the Chartered Institute of Housing illustrated the potential for increasing the social housing supply. It highlighted LGA research which indicates councils could build an additional 15,000 to 17,000 homes a year within five years if borrowing constraints were removed or substantially relaxed. It gave the example of Birmingham City Council, which currently plans to build over 2,000 new homes in ten years, investing £254 million from its housing revenue account. But if its borrowing cap of £1.14 billion was lifted it could build a further 18,000 homes by 2031, meeting a quarter of the city's housing requirement.

Housing completions by tenure since the 1970s



Source: Department for Communities and Local Government

HRA borrowing capacity (LGC survey findings) Spring 2014



Source: Local Government Chronicle

Options include allowing councils to act as registered social landlords, and to be able to borrow for capital investment that pays a return, including housing.

There was strong support for allowing authorities to trade their borrowing limits among themselves — enabling councils with spare borrowing headroom to make this available to other authorities, allowing increased housing capacity in areas that were willing and able to build. Recent surveys have indicated that only 9 per cent of housing authorities have reached their borrowing limits, but borrowing capacity is largely in the wrong places for house-building.

The models put forward include an incentive for the contributing authority in the form of a 'commitment fee' charged on the headroom transferred. As councils increasingly cooperate across local areas, particularly if there is a sub-national element to funding distribution, there is an inherent incentive to work together in meeting housing need. It may well be in the interests of one authority to stimulate house-building next door.

There were calls for the housing revenue account to be taken out of the definition of the Public Sector Borrowing Requirement, arguing that it would bring this country into line with practice in Europe.

Other measures to increase the housing supply included powers to tax undeveloped sites, and providing more flexibility for local government pension schemes to invest in housing — an idea backed by the Royal Institute of British Architects' Future Homes Commission in 2012.

A number of respondents suggested the New Homes Bonus needs to be reformed. The scheme was established by the government as an incentive to increase housing supply in England and cost £2.2 billion from 2011–15. We have heard that the scheme, while benefiting some councils, has the effect of reducing income for a number of local authorities in deprived areas. The Commission has also been told by county councils that the distribution of the New Homes Bonus between county and district councils does not adequately reflect the counties' role in providing supporting infrastructure for housing developments. Once again this raises the question of how incentives can be introduced which are sufficiently flexible to meet the very different contexts in which local authorities and their partners are working.

Many low income families have benefited from the Right to Buy scheme but only half the properties sold have been replaced with new social housing. Since low-cost housing is where the need is most pressing, many submissions argued that Right to Buy needed to be reformed. Options included making its use discretionary, returning all the receipts to local authorities to fund new housing, and reducing the current Treasury top slice to 15 per cent of receipts. Some suggested that it should be scrapped altogether.

Overall there was a strong belief that local government needed to play a major role in house-building. As one submission said: "*It seems neither right nor possible to tackle the housing crisis and deliver a step change in housing delivery without local authorities making a more direct and sizeable contribution to supply.*"

Housing — the Commission's view

The Commission believes that the legitimate desire to control borrowing is being pursued without regard to wider social and economic imperatives, while the determination to marginalise local government's role in the provision of social housing is a doctrine from three decades ago which, again, fails to recognise the scale of the problem we now face. Local government is not the whole answer to the housing crisis, but it is a crucial part.

The Commission supports the recommendation in the IPPR report Together At Home that the Government reviews its approach to the classification of local authorities' housing debt. This is currently capped for councils despite the self-financing brought in by reforms to the housing revenue account. If, instead of focusing on the public sector borrowing requirement (PSBR), the government adopted fiscal rules and accounting practices based on general government borrowing and debt (as happens elsewhere in Europe), local authority house-building would be excluded from the target measure.

Each year of inaction exacerbates the housing problem. Addressing the housing issue will be a substantial focus of the Commission's final report.

Q14 *Should restrictions on councils' borrowing for investment that pays a return be lifted?*

Q15 *Should councils be allowed to act as registered social landlords?*

Q16 *Would allowing local authorities to 'trade' borrowing headroom enable local government to meet the housing shortage across the country? What other mechanisms could be used?*

Q17 *Should councils control Right to Buy, including having the power to scrap it?*

Stimulating growth

Every submission addressed the need to stimulate economic growth. Local government is one of the few parts of the public sector that uses its resources to drive the economy, and adapts its economic strategy to meet the particular challenges and opportunities of the local area.

For example, councils help business access finance in a variety of ways, including direct loans. Prudential borrowing by South Staffordshire, Wolverhampton and Staffordshire councils secured the Tata investment in the Jaguar Land Rover low emissions engine plant in South Staffordshire, with the councils leveraging £400 million of private sector investment. Other councils have underwritten risk to promote housing and other developments.

> *"Local government is one of the few parts of the public sector that uses its resources to drive the economy, and adapts its economic strategy to meet the particular challenges and opportunities of the local area."*

But, with greater autonomy and devolved powers councils could do even more to encourage economic development, such as using local commissioning to overcome the mismatch between local and national infrastructure planning, supporting far more local development through prudent risk-taking, and cutting centrally imposed regulations which drive up business costs and inhibit expansion. The most common recommendations for strengthening local government's ability to support growth were: increase business rate retention; allow additional local taxes; introduce multi-year funding settlements; and increase local pooling of public sector budgets.

There was support for implementing fully the recommendations of Lord Heseltine's review of economic growth, which called for the devolution of up to £50 billion of government funding over four years to support growth instead of the £2 billion a year Local Growth Fund now proposed.

Business rate retention — County Durham

The Business rate retention scheme can have perverse effects, potentially discouraging support for manufacturing industry in favour of retail units.

The new Hitachi factory in Newton Aycliffe is due to open in 2015. It is expected to create 600 jobs in the factory plus many more in the supply industries, a lot of which will be highly skilled and highly paid. The rateable value and 49 per cent business rate retained by the council is forecast to be:

Forecast Rateable Value	**£1,140,000**
Multiplier	**£0.482**
Durham Retention (49 per cent)	**£269,245**

This compares to a proposed supermarket site in the county where the jobs will be low paid and part time. The rateable value and 49 per cent business rate retention is forecast to be:

Forecast Rateable Value	**£3,100,000**
Multiplier	**£0.482**
Durham Retention (49 per cent)	**£732,158**

So the business rates retained by the council from the supermarket will be more than £460,000 higher than for the Hitachi factory. Durham believes the Government's objective of encouraging manufacturing would be better served by allowing local authorities to retain 100 per cent of business rates for industrial developments.

Stimulating growth — the Commission's view

Under business rate retention, local authorities are incentivised to encourage economic growth through retaining a significant portion of the taxes raised in their area. In theory this means that the more they raise the more they keep, but it is distorted by a complicated system of tariffs and top-ups which undermines the incentives and makes it difficult to understand how it works. Business rates have hints of self-sufficiency, but the overall package is too limited to be effective.

The balance between local choice and national entitlement

The Commission recognises that there are some aspects of local government's responsibilities where the public expects the same outcomes across the country. For example, there is an expectation of the same quality of child protection, but decisions about other aspects of child support such as school transport and nursery provision are best taken locally.

The right balance between national expectations and local autonomy is less obvious for adult social care. While there are common expectations around adult safeguarding — keeping adults safe from harm — there is wide variation in the extent to which local authorities meet low and medium levels of social care need; many councils now only commit to meeting critical and substantial need.

Local choice and national entitlement — the Commission's view

In moving to a system of greater local autonomy, the public and Parliament must have confidence that some areas of service provision will deliver comparable outcomes everywhere. We believe it is important to have a national conversation about the appropriate balance between consistent outcomes and local decision-making. We are keen to solicit a wide range of opinion on this issue.

Q18 *Which local services should be aiming to achieve comparable outcomes across the country?*

Moving from welfare to work

Submissions to the Commission stressed the importance of local authorities having the freedom to adapt the welfare, skills and training systems to meet local needs. One of the strongest calls was for a greater role in shaping welfare to work programmes. A common demand from businesses is for councils to replace the current plethora of central government training and skills schemes with a coherent strategy that matches skills to the needs of local businesses. This is another example of how handing a national scheme over to local control will ensure more effective use of public money.

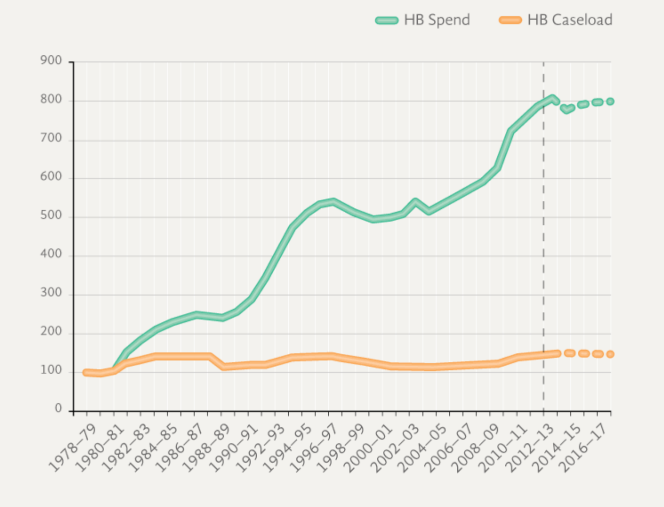
Recommendations on welfare payments included allowing individual councils to decide whether and how to run the spare room subsidy scheme and establishing full local control of council tax support so local areas could shape discounts, exemptions and benefits.

The recent partial localisation of council tax support — with local authorities being asked to run the council tax benefit system — was seen as an example of councils having responsibility for a service without the power to make it work effectively. The Government cut the scheme's funding by 10 per cent and imposed a framework prescribing the classes of people it had to cover and the reductions to which they were entitled. This protection — notably aimed at pensioners — pushed more of the tax burden onto particular deprived groups and blocked potential changes such as reducing the single person discount.

We were told that localising central government housing capital grants and full control of housing benefits could lead to a rebalancing between investment in housing stock and subsidising rents.

Around £20 billion of housing benefit is paid annually, two thirds of it for social housing. According to the IPPR the housing benefit bill has grown in 2011/12 prices from £1.1 billion in 1970/71 to £22 billion in 2010/11. This means just 5 per cent of total public housing spending goes on house-building. We were told that this has been driven by increased use of private sector landlords, higher rents and an increase in the working age client group. Again, this is administered by local government without the freedom to shape it to local circumstances.

Change in housing benefit Caseload and Spend (indexed 2012–13 prices)



Source: Department for Work and Pensions

Welfare and work — the Commission's view

Policy around housing, welfare support and training needs to be developed as a single coherent framework which supports the vulnerable, helps people find work by developing the skills that local businesses need, and shifts public spending from subsidising rents to investing in social housing.

Councils understand local skills needs through their work with local businesses, but have limited powers to shape the supply of local labour. National skills programmes will never be as successful as local ones because they cannot hope to meet those specific needs.

Giving local government, with businesses, more control over skills development would benefit the UK economy.

We recognise that bringing down rent levels is not straightforward, because it would diminish the supply of private rented housing. However, if councils can lower the housing subsidy bill through lowering rent levels or demand for benefit, they should be able to use that money to invest in new housing. The Commission will explore these ideas further.

Q19 *How could welfare, housing and skills policies work locally?*

Q20 *What should be the local government role in reducing welfare dependency and developing skills?*

Q21 *Is there a financial model that incentivises councils to reduce welfare dependency?*

Supporting families and young lives

We have been told that the costs of failing to support young people are high — £5,485 to lock up a young offender for a month, £46,389 to take a child into care and £4,528 to maintain an 18–24 year old NEET for a year. Coordination of different services to provide a joined up intervention when families hit problems has been improving, with the Troubled Families programme building on best practice in local government.

However, practitioners have told us that still more could be done in Whitehall to ensure that departments work together efficiently and coherently. The system would deliver better outcomes for children and families if it was less fragmented.

Health and social care—finding the right route to integration

The emphasis here was on increasing the focus on prevention and early intervention, and accelerating the integration of health and social care services. New rules *"should be based on what benefits the patients/people first, rather than responding to the old architectural divide"*.

Ideas included pooling budgets and risk between health and local government, possibly through a single commissioning system across health and social care led by health and wellbeing boards. There was support for reforming the NHS 'tariff' payment system to encourage greater collaboration on prevention and early intervention.

Supporting families and young lives — the Commission's view

Local support for families and children typifies the fragmented approach to services imposed by the current system, with money coming through around a dozen funding streams.

These include the mainstream and special needs elements of dedicated schools grant (up to £36 billion), early years children's support (up to £9.2 billion), free nursery places (£543 million), adoption support and reform (£150 million), Pupil Premium grant (up to £1.8 billion), Pupil Premium Plus (up to £40 million), public health grant for young children (£850 million from 2016), education services grant (£800 million), free school travel (up to £38 million), and the early years element of dedicated schools grant (up to £2.1 billion), as well as councils' own spending of around £4.5 billion.

The Commission recognises that addressing this issue is one of the most difficult areas of reform because it requires a big change in political culture. Nonetheless, the waste in money and life opportunities perpetuated by the current fragmented system cannot be allowed to continue.

Q22 *How can we enable local communities to provide efficient, joined up support for children and families?*

Health and social care — the Commission's view

The health and social care system faces immediate challenges from rising demand and fixed or falling resources, but more fundamentally the needs of the population are changing with an ageing population and an increasing prevalence of long term physical and mental health problems. There is a growing consensus among politicians, policy makers and practitioners that to meet this challenge we need better coordinated care, but too often services feel fragmented.

The responses to this Commission make the case for better integration of care, and many have called for pooled budgets and joint commissioning of health and social care. But evidence around effective models of integrated care and the role of financial tools such as pooled budgets and payment incentives in delivering integration is limited, so there is uncertainty about how to deliver integrated care for local populations at pace and scale. In the next phase of this review we will explore the role of financial levers to support integrated care, building on the range of local initiatives such as the Better Care Fund and integrated care pioneers. The Commission will also consider how to drive forward change with the necessary urgency without further structural reorganisation of the NHS, and respecting local circumstances.

Other solutions should be explored, such as money following the service user. This may prove a more effective and practical path to integration than trying to force together two fundamentally different funding systems.

Q23 *What is the best way for local government and the NHS to collaborate in the commissioning of health and social care, without another restructuring?*

Q24 *If the principle was adopted of the money following the service user through the health and care system, how might this work?*

Better financial planning

We have heard that the practice of announcing each year's funding settlement just a few weeks before the new financial year has led to rushed budgeting, and that it pushes councils towards increasing reserves, which ministers have routinely attacked. Many submissions asked for the government to announce its local government funding plans at the beginning of each Parliament.

Financial planning — the Commission's view

Effective financial planning matters. At a time of austerity every effort should be made to ensure that those charged with managing taxpayers' money are able to do so effectively. Common sense dictates that local authorities should be given their funding allocations as far in advance as possible; there is no justification for announcing the distribution of billions of pounds just weeks before the new financial year. The Commission sees strong merit in setting out the spending plans for a whole Parliament.

Q25 *How could central government support more effective financial planning?*

Next Steps

Over the coming weeks the Commission will hold a series of seminars in which the issues and questions raised in this report will be considered and tested against the five priorities — housing, growth, health and social care, welfare and early intervention.

The Commission would welcome further submissions in response to the interim report and these can be sent to enquiries@localfinancecommission.org

It would be helpful to receive submissions by 28 November 2014.

The Commission will continue to engage with stakeholders across the country in the coming weeks. We will listen to the views, consider the responses to this interim report and reflect on other research and expert advice.

We plan to publish our final report early in 2015.

Appendix 1

List of organisations that have made submissions to the Commission

- Association of County Chief Executives
- Association of Directors of Public Health
- Association of North East Councils
- Birmingham City Council
- Bradford District Council
- Brighton and Hove City Council (Unitary)
- British Property Federation
- Cambridgeshire County Council
- Camden Borough Council
- Cannock Chase Council
- Chartered Institute of Housing
- Cleveland Fire Brigade
- Core Cities Group
- Cornwall Council (Unitary)
- County Councils Network
- Cumbria County Council
- Dartford Borough Council
- Devon County Council
- District Councils Network
- Dorset Fire Authority
- Early Intervention Foundation
- East Northamptonshire District Council
- Essex County Council
- Greater Manchester Combined Authority
- Hampshire County Council
- Hampshire Fire and Rescue
- Hartlepool Borough Council
- Havering
- Hinckley and Bosworth Borough Council
- Joint submission by the LGA Fire Service Management Committee, The Chief Fire Officers Association and the Fire Finance Network
- Kent County Council
- Kettering Borough Council
- Knowsley Borough Council
- Leicester, Leicestershire and Rutland Combined Fire Authority
- Leicestershire County Council
- Liverpool City Council
- Local Government Shared Services
- London Borough Lambeth
- London Councils
- Melton Borough Council
- Milton Keynes Borough Council (Unitary)
- National Audit Office
- National Housing Federation
- National Union of Students
- Newcastle City Council
- Norfolk County Council
- Northamptonshire County Council
- Peterborough City Council
- Police and Crime Commissioner — Hampshire
- Police and Crime Commissioner — Lancashire
- Police and Fire Commissioners Treasurers Society
- Preston City Council
- Rev Cooper (rural parish Preston)
- Royal Town Planning Institute
- Rural Service Network
- Slough Borough Council (Unitary)
- Society of County Treasurers
- Solihull
- South East England Councils
- Sparse Rural
- Stafford Borough Council
- Stockton-on-Tees
- Stoke on Trent City Council (Unitary)
- Suffolk County Council
- Tandridge District Council
- The LEP Network
- The Special Interest Group of Municipal Authorities (outside London) within the LGA
- Training Standards Institute
- Tyne and Wear Fire and Rescue
- Visit England
- Warwickshire County Council
- West Oxfordshire District Council and Cotswold District Council
- Worcestershire County Council

Appendix 2

Overview of local government finance

Revenue

Local
- Council Tax
- 1/2 Business Rate Retention

Central
- RSG
- New Homes
- Bonus
- Other Grants

Local
- Housing Benefit

Central
- Council Tax Benefit

- HRA

Income

Funding for Services

Funding for Welfare

Ringfenced housing income and expenditure £8.2 bn

Capital

Local
- Capital receipts
- Borrowing
- Revenue

Central
- Central Government Grants

Expenditure

Local authority net revenue expenditure on services is just over £100 billion per year

Education	Ringfenced	£37 bn
Highways		£5 bn
Children's		£7 bn
Adult's		£15 bn
Housing	Ringfenced	£23 bn
Culture, environment, planning		£9 bn
Fire		£2 bn
Central		£3 bn
		£101 bn

Capital expenditure in 2013/14 was £24 billion

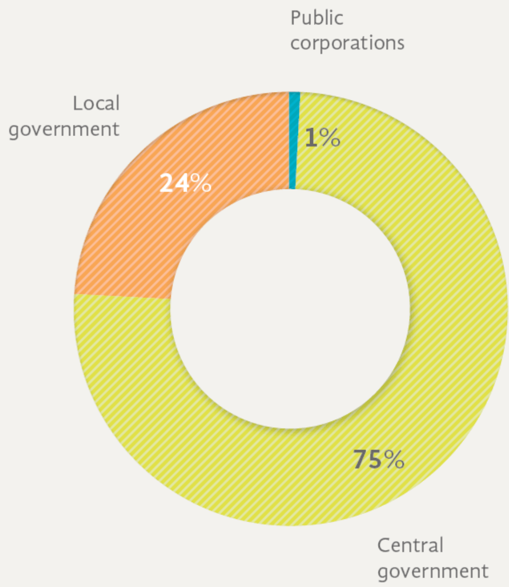
Education	24%
Housing	20%
Transport	32%
Other	24%

Net controllable expenditure = £51 bn
(excludes expenditure on schools and housing)

Source: LGA

Local government finance in context

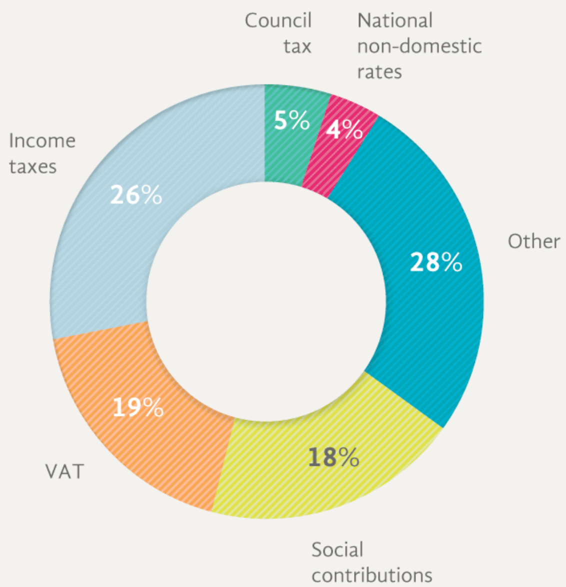
Local government accounts for 24 per cent of total public expenditure



Source: Office for National Statistics

Council tax and National non-domestic rates

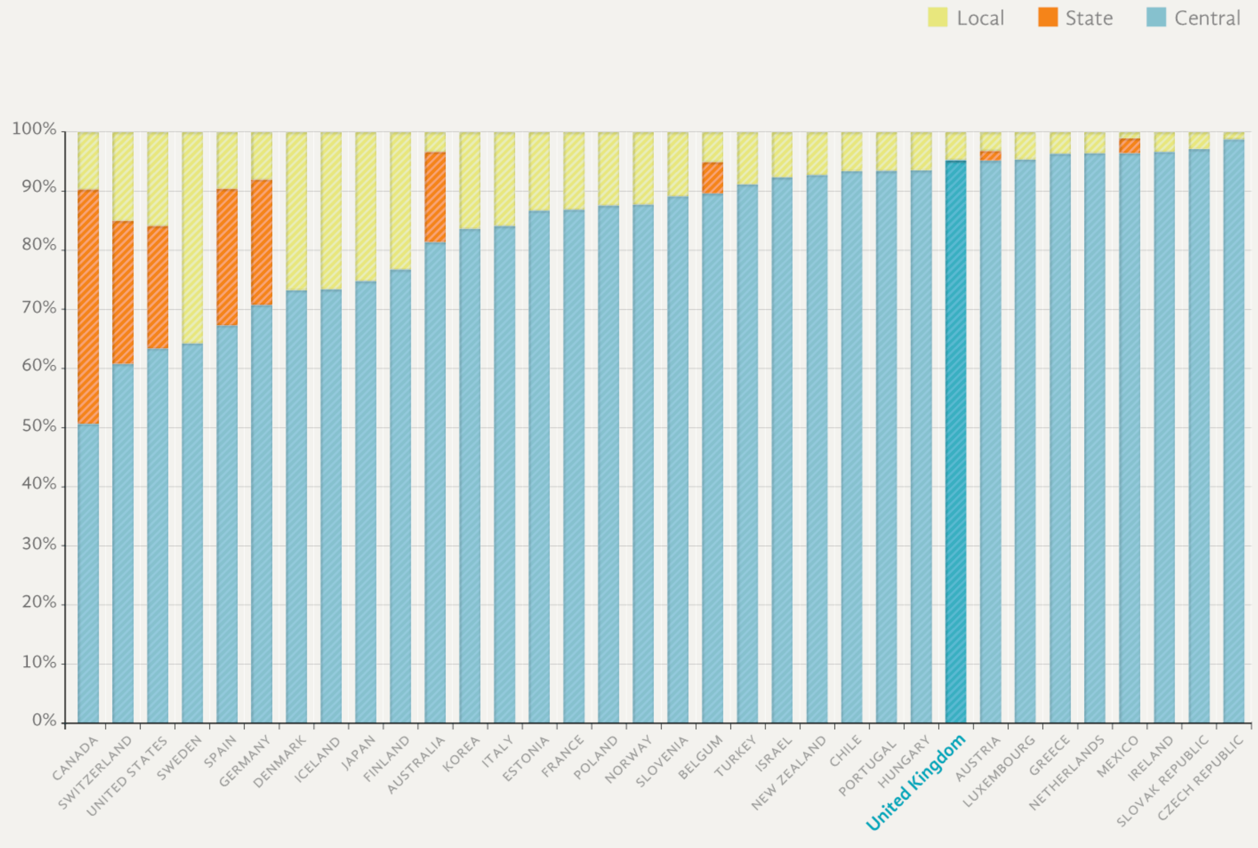
Council tax and National non-domestic rates represent just 5 per cent and 4 per cent respectively of total government receipts



Source: DCLG

Tax revenue by tier as a percentage of total tax revenue in OECD countries 2011

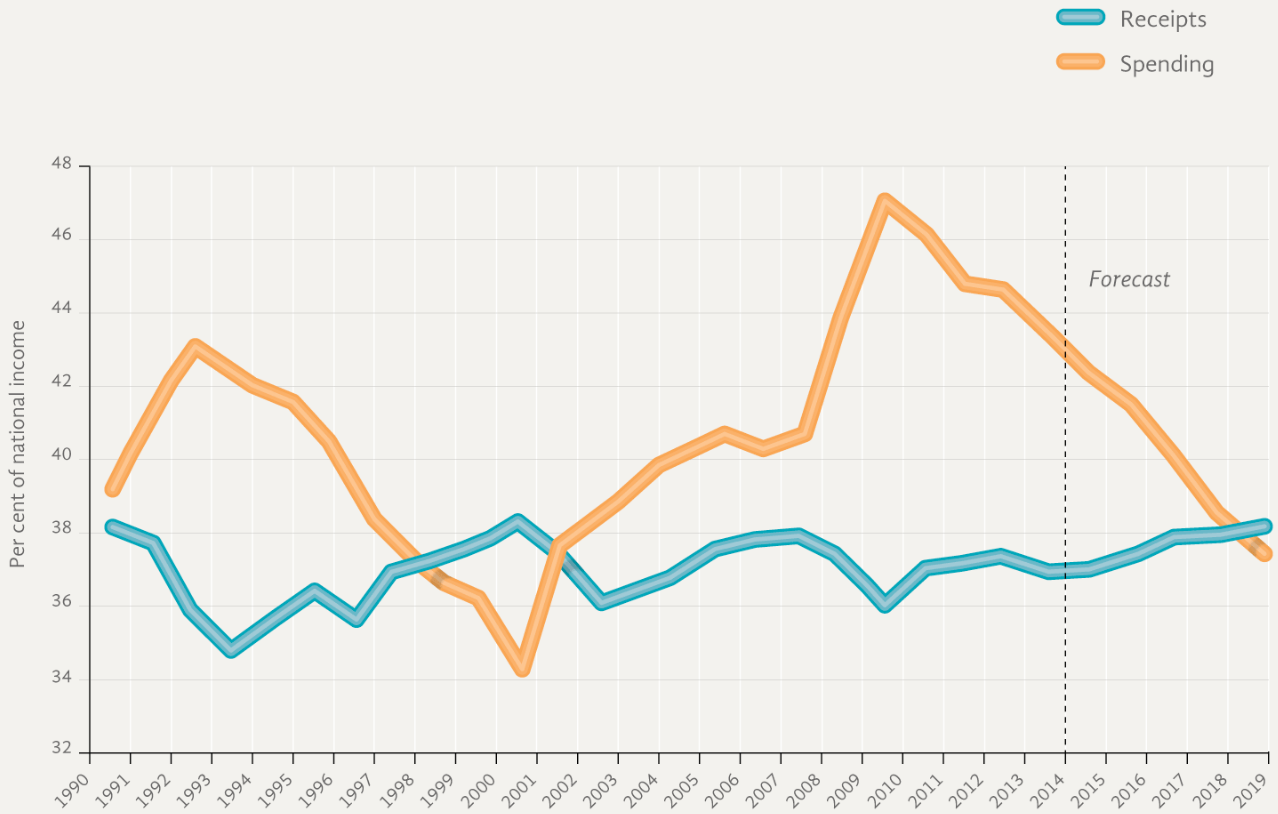
International comparisons show that the UK is one of the most centralised countries



Source: OECD

The gap between receipts and spending

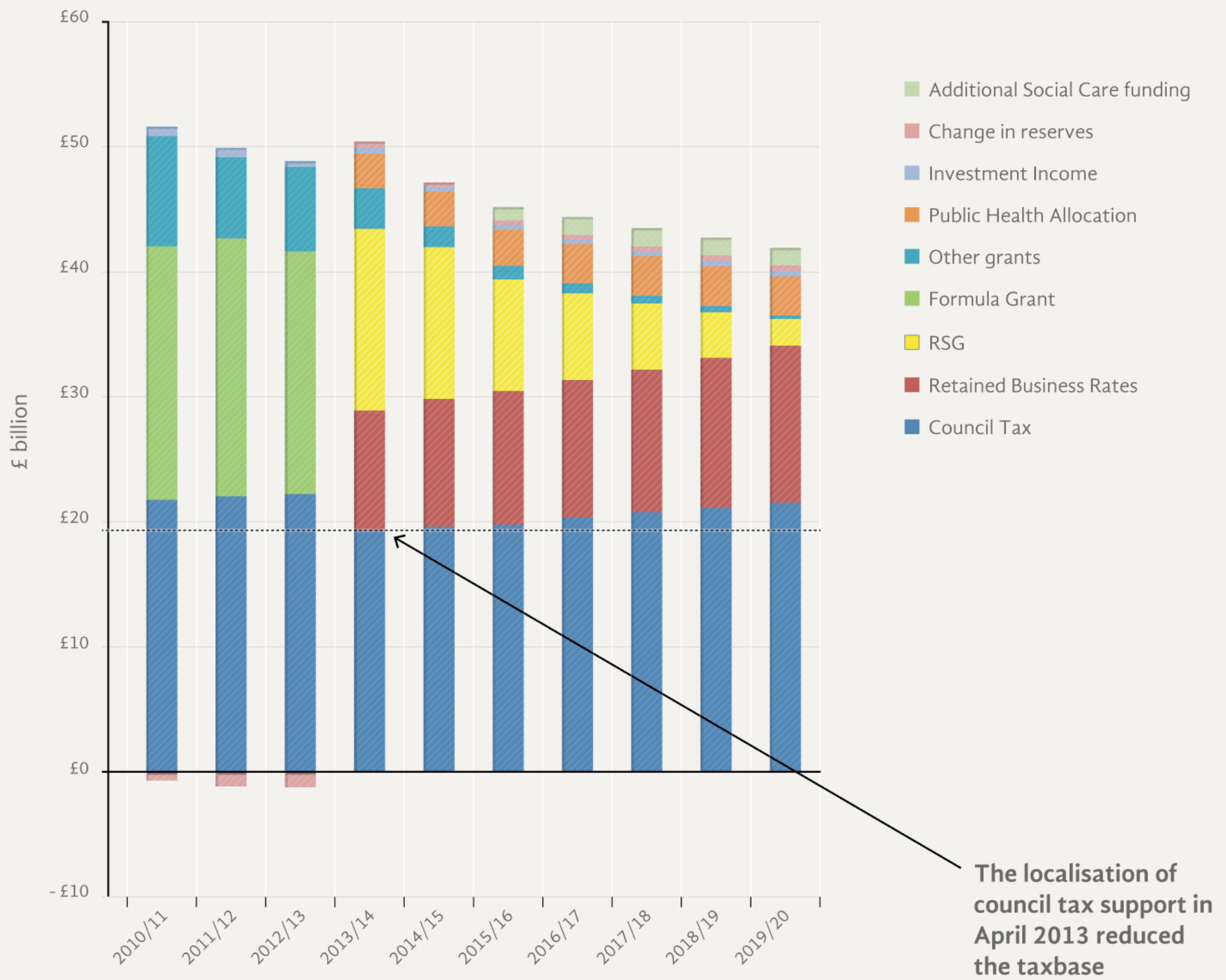
Public spending is set to fall to 37 per cent of national income by 2018/19; this is a level not seen since 2001 and not consistently seen since the 1960s



Source: ONS, OBR

Local authority funding 2010/11 — 2019/20

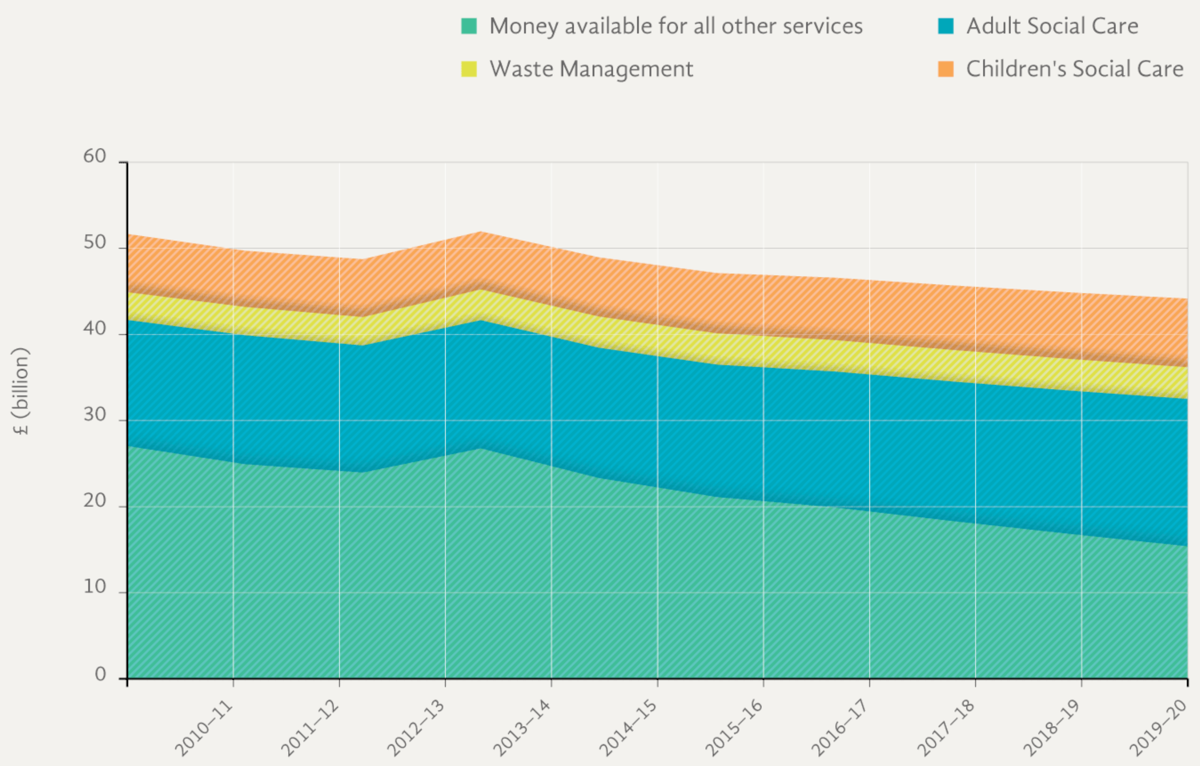
The fall in public funding since 2010/11 has resulted in particularly large reductions for local government. This is partly as a result of the protection of other areas of expenditure such as health, education defence and international development. Total funding is projected to fall to £43.4 billion by 2019/20. This includes £3.1 billion of Public Health funding which carries with it a new responsibility.



Source: DCLG, LGA

Shrinking resources for non-statutory services

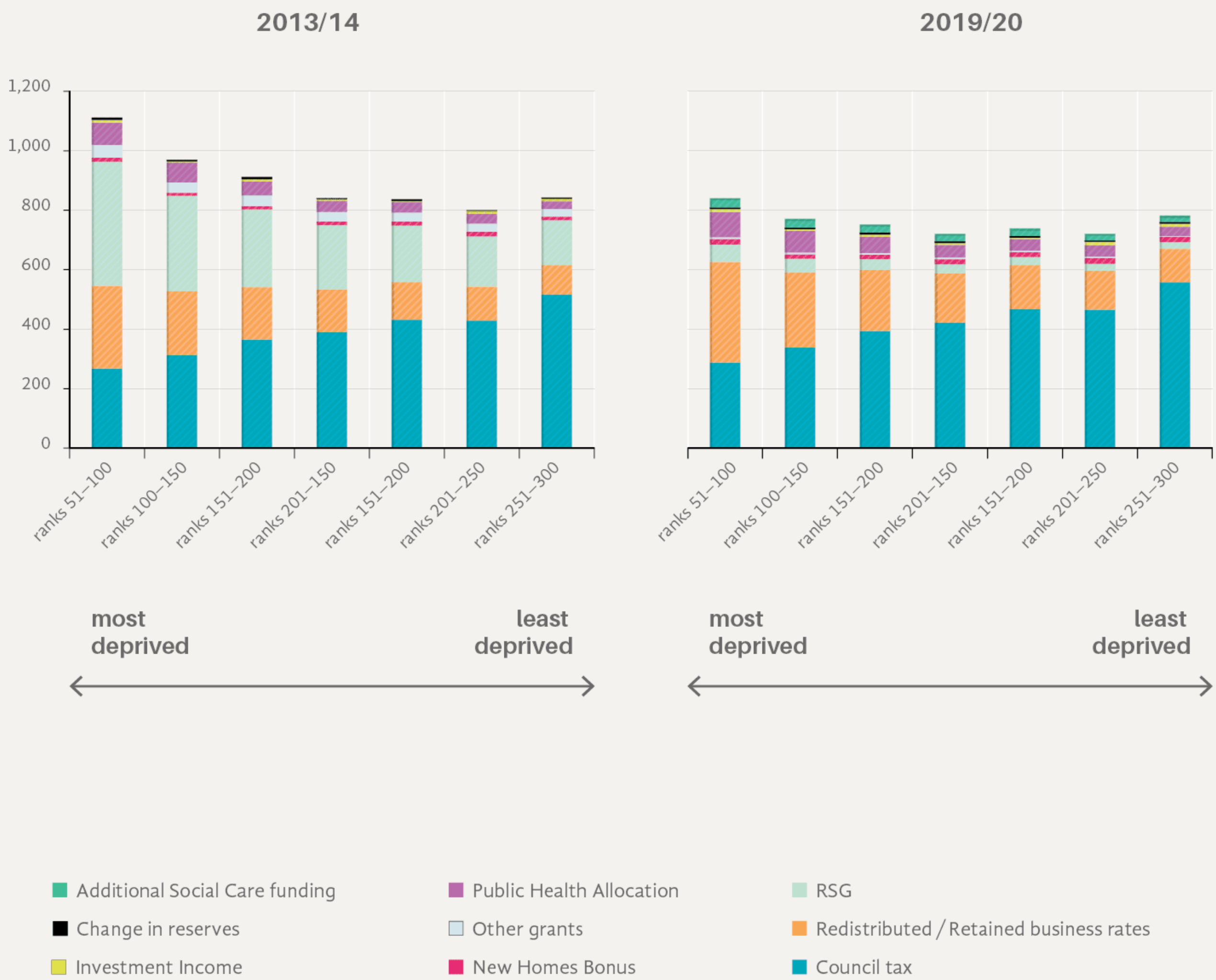
When we account for inflation and demographic pressures in waste management and social care, the money available for all other services shrinks from £26.6 billion to £15.1 billion (and £3.1 billion of this is for new Public Health responsibilities).



Source: LGA

Per Capita Total Funding reduces by 28 per cent for the most deprived council and 4 per cent for the least deprived—between 2013/14 and 2019/20

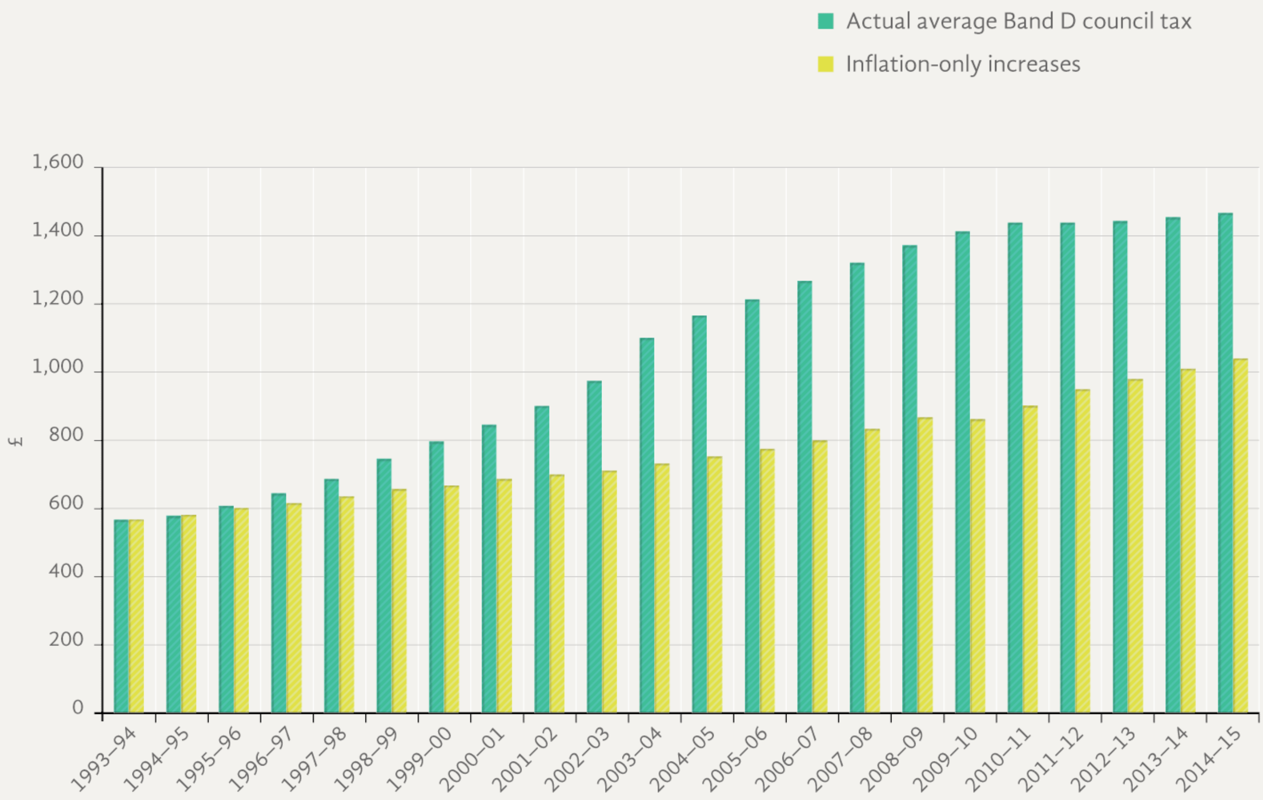
The fall in funding for local government has been delivered through reductions in government grant (Revenue Support Grant). As a result, those areas which are most deprived and most dependent on government grant have seen the largest percentage reductions. The consequence of falling revenue support grant is that funding per head is more equal.



Source: DCLG, LGA

Council tax

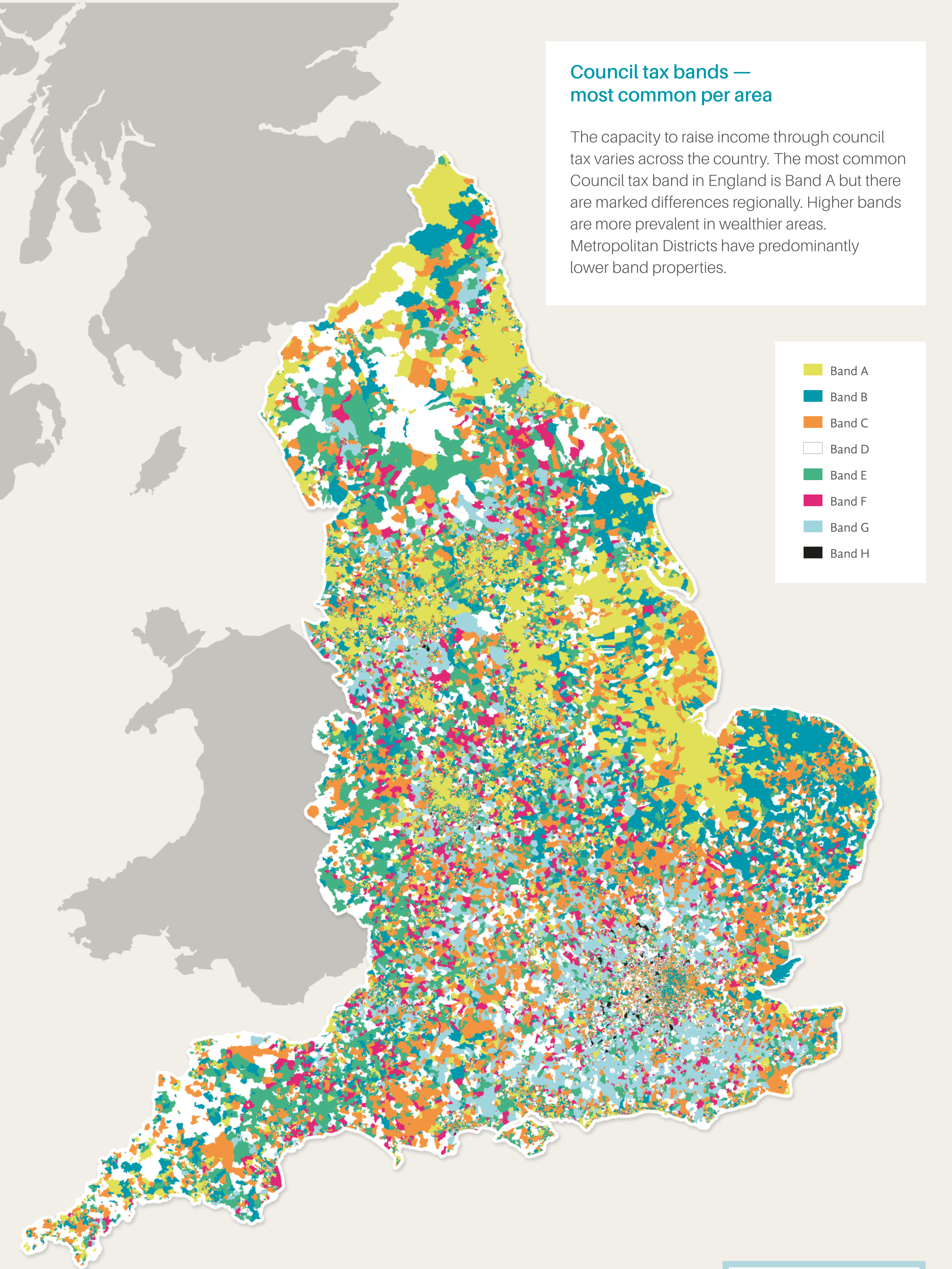
Council tax, one of the main sources of local income, is under pressure. Band D council tax from 1993 (£) has been flat since 2010/11 despite decreasing grant yield.



Source: DCLG, LGA

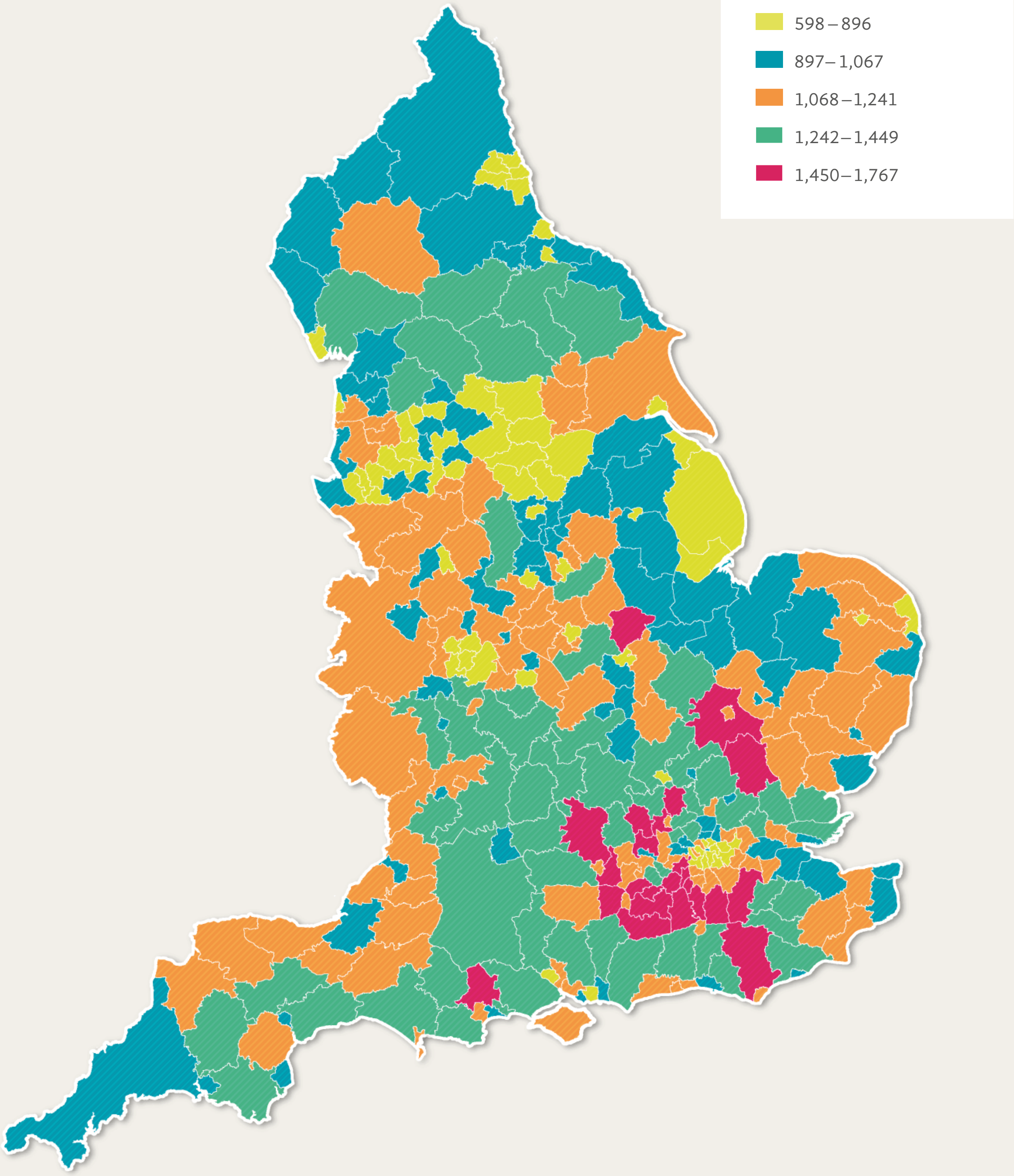
Council tax bands — most common per area

The capacity to raise income through council tax varies across the country. The most common Council tax band in England is Band A but there are marked differences regionally. Higher bands are more prevalent in wealthier areas. Metropolitan Districts have predominantly lower band properties.



Source: DCLG, LGA

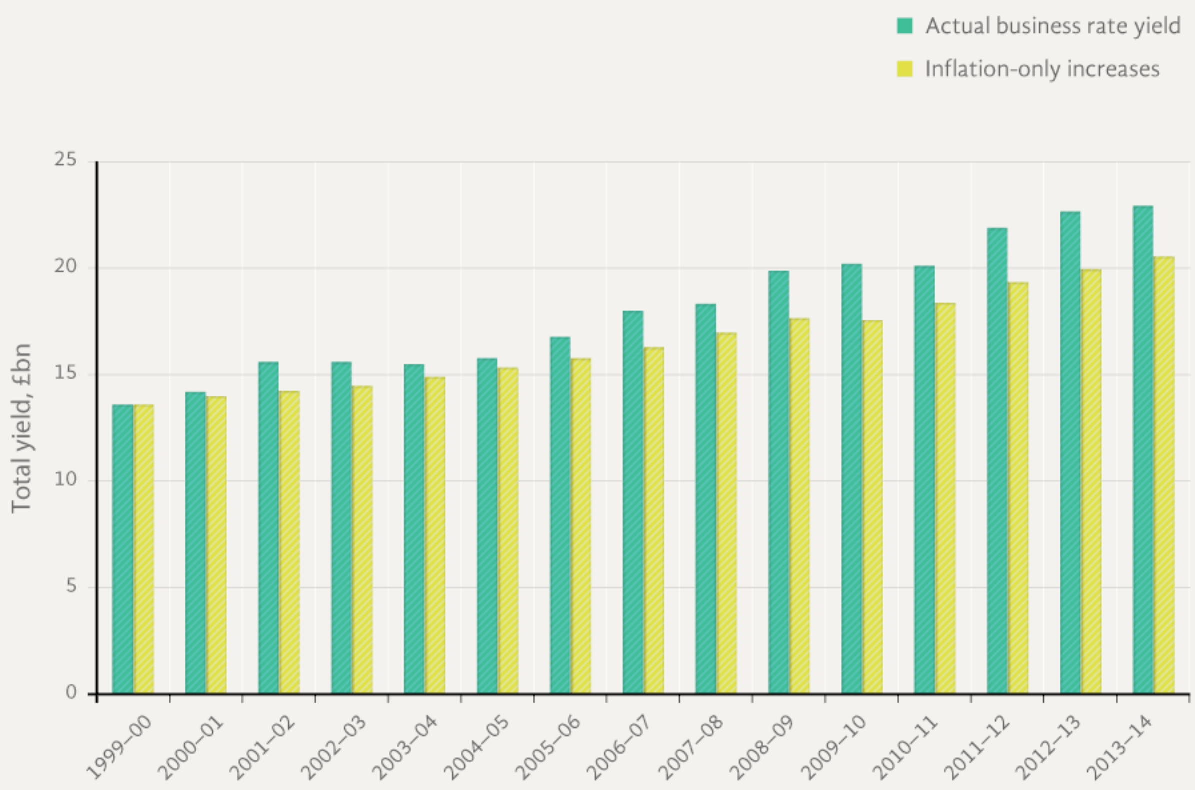
Council tax per dwelling (England, 2014)



Source: DCLG, LGA

Business rates

Current total Business rate yield is worth £22.4 billion

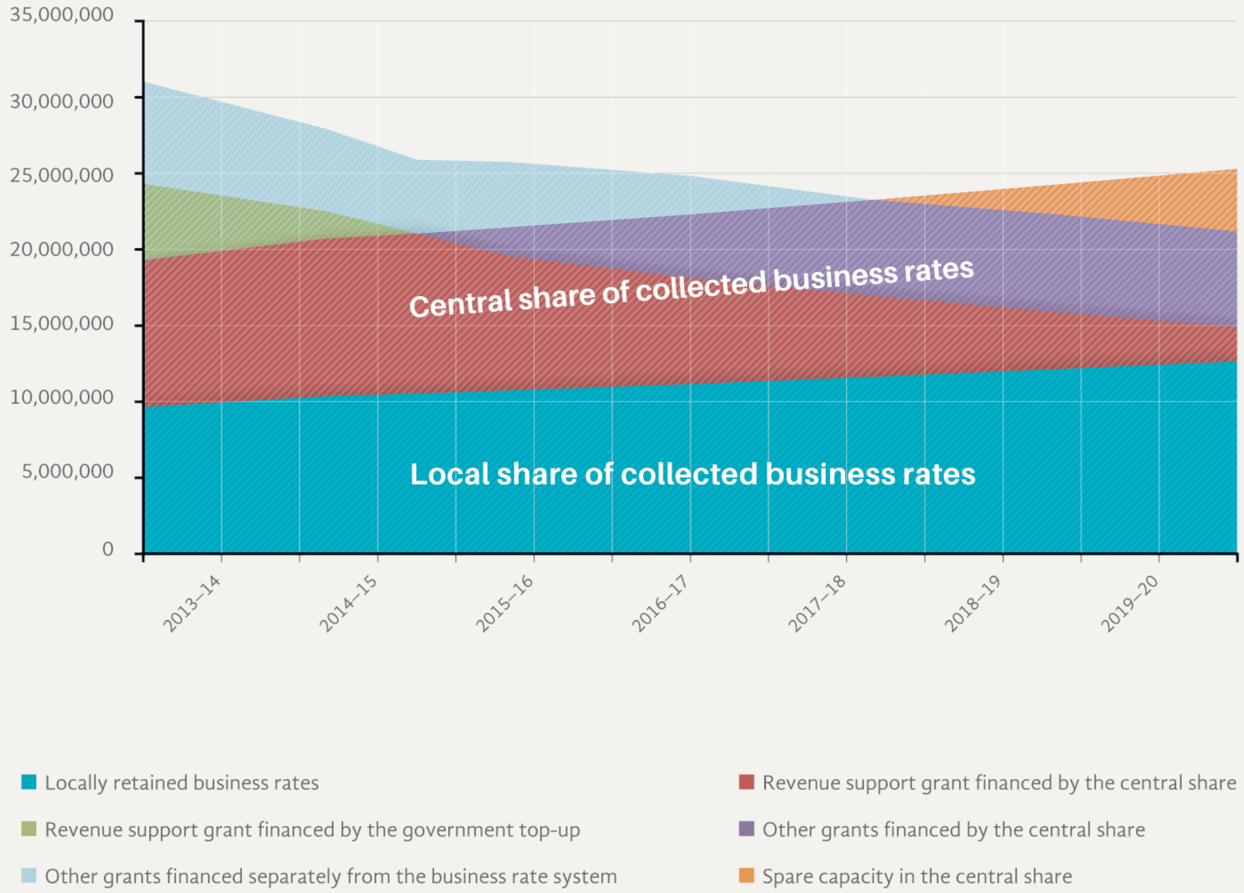


Source: DCLG, LGA

The projected growth in business rates

Since April 2013, councils keep 50 per cent of locally collected business rates (the local share), with the other half transferred to central government to be used to finance grants (the central share) Local share of collected business rates.

The only grant financed through the central share is currently RSG, but this is likely to change as RSG reduces to a level less than what is collected through the central share. At this point, other grants should be financed with the remainder. It is predicted that in 2015/16 there will be a gap of £3.2 billion between revenue support grant and the central share



Source: DCLG, LGA

Council Reserves

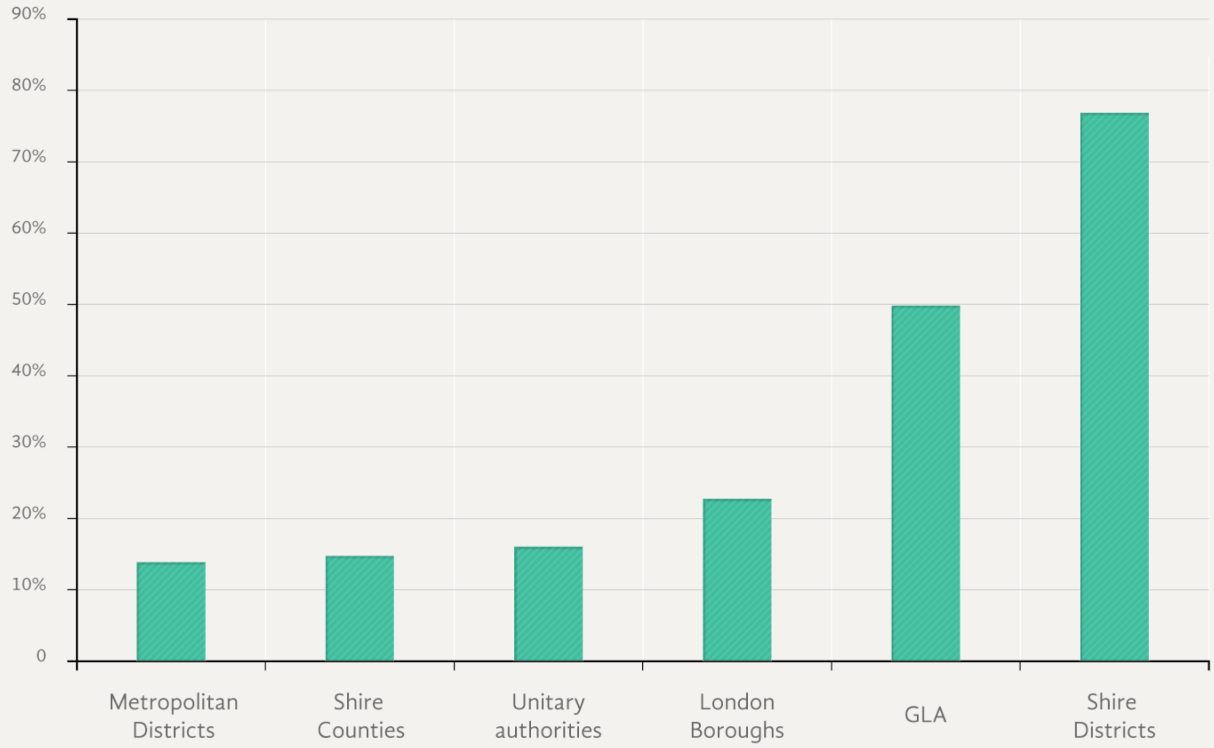
When looked at in terms of annual net expenditure, reserves do not appear to offer councils scope to offset falling income. 7 per cent of annual net expenditure represents the equivalent of about 26 days net expenditure.

Estimates as at 31 March 2013, using 2012/13 RO data	£ bn	% Annual net Expenditure
Councils Earmarked Reserves	11.1	22%
Councils General (unallocated) Reserves	3.6	7%
Total "usable" reserves	**14.7**	**29%**

Source: DCLG, LGA

Non-school revenue reserves as a % of revenue expenditure as at 31 March 2013

The picture on reserves varies across councils

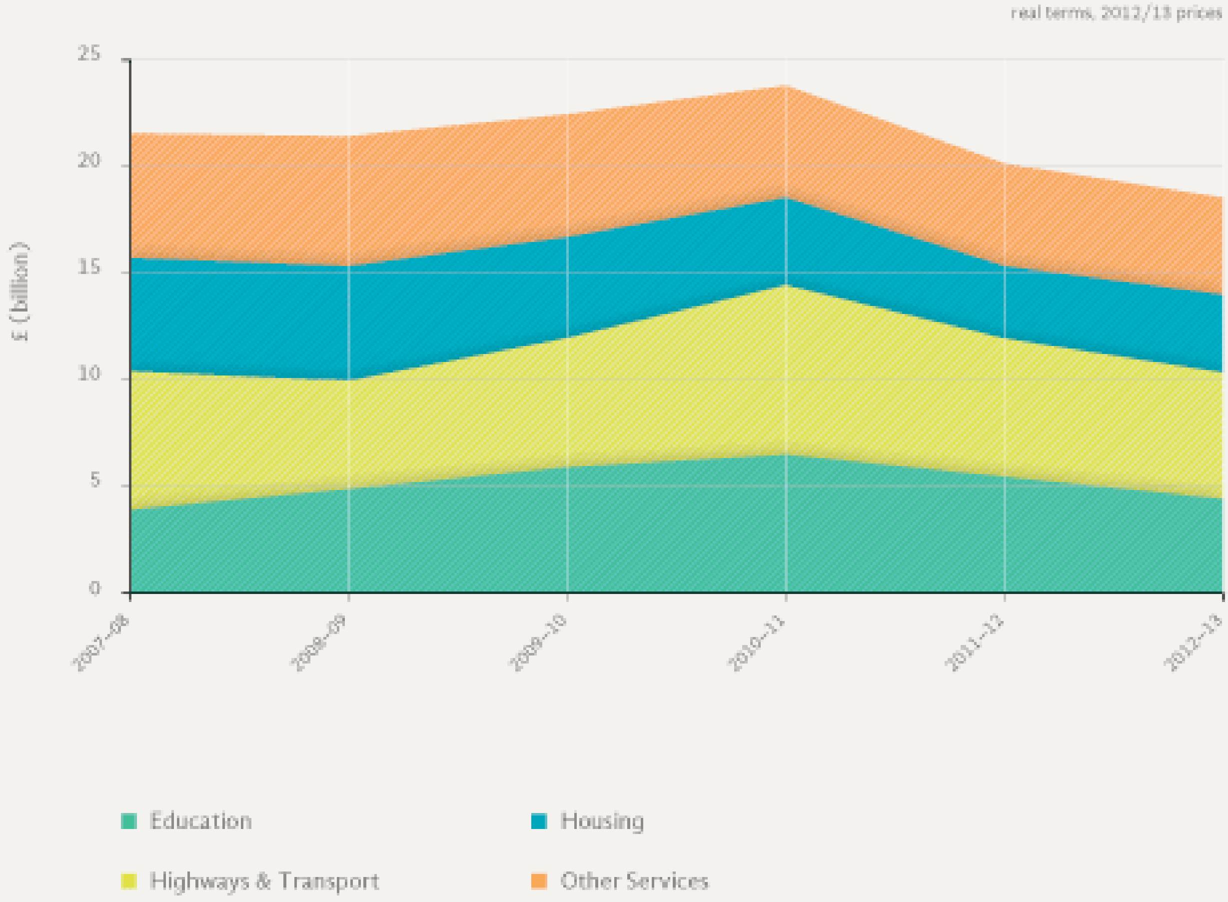


Source: DCLG, LGA

Capital expenditure by category

Capital

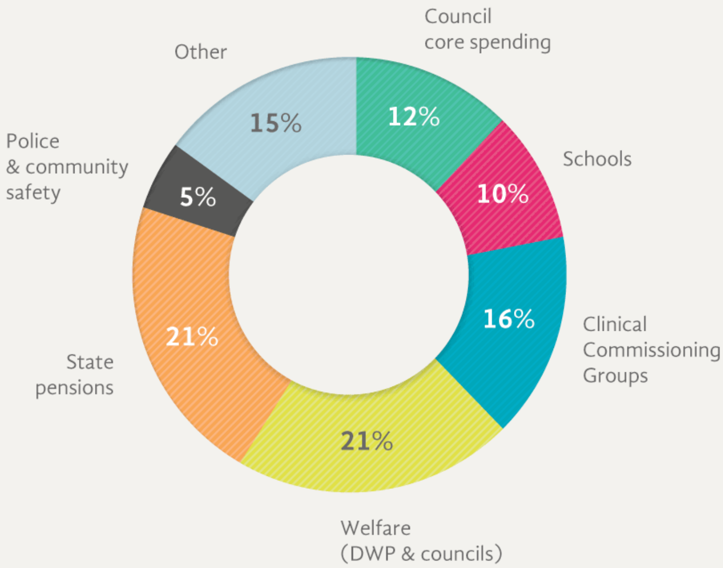
In real terms, capital spending decreased by 13.4 per cent between 2007/08 and 2012/13. During this period, capital expenditure on education has increased by 11.4 per cent, while spending on housing has declined by 32.0 per cent and other services by 20.7 per cent.



Source: DCLG

Make-up of place specific spending, 2013/14

Council core spending accounts for around 12 per cent of place based spending



Source: DCLG, LGA

Appendix 3

Changes suggested by respondents to the Commission

How funding is allocated

The local government finance system must have some level of redistribution within it to ensure that there is some process of resource equalisation in place.

Additional funding has recently been made available to support rural needs. The allocation should recognise pockets of need, but it is currently allocated based on net rather than gross sparsity.

Top slicing and holdbacks of local authority resources should not be a feature of the local government finance system.

Measures should be put in place to ensure that local authorities are adequately compensated for the costs of schools transferring to academies; in some cases debt burden remains as a legacy.

The Government should review the operation of damping in the current system.

The system should be changed to allow more of the funds that are generated locally to be retained locally.

Council tax income should be included when calculating the reductions in Revenue Support Grant required for each authority, thus equalising the savings challenge requirement for all authority classes and not favouring any.

Central government should extend the remit and scale of Community Budget pilots through devolution from existing Whitehall budgets, leading to comprehensive place based settlements.

Further complexity has been added to the funding system by the introduction of the Education Funding Authority (EFA). The recent funding review has introduced a more rigid funding system allowing less local flexibility.

If councils are to reduce their reliance upon government grant, it is essential that they receive greater powers that enable them to raise, retain and spend money locally.

The range of services provided by fire authorities is not sufficiently recognised by the funding system.

When transferring responsibilities from central government to local government, it is important to ensure that the function is appropriately resourced; the transfer of responsibility for the Council Tax Support Scheme is an example where this has not happened.

Council tax

The erosion of council tax resource equalisation should be addressed.

Thought needs to be given as to how to factor into the funding formula the differences between councils in terms of current council tax levels, efficiency and balance sheet strength.

Precepting by stand alone fire authorities should be taken out of the council tax debate.

Stand alone fire services' funding should sit outside the new system for the localisation of council tax support.

The issue of council tax equalisation needs to be addressed as it is one of the biggest single barriers to structural change in fire and rescue services.

The council tax resource equalisation amount should be reset to its 2013/14 level and it should be protected in the same way that the council tax freeze grant is protected.

Consideration should be given to introducing new property value bands into the system, which would avoid the need for a wholescale revaluation exercise.

The level of council tax support should be protected in cash terms for individual councils; currently, this funding is being cut annually within the Settlement Funding Assessment.

Council tax freeze grant needs to be reviewed as it currently rewards those more affluent authorities who have a higher tax base and higher council tax level, than those with the greatest needs.

Council tax capping needs to be relaxed or special provisions should be recognised for low tax base/rate authorities.

Linking the trigger point for referenda to inflation should be considered.

Students should retain their exemption from council tax.

Business rates

Authorities should be provided with clear guidance on what will happen during the reset.

The reset of business rates should incorporate a new (or updated) needs-based assessment to determine Settlement Funding Assessment's (SFA) and funding baselines.

The calculation of business rates baselines at reset should not penalise those authorities that have grown at a faster rate than others.

Any reset of the business rate retention scheme should include the introduction of an element to recognise the expected increase in population as a result of delivering a growth deal.

Pooling for business rates should be better incentivised to encourage growth through joint working.

Safety net protection should be reviewed for business rate pools.

The overall business rates income should be allowed to fluctuate with the economic cycle, thereby abolishing Retail Price Index-linked annual increases.

The pre-2008 availability of relief from empty property rates (100 per cent for industrial properties, three month grace period followed by 50 per cent for all others) should be reinstated.

Revaluations should be carried out annually with a one year antecedent valuation date.

There should be no reset and the levy should be decreased.

The business rate retention system should not be applied to the fire service as it has little influence over business rate generation.

More collaboration and information is needed from the Valuation Office - revaluations should be scheduled as soon as possible with regular updates to prevent big changes at revaluation. Given the long-term delays currently being experienced, authorities should be afforded some additional protection for the impact of late large-scale revaluations.

The potential loss of revenue due to unplanned shutdowns of nuclear power stations means that they should be treated as a special case in terms of business rates, which would protect councils from financial instability.

Councils should have a greater share of business rates and more financial freedoms with the risk and rewards this creates, thus encouraging councils to pay greater attention to helping local business.

The £120 million hold back for business rates safety net should be abolished with a different approach taken to manage the risk associated with a higher level of appeals and reduced business rate income.

Councils should have control over the setting of business rates. Flexibility on the setting of business rates on a case-by-case basis would allow authorities to incentivise pro-growth behaviour such as job creation, re-investment and the up skilling of the workforce.

The government should use the RSG mechanism to incrementally reduce the disparity of funding between urban and rural areas from 50 per cent to 40 per cent by 2020. This could be done by reducing the weighting for population density in the ECPS block and by allowing damping to unwind.

Financial management
A five year settlement period should be introduced to provide more certainty over future planning. There is a need for an increased transparency and early availability of information in any given year's settlement to enable local government to plan prudently and effectively.

Government should adopt a more strategic approach to the co-ordination of grant funding streams at the national level.

Government should issue all grants as 'Section 31' grants, ie non-ring fenced, to allow for greater local decision-making.

Fees and charges and other sources of income
Greater clarity is required as to what services can be charged for and where the line is between statutory and discretionary services. Further consideration should be given to where it may be appropriate to charge for discretionary services.

Restrictions should be removed on local authorities making a profit.

New taxes, such as tourism tax, should be explored as an additional source of income for local authorities.

Capital
Capital financing regulations should be reformed to remove the restrictions around the use of capital receipts.

A greater proportion of capital funding should be announced and released up front to help with the planning and delivery of growth.

Capital funding requirements, across areas, should be properly assessed and included in future funding requirements.

Capital funding for fire authorities should revert to a funding formula rather than the current bidding process. Bidding is not appropriate for monies that all fire authorities need to share for investment in buildings and equipment such as fire engines.

The current requirements relating to the sale of assets that require councils to demonstrate best value in terms of capital receipt should be reviewed. There may be occasions when the current rules inhibit a joined up approach to developments in circumstances where one party may not achieve best value, but the overall project may deliver enhanced benefits across the whole public sector.

The Public Works Loan Board should reinstitute the power for councils to transfer debt between each other to facilitate the pooling of debt and create greater local flexibility to manage resources.

The Minimum Revenue Provision (MRP) regulations are too onerous and often make it very difficult for local authorities to operate in a more commercial sense - MRP mechanisms need to be revised so that local authorities can promote more capital investment schemes.

There appears to be a greater reliance on short and very specific funding bids for capital grants; often involving highly bureaucratic processes. This short term fragmented practise reduces the ability for local areas to develop longer term solutions and be more aspirational.

Housing
Councils should be allowed to trade their borrowing limits between each other so that borrowing capacity is available to those areas that are willing and able to build.

To promote councils building more houses, the Housing Revenue Account should be taken out of the definition of PSBR, as is the case in many OECD countries.

The ability of local councils to enter into local authority mortgage schemes, to increase home ownership at the lower end of the market, should be extended.

Councils should receive NHB regardless of whether they have initially refused planning permission, to help to mitigate the high levels of costs they incur in relation to growth.

A ten-year funding commitment from the Homes and Communities Agency is needed to provide greater financial certainty enabling delivery of new homes, and driving value for money.

The Government should remove the borrowing cap and enable council's borrowing to be entirely linked to the affordability of such an approach within its business planning framework.

HCA capital funding should not be refused simply because affordable rents will not be charged.

The Government rules around state aid on local authority led housing projects should be reviewed.

The Treasury should clarify current rules which act as a disincentive to councils which have closed their HRA from reinvesting in housing.

Councils should have discretionary local powers to tax undeveloped sites.

Right to Buy should be ended or as a minimum there should be a reduction in HM Treasury top-slice to 15 percent.

100 per cent of Right to Buy receipts should be retained for investment in housing.

Rules which prevent councils from using HRA funds more widely should be changed to allow them to fund mixed tenure schemes and rent to buy schemes in which households can 'staircase' both into and out of full ownership.

'Housing and development grant' should be re-examined as a potential incentive mechanism for improving housing supply.

In order to prevent an increase in and enforced homelessness a discretionary housing payments specific grants scheme needs to continue at the current level.

Growth

There should be meaningful devolution of significant levels of un-ringfenced spending on areas relating to economic developments.

There should be a comprehensive and transparent analysis of how the spending review and budget decisions in the next parliament support economic rebalancing between regions.

Fiscal devolution will further enable areas to work closely with their business leaders to understand which investments are most likely to support business start-up, relocation and growth, and stimulate inward investment, private sector spending and jobs.

Devolution should not move at the pace of the slowest. A differential approach will enable the most advanced places to go further faster.

A wider range of taxes should be brought within the scope of Tax Increment Financing (TIF) to improve potential for greater future funding certainty and to make TIF more attractive as a means of funding long term projects.

To enable county economies to flourish further, they need to be given the same tools to boost economic growth as those granted to cities.

The Government should enable councils to take a balanced risk approach to infrastructure investment; balancing economic returns with social and regeneration benefits.

Councils should have greater control over skills funding and commissioning to ensure a better match between training and local employer needs.

There is a strong case for greater funding to be devolved to councils particularly from departments such as Business Innovation and Skills (BIS).

Ability of local authorities to invest in the local infrastructure has been constrained by the introduction of higher borrowing rates by the Public Works Loan Board (PWLB). Reducing rates to previous levels will allow the local authorities to spend more on infrastructure locally and less on interest payments to Government.

County councils have a greater influence on local growth through the provision of supporting infrastructure, and at least some CIL contributions could be received by county councils.

Affordable health and social care

Currently NHS capital receipts are centralised which makes joint local decision-making, pooling of budgets and the generation of joint savings more difficult.

The NHS tariff systems should be reviewed and reformed to incentivise prevention and align financial incentives between providers and commissioners. This could reward achievement for outcomes rather than activity.

Under the new burdens doctrine, councils are meant to be fully compensated by government for the increased cost arising from new duties. There is a need to draw attention to the funding shortfall facing adult social care as a result of new duties arising from the Care Act.

Additional financial support should be made available to authorities who are unexpectedly, adversely impacted by the Care Act.

Best outcomes in health and social care will be achieved through a single commission body holding a pooled budget.

If it were possible to combine budgets more effectively between multiple public sector organisations such as health, local government, DWP and police, it would be possible to find greater efficiencies through joint working. This cannot be done piecemeal but needs serious public service redesign which would need to be done on a national scale.

There should be increased funding allocated to those local authorities that have had historically low public health expenditure to allow them to increase their commitment to the level of at least the average per capita.

Welfare to work

Welfare to work schemes such as the Work Programme should be commissioned locally on a risk/reward basis for those with the most complex needs, and local partners should have greater influence and perhaps be co-commissioners for other cohorts.

Councils should be allowed to pay housing benefit direct to private landlords to reduce the risk of homelessness (with the appropriate regulations to prevent abuse of the system by landlords).

DWP funding for the social fund is to be withdrawn from 2015. There is a need to clarify that funding will be provided within the overall grant settlement for this activity, which aims to support those most affected and at risk.

Prevention

Greater attention should be given to outcome based budgeting in order to take account of preventative work and early interventions and promote partnership work between services.

Funding of early years currently incentivises establishment capacity over quality or location and this should be changed.

Greater flexibility in local use of funding such as additional allocations for pupil premium, with opportunities to grow/match funding earmarked for prevention, should be explored.

Enable local authorities to use dedicated schools grant to support vulnerable children and families.

Notes

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The Commission on Local Government finance was established by the Local Government Association (LGA), the national voice of local government, and the Chartered Institute for Public Finance and Accountancy (CIPFA), the professional body for public finance professionals.