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Local Government Finance and the 2019 Spending Review inquiry: Submission to the House of Commons committee on Housing, Communities and Local Government

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Introduction

Thank you for the opportunity to respond to the call for evidence on the system of local government finance in England. We are academics who previously held senior posts in local and central government and the Chartered Institute of Public Finance and Accountancy, and have extensive practitioner and research experience of council policy, performance and financial management. Collectively, we have published numerous peer-reviewed articles and books on issues of local public services over the last seven years, and also written practitioner-focused reports for the National Audit Office and articles in the local government professional press.

Our submission below addresses the four questions set by the Committee to frame its inquiry in turn. For pragmatic reasons we favour a dual approach to reform: immediate suggestions for inclusion in the 2019 Spending Review; and longer-term, more fundamental change led by Parliament via an independent inquiry, which would tie in with moving central-local relations onto a more stable and statutory footing.

- ***What lessons can be learned from past changes to local government funding in England, the current financial situation of councils, and how this has affected their ability to deliver services?***

Successive calls for a comprehensive and systematic review of local government finance have fallen on deaf ears, while outdated property valuations have been allowed to continually distort and undermine basic fairness since the introduction of the Council Tax. The opacity of the system is a symptom of the uncertain and unclear nature of central-local relations, an issue that official reports have consistently argued should be placed on a statutory footing (Layfield, 1976; Lyons, 2007). Frequent *ad hoc* and piecemeal reforms, such as the decision to allow councils to retain a share of business rates raised in their areas, illustrate the dynamic and complex nature of the situation and make it difficult for council managers (not to mention the public) to keep track of how the system is supposed to operate.

At the same time, there are substantial economic disparities across England (Brien, 2019); councils in more deprived and urban areas are much more reliant on central funding than their wealthier counterparts and cuts to the Revenue Support Grant since 2010 have had a significant impact on local government – particularly in these poorer parts of the country (Gray and Barford, 2018). The fact that Council Tax bands are still based on 1991 property prices, together with annual limits that the Secretary of State sets out for Council Tax rises, means that most authorities operate within a highly restricted fiscal context and creates a 'gearing' effect that means proposed increases result in a smaller percentage growth in overall revenue. This is particularly the case in those areas that have a low tax base because the majority of their domestic properties fall into lower tax bands. The proposed 'Stronger Towns' fund that is proposed for many of these areas represents only a tiny fraction of the EU Structural Funding it is supposed to replace – and it is not clear whether local government will even have a role in administering it.

In recent years, the legal requirement to deliver balanced revenue budgets together with a prolonged period of austerity has led to councils focusing overwhelmingly on costs rather than service delivery; an approach that we have previously termed 'financial *con*formance' instead of operational *per*formance (Ferry and Eckersley, 2015; Ferry et al., 2017).

As the National Audit Office (2014; 2018) has highlighted, there is a significant and growing risk of service failure, because councils will find it easier to demonstrate compliance with their legal duty to balance revenue budgets than show that they are delivering statutory services effectively. This is particularly the case now that central monitoring and oversight of council performance through the Audit Commission has largely been abandoned and councils have moved towards a sector-led improvement approach (Murphy and Jones, 2016) – in a period when demand for services has increased. Consequently, we have seen authorities focus their spending on those service areas that are still subject to some central oversight and scrutiny (social care and children's services), which suggests that other sectors (such as planning, trading standards, environmental services, and culture and leisure) have been relatively under-resourced (Ferry and Eckersley, 2019).

Although councils have tried to protect front-line services from cuts (Ahrens and Ferry, 2015; Elston and MacCartaigh, 2016; Steccolini et al., 2017; National Audit Office, 2018; Barbera et al., 2019), they have nonetheless had to make reductions across a range of sectors (Fitzgerald and Lupton, 2015; Webb and Bywaters, 2018) – often resulting in a disproportionate impact on women (Women's Budget Group, 2019). In addition, resource reductions in the 'back office' put authorities in a much weaker position to gather relevant data to inform decision-making and strategy in response to emerging challenges, evaluate the effectiveness of initiatives and hold decision-makers to account for their actions. Such reductions in managerial and oversight functions also mean that many councils know less about how close their services might be to collapse; as a result there is a growing risk that they could fail without warning (Ferry and Eckersley, 2019).

Despite local government's effort to cope with fiscal stress by prioritising financial conformance above operational performance, we nonetheless have seen Northamptonshire issue two Section 114 notices and four-fifths of respondents to a recent survey say that they were 'not confident in the sustainability of local government finance' (Local Government Information Unit, 2019). More recent innovations, such as CIPFA's financial resilience index (Chartered Institute of Public Finance and Accountancy, 2018), could help to give finance managers a better picture of their council's overall fiscal health. However, the Local Government Association (2018) has criticised it as simplistic, and – crucially – the index will not address the cause of their symptoms, which is a lack of resources to deliver public services.

- ***The efficiency, fitness for purpose and sustainability of the current system for funding local government (central government funding, council tax, business rates retention and other income); how it could be improved, including options for widening the available sources of funding; and what lessons can be learned from other jurisdictions.***

The current system of local government finance is extremely complex and opaque, which means that very few people understand it and weakens public accountability. However, although a shift towards greater reliance on locally-raised revenue through business rates retention and the reduction in Revenue Support Grant might help to clarify how councils are funded, there is a significant risk that it will exacerbate current disparities across England (Rogers and Evans, 2018; Murphie, 2018). Wealthier areas are much better placed to raise their own revenue through council tax and business rates than poorer ones, and these wealthier areas have also been less affected by funding cuts since 2010 (Amin-Smith et al., 2019). Therefore, any attempt to accelerate the overall shift away from central support (including the business rates retention plan) needs to be complemented with a back-up scheme that ensures such places are not left behind.

Other possible revenue streams, such as congestion charges or a tourist tax (currently being mooted by the City of Edinburgh Council and popular in many continental countries) are unlikely to generate significant income in more deprived areas, and are likely to exacerbate regional inequalities. A number of councils have sought to mitigate the impact of revenue funding cuts by borrowing to invest in commercial property and other profit-making ventures (with a view that they will generate sufficient rental and other income from these schemes in the future), but this approach entails risks, particularly given the decline in high-street shopping and economic uncertainty surrounding Brexit.

Some have suggested moving towards a local income tax (Lyons, 2007; Amin Smith et al., 2019) or land value tax (McLean, 2018), but these would not remove the risk that deprived areas could fall further behind if they are not accompanied by a redistributive mechanism of some kind. It is worth remembering that wealth disparities within England exceed those of the nine other northern EU countries (Eurostat, 2019). This strengthens the case for central government to redistribute revenue around the country through local authority grants, rather than requiring councils to be entirely or largely self-funded. At the same time, however, moving to even greater reliance on central funding risks neglecting specific local needs and undermining accountability; experience suggests that Whitehall is unlikely to be in a better position to identify and address local needs than council officers or members. Even if greater reliance on central funding included giving councils substantial autonomy in spending decisions, widespread distrust of central government at the local level would lead to councils suspecting that central government could revoke this freedom and reintroduce significant ring-fencing to ensure that authorities focus on central priorities.

As a result, any redistributive mechanisms need to be both robust and transparent, to ensure that the public can understand who is responsible for funding public services and spending money at the local level. One principle that ministers could consider is adopting the German constitutional requirement for financial equalisation across the country, which ensures that poorer councils are not disadvantaged in terms of public revenues. This also underpins a system of shared sales, business and income taxes, and facilitates policy co-ordination across tiers that helps government to achieve its objectives (Eckersley, 2018, 59). Alternatively, something akin to the assigned revenues system to provide a framework for distributing central grants to English councils could be revived to ensure that local government is guaranteed a certain share of overall public spending.

- ***How funding needs of local government are assessed. The current and forecast funding needs of local government and how these needs can be better understood at both a national and local level.***

It is increasingly unclear how (or indeed whether) the government assesses local government's funding needs when deciding on grant allocations. Prior to 2013, the system was based on over 120 different indicators, but its replacement is much more simplistic and based more on population numbers rather than deprivation or a thorough assessment of socioeconomic need (Sandford, 2019a). The weightings of individual indicators within the system have changed relatively frequently, and although this appears to represent marginal change, in aggregate the redistributive effect at the individual local authority level was significant.

There is a prevailing belief within many in local government that ministers have reduced the funding source that was easiest to cut (the Revenue Support Grant), rather than take such decisions based on any judgement about local needs, as was the case prior to 2013 (Sandford, 2019b). As councils become more reliant on locally-raised revenue, this view is likely to become more widespread – particularly amongst authorities in deprived areas. In order to address these concerns, the Government needs to make the process of determining need and allocating funding, as well as the information upon which these decisions are taken, much more transparent.

An additional factor here is that increased reliance on business rates would increase the unpredictability and volatility of council revenue streams; if a large local company encounters financial difficulties, this is likely to have a disproportionate impact on the area's economy through its supply chains, which the local authority may not be able to mitigate easily – particularly if they still need to deliver balanced revenue budgets. Furthermore, many of the systems that helped to collect information about local needs, performance systems, processes, evaluations and value for money have been dismantled since 2010. This means that we know less about how councils are performing and what they might require to improve, which has a negative effect on policymaking and accountability (Ferry, Eckersley and Zakaria, 2015; Ahrens and Ferry, 2017; Ferry and Murphy, 2018; Murphy et al, 2019). To understand these issues better, it is important that performance management and audit and inspection arrangements have a way to take account of not only the financial situation, but value for money in terms of economy, efficiency and effectiveness, and also equity (Ferry and Eckersley, 2019).

Alongside issues such as the demographics and geography of the local area, a new system of central grants should take these factors into account when assessing need and allocating funding accordingly. This also needs to be informed by international comparisons such as those demonstrated by the IFS (Amin-Smith et al., 2019), albeit at considerably more breadth and detail than the IFS examined.

The methodology for calculating revenue requirements should also be kept under regular review by an independent commission, answerable to Parliament. At the moment, neither the process for allocating funding nor the information upon which these decisions are based are easy to access and understand. Such a lack of transparency harms public accountability and makes it difficult for decision-makers to target resources effectively.

- ***The approach the Government should take to local government funding as part of the 2019 Spending Review, what the key features of that settlement should be, and what the potential merits are of new or alternative approaches to the provision of funding within the review*.**

The Government needs to acknowledge that local government plays a key role in delivering its policy objectives, and that these objectives extend beyond controlling or reducing public expenditure. Some changes in recent years, particularly the shift towards multi-year spending frameworks, have helped councils to plan better in an era of fiscal restraint (Ferry and Eckersley, 2011; 2012; 2015; 2019), and we would recommend continuing with them. Overall, however, we would stress that the system has needed a wholesale reform for many years. Furthermore, because these changes should be underpinned by a proper consideration of how central and local government should cooperate in order to address shared challenges whilst allowing for local flexibility, we would not expect the Government to introduce major reforms ahead of the Spending Review later this year.

In the interim, however – and particularly if the Government might wish to keep Council Tax in future – it should adopt some of the recommendations of the Lyons Review (2007), such as introducing additional bands to reflect the broader range of property values across the country. Aside from this, it needs to ameliorate the near decade-long squeeze on council budgets caused by funding cuts. Together with the distractions of Brexit, austerity is having a significant deleterious impact on local public services and the capacity of the state at all levels to achieve its objectives. Local government has shouldered a greater proportionate burden than nearly every other part of the public sector, and in many areas of the country it is now at breaking point. Some of its responses to fiscal constraint are not well understood and carry significant risks – such as borrowing to invest in property and other assets, and an increase in corporatisation (the setting up of local authority companies) to deliver services (Andrews et al., 2019; Ferry and Eckersley, 2019; Ferry et al., 2018).

Alongside these short-term changes, the Government should also announce a comprehensive, independent review of the local government finance system. As stated above, in previous inquiries (Layfield, 1976; Lyons, 2007) and on an earlier occasion when one of us gave evidence to this select committee (Ferry, 2017a, 2017b), this needs to be underpinned by a proper examination and recommendations on the role of English local government within the UK public sector. This inquiry should investigate spreading the financial risks that local government faces by increasing the sources of funding upon which councils can draw. This could include allowing them to levy or share revenue from taxes on income, land and sales, for example, and whether such taxes should either complement or replace Council Tax. The new system should incorporate a blend of both central and local funding, to ensure that some parts of the country are not left behind whilst retaining the important link between local revenue and local services. If the Government ultimately decides to retain Council Tax, it should propose legislation to ensure that properties are revalued at regular intervals to update the tax base, and also consider raising or abolishing the level at which an increase requires an authority to hold a referendum to endorse its decision.

These issues could be beyond the scope and timing of the current Committee inquiry, which may not be able to consider the range of other options available in sufficient depth to recommend a course of action for the Government. Nonetheless, key figures in Parliament and local authorities have reiterated the need for fundamental reform over the course of several decades, and we would echo their call. Issues related to the purpose and funding of English local government could be considered as part of a larger inquiry focusing on the wider post-Brexit landscape of devolved and subnational government right across the UK (Ferry, 2017a, 2017b; Ferry and Eckersley, 2018).

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