1. Introduction and key points

Within the larger, longer-term and ongoing debate in England about what local government is for and how it can be funded, a central issue is fiscal decentralisation: the decentralised powers and instruments that local authorities have for local revenue generation. Within the current highly centralised governance and funding system in England, reforms since 2010 have introduced incremental changes providing some limited kinds of fiscal decentralisation including business rate retention and various precepts and supplements. On some calculations, the share of local government spending raised locally increased from 25.2% to 40.4% between 2010/11 and 2016/17\(^1\). To contribute to the inquiry’s focus upon developing a fair and effective funding system for local government in England, this evidence addresses the limitations of fiscal decentralisation in the new system.

The key points are:

i) The reduction and replacement of central transfers that offered a degree of certainty and stability with a fragmented stream of local revenue raising instruments has reinforced dependencies, introduced greater uncertainty and instability into the system and heightened the spatial disparities between large and strong and small and weak local tax base areas

ii) More imaginative thinking and innovation is needed to formulate a more strategic and longer-term financial plan for local government in England capable of reforming a highly centralised system in ‘fair’ and ‘effective’ ways simultaneously to provide greater fiscal decentralisation and retain redistribution between areas with smaller and weaker local tax bases and larger and higher economic and social needs.

2. The potentials and limits of fiscal decentralisation

Achieving appropriate balances between incentives and redistribution is a longstanding issue for local government finance in England\(^2\). Reforming a complex and highly-centralised system has proved an enduringly challenging task for

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successive UK governments. From 2010, the rationales for fiscal decentralisation articulated by UK government included reducing overall public expenditure and reliance upon transfers from national government, increasing local government’s financial responsibility, incentivising entrepreneurialism and boosting economic growth. For local government, the arguments for increased fiscal decentralisation included increasing the need to raise local revenue generation to fill the gap left by the reductions in national government transfers, encouraging greater financial ‘self-sufficiency’ and reducing reliance upon national government, and increasing local accountability over taxing and spending decisions.

As the reforms have unfolded, some of their potential and limitations are emerging. Central transfers that offered a degree of certainty and stability have been reduced and replaced with a fragmented stream of local revenue raising instruments that has reinforced dependencies, introduced greater uncertainty and instability into the system and heightened the spatial disparities between large and strong and small and weak local tax base areas. While potentials exist, including increases in the autonomy and responsibility of local government for its own funding and increased incentives to engage in activities to maximise local tax revenue generation, the focus here is on the emergent limitations:

i) Short-term and one-off fixes lacking a long-term and strategic financial plan.

ii) Growing mismatches between the finance system oriented towards economic incentives and local government provision focused upon statutory obligations for core social care services and between the broader base of local populations of people and businesses and their payment of taxes primarily for these narrowly targeted local social care services.

iii) Significantly increased dependence upon local commercial and residential property taxation and markets – given business rates and council tax will be around half of local government income by 2020 and increased levels of investment in commercial property assets and their revenue streams both within their areas and able to contribute to local business rate generation as well as beyond in other areas.

iv) New dependency and exposure to variable and uncertain local tax revenues that make longer-term financial planning difficult – e.g. business

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rates that change with local and national business cycles and are based on national valuations, subject to appeals and retain significant loopholes (e.g. student accommodation)

v) Precepts on existing taxes have been little used e.g. on council tax

vi) Political difficulty or even infeasibility of increasing existing tax levels and/or introducing new local taxes\(^8\) has meant they have rarely been introduced or sought by local political leaders or sanctioned by HM Treasury (e.g. Nottingham’s Workplace Parking Levy as part of its City Deal\(^9\))

vii) New innovations to the system whether through substantive reforms or local (devolution, city, town) deals have been limited and modest due to continued tight central HM Treasury control and concerns about local government competence, capacity, “fiscally neutral” and effective governance, “agreed” geographies, overall national tax receipts, geographical variations, displacement and potential profligacy shaped by previous negative experiences\(^10\). New ideas including localising shares of national taxes (e.g. income, national insurance, stamp duty), new forms of tax such as land value capture instruments and innovations in deals (e.g. hypothecating, recycling and transferring corporation and other business tax revenues between sites within a local authority area) remain unauthorised or under debate and review

viii) Heightened differences in local revenue raising powers between areas with large and/or strong and small and/or weak tax bases – e.g. business rate retention potentially benefits those with the demand and space to build new business floor space\(^11\) and expenditure reductions have negatively affected those areas with the highest need and demand for statutory services and/or dependence upon central grants\(^12\)

In sum, such issues have raised increased concerns about the financial sustainability and resilience of local government in England\(^13\). In addition, the funding assumptions

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of some of the new Mayoral Combined Authorities have also been exposed and led to their future funding being categorised as an area of “primary strategic risk”\textsuperscript{14}.

\textit{March 2019}