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What is limiting modern local government?

Summary

This chapter examines the constraints and inhibitions on modern local government and what this means for the place-shaping role that I advocated in my May report, *National prosperity, local choice and civic engagement*. The constraints on local government are systemic, behavioural and also, in part, based on assumptions about public attitudes to choice and difference. This chapter explores:

- the high degree of central control, both through formal targets and monitoring regimes, and through softer and less direct controls;
- the lack of flexibility that English local authorities have to raise additional revenues and use existing resources to support local priorities;
- the role of needs, expectations, national funding, efficiency and local choice in determining pressures on council tax;
- the confused accountability in the finance system which contributes to a poor understanding of how the system works and unrealistic expectations of how much services cost. It also considers the complex governance arrangements within English local government and how this affects work across authority boundaries to drive economic prosperity;
- public attitudes to local government, which are more complex than generally accepted and supportive of 'managed difference' when based on effective engagement;
- the lack of trust in local government caused by poor accountability, concern about council tax and the impact of the adversarial relationship between central and local government; and
- the incentives in the system that distributes national resources, in particular how they can help to develop a more constructive relationship between central and local government and also to support local authorities in pursuing improvements in economic prosperity and housing supply in their area.

This chapter concludes that the important issues for reform are: greater flexibility, better incentives, clearer accountability, tackling perceived unfairness and continued improvements in efficiency – both in delivering services as cost-effectively as possible and in ensuring that local government is working with local partners to deliver the right priorities.

INTRODUCTION

3.1 The presenting problems which preceded the setting up of the Inquiry were public concerns around council tax and the balance of funding between local and central government. However, it became clear early in the course of work that these issues are driven by larger systemic issues about the role and function of local government. In order to answer questions about how best to fund local government, it was important first to develop a clearer understanding of the appropriate role and function of local government, which I addressed in my May report.

3.2 Chapter 2 explored the modern role for local government based on the fundamental goal of improving the well-being of its citizens, through the exercise of collective local choice based on effective engagement. My May report proposed that this is best achieved through what I have called place-shaping. This encapsulates a wider, strategic role for local government rather than one solely focused on service provision, and it more fully recognises that it has a unique responsibility for its local community and its local area.

3.3 This chapter analyses the reasons why local government is not currently able to fulfil its place-shaping role in every area. It explores this in relation to the actions and behaviours of central and local government and the relationship between them, as well as the incentives and constraints imposed by the tax and finance system. It is based on a wide range of analysis and expert input. Some of this was commissioned for the Inquiry, but I have also drawn on other published work and evidence from the Inquiry's seminar series, submissions and other meetings and events. The content of this chapter is complemented by a more detailed analysis of the issues surrounding local government finance, in Chapters 6 to 9, and by annexes on the research commissioned for my Inquiry and a summary of the submissions that I have received.

3.4 Some of the analysis and research that underpins this assessment is common to the Local Government White Paper, *Strong and Prosperous Communities*. Consideration of the White Paper's proposals and their implications are included in later chapters.

HIGH DEGREE OF CENTRAL CONTROL

The balance between central and local control

3.5 As described in Chapter 1, the 1980s and 1990s saw increasing centralisation across a range of local public services, driven by concerns to control public sector expenditure and efforts to improve public services. In recent years this has been driven through new systems of performance management and Public Service Agreement targets, greater emphasis on delivery and a willingness by central government to take responsibility for specific issues across the country. This has clearly improved performance on a wide range of measures.¹ However, it has inhibited the ability of local government to respond to local needs and preferences and manage pressures on their budgets.

3.6 The 2001 White Paper, *Strong Local Leadership – Quality Public Services*, sought to release local government from some regulatory burdens and provide greater freedom to use powers and resources to meet local needs and aspirations. The recent evaluation of this concluded that there was a mixed picture in relation to how far this agenda had taken hold. Central government departments differed in how far they were prepared to give local authorities more flexibility, particularly in relation to the degree of ring-fencing of grants. The evaluators also recorded limited changes in the overall level of inspection of local authorities and highlighted the need for a more commercial attitude on the part of some local authorities to take advantage of trading and charging

¹ Martin, S., *Implications of Local Devolution for Efficiency and Effectiveness in Service Delivery*, Lyons Inquiry Seminar: Greater Devolution: Evidence in Support, June 2005.

powers. The conclusion was that ‘a shift in mindsets [is] still required by elements of both central and local government’.²

3.7 This sense of opportunities not taken is reflected in the submission from the National Audit Office, where they set out their estimate that the overall cost of monitoring local government was in the region of £2 billion a year. Recent work which informed the 2006 White Paper and led to the ‘Lifting the Burdens Task Force’, found that central government and its agencies collectively demand 566 performance items from local authorities, at an average cost of £1.8 million per authority.³ The most significant burdens were from Department for Education and Skills, Department of Health and Communities and Local Government but other central departments also required substantial performance evidence.⁴

3.8 The Local Government Association argues that the extent of the central control over local government is not proportionate to the local role – it estimates that local government is responsible for 25 per cent of public expenditure but has 81 per cent of central targets.⁵ This definition includes all expenditure, including welfare benefits, but none the less suggests that, given the level of central funding, local services are disproportionately controlled by central government.

Soft controls 3.9 The recent Local Government White Paper has recognised the burden of performance management and national target setting. However, I am also concerned about the extent of central government influence exerted through a range of softer and less direct controls such as guidance, central encouragements and conditions on grant. The indirectness of these soft controls, and the subtle forms they take, make them more difficult to assess than direct targets and indicators. Their impact can be profound in terms of the time and attention that are paid to them at the local level and the strength of direction that is inherent in them, as illustrated in the following quotes taken from the research commissioned for the Inquiry:⁶

There’s been quite a subtle change in the prescription from central government when legislation’s drafted. I use licensing as an example, [the legislation states] you have to have regard to statutory guidance, the statutory guidance is 200 pages long.

Some partners faced a lack of flexibility regarding how they could spend their budgets. For example, 80 per cent of youth service funding has to be spent on young people aged 14 and upwards, but in this area the police would like to develop activities for young people aged 10 onwards.

Causes of central prescription 3.10 I recognise that the drivers of central control over local government are complex and not simply the result of a narrow central control objective. Indeed, central control and prescription is often driven by well-intentioned actions by ministers in the face of strong pressure from the media and lobbying from special interest groups to take action to tackle a problem found in one or a few areas of the country. Our country appears uniquely preoccupied with the ‘postcode lottery’ in a way which can lead us to value uniformity far above the need to find the right solution for each area.

² *Evaluation of Freedom and Flexibilities on Local Government: Baseline Study*, Communities and Local Government, 2006.

³ On performance see: *Mapping the Local Government Performance Reporting Landscape*, Communities and Local Government, 2006; on the task force, see the announcement by Ruth Kelly MP, Secretary of State for Communities and Local Government, to the LGA conference on 5 July, 2006.

⁴ It should be noted that the assessment of the department for Communities and Local Government’s role includes costs for some frameworks where it acts as a performance management channel for other government departments, for instance, Local Area Agreements.

⁵ *Meeting the Challenges Ahead*, Local Government Association, 2006

⁶ Entwistle, T. et al., *Perspectives on Place-shaping and Service Delivery: A Report of Case Study Work*, Lyons Inquiry, 2007.

3.11 In this context public opinion is often used to justify central action. However, as the survey and research work commissioned for the Inquiry shows, public opinion is more sophisticated than is sometimes recognised. My research reinforces the view that people want to ensure that there is an element of national fairness and protection via minimum standards, but it also shows that the public recognise the need for flexibility to provide services in the way that best meets local needs. These issues are discussed in detail later in the chapter.

3.12 There is also evidence that champions of individual services within local government itself often encourage intervention by central government to protect their particular service areas. As my case study research found, among managers working within local government, “service respondents generally ... saw considerable benefit in the continued, and in some cases heightened, use of hierarchical policy instruments”. Local government officers were themselves in many cases arguing for new central government targets or direction because they were “inclined to see central government as a source of much needed resource and direction” some even calling for more ring-fencing to protect their funding.⁷

3.13 This contrasted with calls from those local government officers who saw their work in a more strategic and corporate way and who were frustrated by such central controls, arguing that they damage the ability of the local authority to meet local needs and priorities in pursuing the more strategic aims of place-shaping. As the research states:

At the other extreme, strategic interviewees wanted to see less command and control and rather more local autonomy. These interviewees claimed that their work was positively frustrated by excessive central involvement in local decision-making, and they called for a series of reforms which would increase the autonomy of local authorities.

3.14 Many of the service respondents who argued for greater central direction worked with vulnerable people and children, so their concerns are, perhaps, understandable and arguably fall within those service areas that can be rightly considered a mainly national responsibility. However, there is a need for local government to recognise the potential tension between the messages they give central government from within service-based parts of their organisations and the messages emerging from their strategic functions. This has implications for the way in which local authorities are led across the full range of their functions, and I discuss this more fully in Chapter 5.

3.15 Whatever the causes, it is clear to me that too much central control damages the strategic, place-shaping role of local government, which needs to be driven by the needs, preferences and priorities of the local community. As the case study research recognises “this is not just a debate about the appropriateness of different policy instruments to different areas. It is also a debate about the kind of relationship that local authorities should have with their local communities”. It is this latter relationship that is underplayed in the current funding system and framework within which local government operates.

Crowding out local choice

3.16 I argued in my May report, in line with the wide literature on fiscal federalism, that central government cannot fully understand or respond to different local needs and wishes, and there is therefore a need for local variation and choice.⁸ Public services which are delivered according to a national sense of priority may not best fit every local community’s needs and wants. The current breadth and detail of central prescription, outlined above, effectively prevents authorities from

⁷ Entwistle, T. et al., *Perspectives on Place-shaping and Service Delivery: A Report of Case Study Work*, Lyons Inquiry, 2007.

⁸ See for example, Oates, E., ‘An Essay on Fiscal Federalism’ *Journal of Economic Literature*, vol. 37, no. 3 (Sept. 1999).

shaping services and taking action on local, rather than national priorities. This runs major risks of restricting local choice and wasting resources on delivering services that are not a local priority, impacting both on citizens' sense of satisfaction and on the ability of local government to manage pressures effectively.

3.17 The case study research and submissions to the Inquiry gave many instances of where national priorities were in conflict with local priorities and could result in perverse outcomes at the local level. The impact of these processes on local priorities is illustrated by this quote:

With the Crime and Disorder Act, the original intention was to let local communities decide which were the important things for their areas, which to tackle. We were required to do an audit for that, to determine what the strategy and the action plan would be. We very quickly found that central government said well, yes, you do all that, but in addition you will need this and this in your strategy too ... In the last strategy we did, 100 per cent of it was dictated by central government.⁹

Crowding out place shaping

3.18 As well as affecting individual services, such centralisation has the potential to oversimplify the role of local government, reducing organisations that are managing complex, interlinked processes to delivering a series of activities in silos. As evidenced in submissions, this risks crowding out local authorities' ability to progress their wider place-shaping role: responding to local priorities to enhance well-being, strengthening the sense of cohesion within and between their communities, developing the local environment and driving local prosperity.

3.19 There is a specific concern that the combination of limitations on revenues and the focus on specific service improvements has tended to crowd out councils' role in economic development.¹⁰ All local authorities should be concerned with the economic prosperity of their area and citizens. The desire to improve employment opportunities, address local skills problems or revitalise town and city centres almost always makes some appearance in the community strategy or other local plans and strategies. However, evidence to the Inquiry from the business community and others suggests that councils do not always adequately focus on or prioritise this role, particularly since the nationalisation of the business rate in the early 1990s, and this has become a major concern for business. There may also be a case for reforming the grant system to improve the incentives and rewards for authorities which successfully grow the local economy, which I discuss later in the report.

3.20 If authorities had more freedom to decide on their priorities and spending choices, I believe many would choose to give the local economy greater attention. A sense of frustration can be seen in the following quote:

Spending on economic development has to be assessed against other City Council priorities ... first priority tends to be given to those departments with high spending requirements, especially those obliged to meet recent Government initiatives around old people and children and young people's services. (Stoke on Trent City Council)

3.21 Strict central control also risks sub-optimal decisions – for example, grant schemes which require spending on one sort of economic intervention will skew activity in that direction, even if the most serious issue for the local economy is something else. The Eddington Study sets out potential concerns in the area of transport if resources cannot be directed towards the most appropriate modes of transport, looking across the piece.

⁹ Entwhistle, T. et al., *Perspectives on Place-shaping and Service Delivery: A Report of Case Study Work*, Lyons Inquiry 2007.

¹⁰ Lyons Inquiry Seminar, *Greater Local Devolution: evidence in support*, 22 June 2005.

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Stifling innovation 3.22 Innovation and experiment can be stifled by centralising processes. There is evidence that decentralisation promotes innovation across a wide range of activities including economic, development, service design, technology and problem solving.¹¹

3.23 The Audit Commission's forthcoming work on innovation in local public services concludes that there were five drivers for change in local authorities: the pressure to make efficiency savings, examples of innovation elsewhere, internal pressure from locally-elected councillors, the demands and expectations of local communities, and top-down pressure from central government. While a focus on efficiency was cited as the strongest driver of innovation, their work also concluded that top-down pressure from central government is a less effective driver than local political pressure or the demands of users and citizens.¹²

3.24 There is a risk that an emphasis on common national standards and central government responsibility means that we, as a society, are missing out on the benefits of local innovation. I believe that the reaction of some local authorities further limits innovation as their perception of the best strategy for success is to 'play it safe':

Authorities complain that there are too few incentives for them to experiment with new approaches. The system appears to be weighted to 'playing it safe' (i.e. doing what the inspectors are looking for). As a result the current approach had had the greatest impact in the worst performers. There has been much less impact, it is argued, on the best authorities. It has 'raised the floor', but had far less impact on the 'height of the ceiling.'¹³

LACK OF FLEXIBILITY

Existing resources

Limited flexibility to manage pressures 3.25 Any grant regime which imposes strict conditions on funding means there is limited scope for local authorities to reduce or 'flex' their activities across all their services in order to manage pressures in the most efficient way possible.

3.26 This is a significant issue for local authorities as large proportions of their funds come from specific grants, which are often tied to government requirements and expectations either formally, through ring-fencing, or informally through expectations over what resources will be used for and the monitoring of expenditure. I am aware that even in highly devolved countries specific grants play an important role in enabling the delivery of national priorities.¹⁴ However, there is an issue about their pervasiveness in England when set against other national controls over services.

¹¹ See Turok, I., *Local and National Competitiveness: Is Decentralisation Good for the Economy?* Lyons Inquiry Seminar: Greater Devolution: Evidence in Support, June 2005; Oates, W.E., 'An Essay on Fiscal Federalism', *Journal of Economic Literature*, vol. 37, no. 3 (Sept. 1999), 1120–1149; Walsh, K., 'Public Services, Efficiency and Local Democracy' in King, D. and Stoker, G., *Rethinking Local Democracy*, 1996; and North, D., *Institutions, Institutional Change and Economic Performance*, 1990.

¹² Taken from a forthcoming Audit Commission report with permission, <http://www.audit-commission.gov>.

¹³ Martin, S., *Implications of Local Devolution for Efficiency and Effectiveness in Service Delivery* Lyons Inquiry Seminar: Greater Devolution: Evidence in Support, June 2005

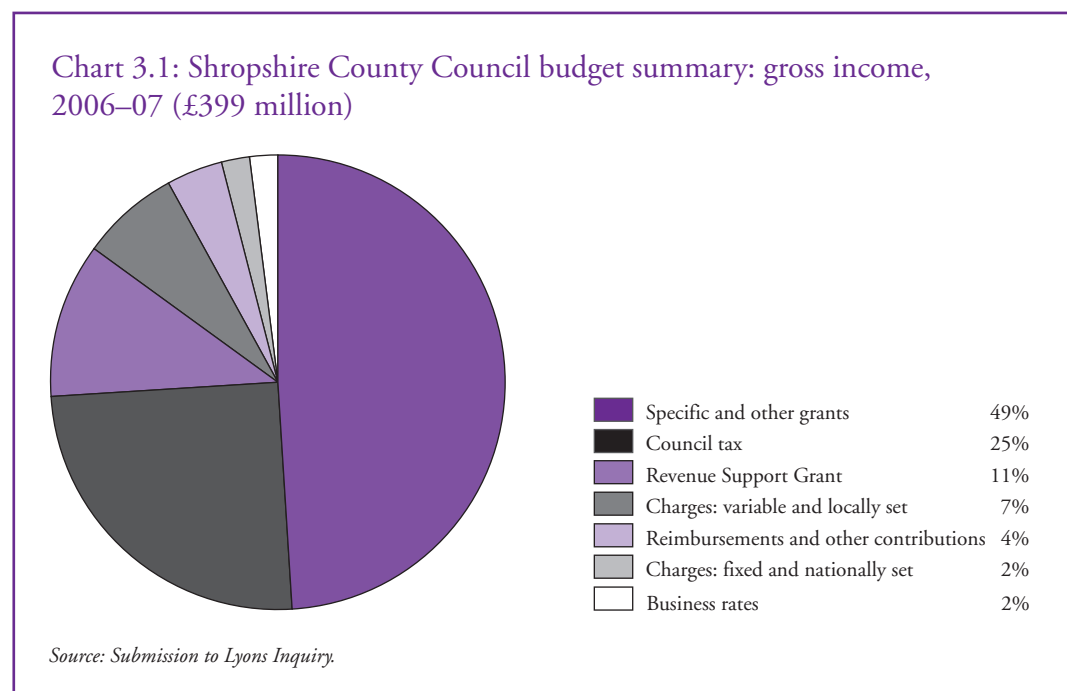
¹⁴ Loughlin, J. and Martin, S., *Options for Reforming Local Government Funding to Increase Local Streams of Funding: International Comparisons*, Lyons Inquiry 2005.

3.27 Central government has recognised this concern and, in stating in the 2001 Local Government White Paper that ring-fencing would be restricted, it argued that:¹⁵

ring-fencing remains an important means of bringing about change ... However, the growth in ring-fencing is excessive – from 5 per cent of all grants in 1997 to 12 per cent this year and on present trends to 15 per cent in 2003–04. This growth threatens to erode local decision making, limit authorities’ ability to tackle important local environmental priorities ... and to increase council tax levels.

3.28 It was announced in 2002 that progress had been made on reducing ring-fenced grants.¹⁶ However, the proportion of funding that comes from specific grants, in general, has increased: since 1998–99 from 6 per cent of central funding for local government to 23 per cent in 2003/04.¹⁷ While figures remain to be finalised, specific grants are likely to be well above half by 2007–08 with the introduction of the ring-fenced grant for schools – Dedicated Schools Grant – in 2006–07. Many of these grants leave local authorities with little discretion over how they should be spent. For instance, the advice accompanying the Waste Performance and Efficiency Grant specifies the aim of the grant, what it should be used to support and provides a detailed list of options that local authorities should consider.¹⁸ Inspections also reinforce local authorities’ impression that even non ring-fenced grants are in essence to be spent on achieving national priorities. An example of this latter point can be found in a social care inspection report where it was reported that expenditure on non ring-fenced grants was in line with national priorities and had been ‘appropriately’ used.¹⁹

3.29 This can have a profound impact on local authorities’ decision-making. For example, one of our case study councils, as shown in Chart 3.1 below, reported that specific grants – including schools grant – now represent approximately half of their total budget and are governed by around 80 different sets of rules and reporting requirements.



¹⁵ *Strong Local Leadership – Quality Public Services*, DTLR, December 2001.

¹⁶ House of Commons Debate (2002–03) 2 December 2002, col. 1068.

¹⁷ Local Government Finance Statistics, England, various years, Communities and Local Government.

¹⁸ *Waste Performance and Efficiency Grant: Advisory Note to Local Authorities*, DEFRA, December 2005.

¹⁹ *Inspection of Social Care: Warrington Borough Council*, CSCI, May 2006.

3.30 An area of particular concern to me, and one on which I have received representations, is the specific impact of recent decisions on schools funding which, as mentioned above, is now funded through a very large ring-fenced grant – the Dedicated Schools Grant. The decision to have such strict control around school funding is a reflection of the importance of education to the Government. However, it has radically changed how local government receives its resources, decreasing the amount of unhyphenated grants they receive from £44.7 billion to £21 billion and in the process greatly reducing the scope of local authorities to prioritise and manage pressures between services. The submission from the representative group for metropolitan authorities, among others, highlighted this issue:

Greater devolution has been compromised with the increase in passporting of funding to local services, reducing the freedom of local councils to decide where their spending priorities should lie. Developments like the Dedicated Schools Grant have made this situation more difficult, giving local councils less room to manoeuvre and invest in local priorities. (Special Interest Group of Metropolitan Authorities)

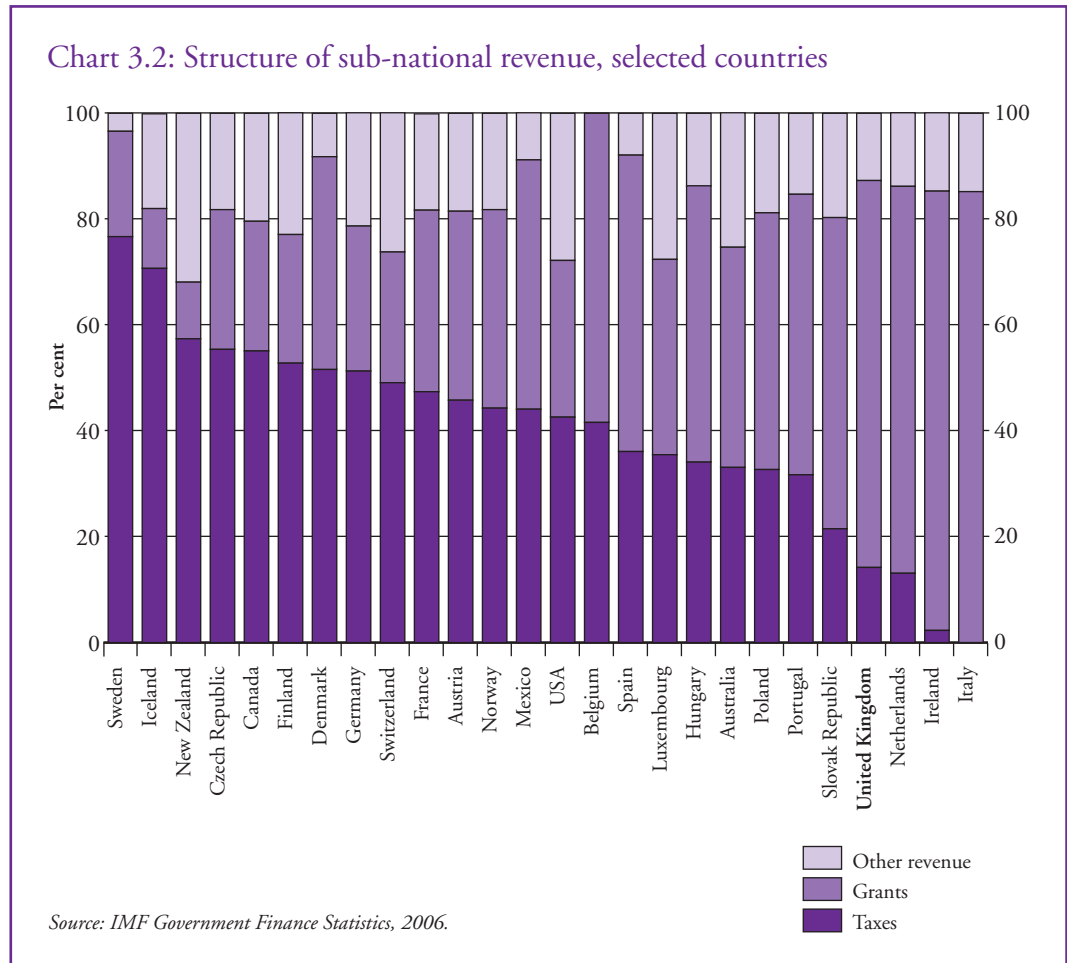
3.31 In a similar vein, representations from police authorities have argued that the National Policing Plan and the Crime Fighting Fund, in effect, determine the make-up of police authorities' workforces. They established the numbers of police officers that each force must employ and, if these levels are not met, the result is a loss of central revenues. This narrow focus on police officers created a perverse pressure to undo the previously cost-effective process of employing civilian staff for administrative and routine tasks, leaving skilled police officers to focus on the safety of their communities. The impact of these processes can be seen in the following submission:

The Government's obsession with police officer numbers severely restricts the flexibility of local police authorities and chief officers, who would like to be able to consider other configurations for delivering services. (Association of Police Authorities)

3.32 The impact of this lack of flexibility has recently been recognised by Government with the Home Office agreeing, in December 2006, to suspend the criteria and allow police forces to determine police officer numbers, which is a very welcome move.

Limited flexibility to raise additional resources

Dependence on central funding 3.33 In other western countries such as the USA, France and Germany, local authorities have significantly greater access to locally raised funds. This is demonstrated in Chart 3.2 which sets out the respective roles of local taxation, central grants and other sources of revenue in funding local services. It shows a wide variation in how local services in different countries are supported and that the United Kingdom is firmly at the grant-dependent end of the spectrum.



Sources of revenue 3.34 Local government does, of course, have access to a number of other sources of revenue. The main one is council tax, which is discussed in detail below, and the others include:

- charging for services as defined by specific statutes or within the general power to charge for discretionary services given through the Local Government Act 2003;
- trading, where powers were extended through the Local Government Act 2003 to enable local authorities to trade at a profit with non-public bodies and non-local authorities;
- ‘Section 106’ contributions from residential and commercial developments whereby developers are expected to make a contribution to a local government’s infrastructure costs;
- Business Improvement Districts, which are schemes to raise additional revenue from businesses, where they agree, for limited purposes and on a limited timescale;
- for authorities with housing stock, that is council housing, the Housing Revenue Account which is separate from the general funding of local government (and cannot be cross-subsidised from other services, or indeed used to subsidise other services) is partly or completely supported by rents from their stock; and
- Corporation of London has a special power to raise an additional business rate which is used, for example, to provide security for the area.

3.35 Authorities, to varying degrees, already make significant use of all of these sources of revenue; for example, charging already accounts for more revenue than council tax in a third of local authorities. However, the picture varies widely between services and authorities.

3.36 Controls over the uses to which the revenues may be put differ between the sources. There are direct controls for BIDs and Section 106 funding, and the use of some revenues from charging is restricted. Some charges are hypothecated to different service areas, or limited to recovery of costs; some are set by central government departments and are not locally variable. This range of different restrictions reflects the way that they have evolved separately over time and some submissions to the Inquiry have asked whether the current suite of financial powers are logical and sufficiently flexible at present.

Councils should be freer to determine the balance between providing services as a community benefit and charging users ... Moreover councils at the moment have the greatest ability to charge for the most life-supporting services, for the most vulnerable people (social care users), and the least for nice-to-have services (e.g. libraries). (Surrey County Council)

3.37 Therefore, while these flexibilities deliver significant income in many areas, a point which is discussed further in Chapter 7, they have limitations as sources of general revenue.

Council tax – a single variable tax

3.38 Council tax is the only locally variable tax that local government in this country can use. England is unusual in its reliance on a single variable local tax – few other countries are in a similar position.²⁰ This is important, as the burden of taxation can be spread between different groups of taxpayers in countries that have more than one form of local taxation.

3.39 Council tax, in addition, is not an inherently buoyant tax. This compares with taxes such as income tax, its yield increasing as jobs are created or wages rise, and VAT, which increases as consumer sales increase. There is, therefore, a contrast between the use of buoyant taxes to support national government and a non-buoyant source of taxation to support local government. This is a key factor in explaining some of the tensions over council tax, where the rate has to be increased year on year simply to keep pace with inflation, and being a very visible tax, coming as it does in the form of an annual bill and receiving widespread media coverage. In contrast, income tax and VAT are buoyant and grow as the overall wealth of the country grows. As already noted, unless there are major pressures on public expenditure or large scale down-turns in growth, central government need not consider increasing tax rates.

Gearing 3.40 Commentators, particularly during the Balance of Funding Review, raised the issue of gearing as contributing to high percentage increases in council tax.

²⁰ Sweden and Ireland also rely on single forms of local taxation. Ireland is similar to England in that it has local property tax and is heavily reliant on central funding. Sweden, however, is quite different. Local government is funded out of a single local income tax but this pays for the majority of their services with central resources in the minority.

Gearing

Gearing is the term used to express the fact that a given percentage increase in local authority spending will require a larger percentage increase in council tax. At the time of the Balance of Funding Review, local authorities' dependence on Government grant meant that for every one per cent increase in spending, they needed on average to increase council tax by four per cent, a gearing ratio of 4:1.²¹

There was, however, a wide variation in gearing across individual authorities which varied from around 2:1 in authorities with the largest council tax base to 9:1 or more in authorities with the smallest tax bases.

Because of the gearing effect, comparatively small spending pressures can lead to some big increases in council tax for individual taxpayers.

Source: Balance of Funding Review – Report, ODPM, 2002.

3.41 This gearing effect was an explicit design feature of the present system introduced at the time of the community charge, intended to sharpen local accountability and act as an incentive on both local authorities and voters to keep spending down. There is no comparable mechanism incorporated into any national tax, but the 1986 Green Paper, *Paying for Local Government*, argued:

If local electors have to bear the full cost of marginal increases in their local authority's expenditure, they will have a stronger incentive to take a much keener interest in the levels of such expenditure and may be less inclined to tolerate large increases.

3.42 During recent years the concern has been more about the impact on the overall level of council tax increases and how this constrains local authorities' ability to raise additional tax revenue. Those concerns led, for instance, to the Local Government Association recommending a 'combination option' for local government funding which would shift the balance of funding towards greater local funding and help mitigate the impact of gearing as well as allowing local authorities "the flexibility to address local priorities and enhance local democracy and accountability".²²

3.43 The merits of sharpened local accountability inherent in gearing can be debated. However, in a world where central government is in part driving marginal increases in local expenditure, gearing can create a disproportionate burden on local taxation for which local authorities are held to account. We need to find ways to ensure that citizens understand better what and who are driving tax changes rather than just whoever is sending out the bill.

Capping 3.44 Local authorities are also constrained in setting council tax in years where central government 'caps' the rate of increase, further limiting local authorities' ability to raise additional revenues to meet new spending pressures or fund local priorities. Capping has its origins in the 1980s and has been updated by the present Government with the aim of making it a more sophisticated tool in controlling what central government perceives to be excessive increases.

²¹ The Dedicated Schools Grant has changed the balance of funding between central and local government and the gearing ratio since the Balance of Funding Report. This is discussed in detail in Chapter 6.

²² LGA, *The Balance of Funding: Implementing the Combination Option*, 2004.

History of capping

Government powers to limit local government spending, known as ‘rate capping’, were originally introduced in the Rates Act 1984 and remained in place throughout the 1980s with parallel powers contained in the 1988 and 1992 Local Government Finance Acts. Between 1991 and 1997, the Conservative Government used a system known as ‘universal capping’ under which it published provisional capping criteria before councils set their budgets, thereby enabling councils to be sure that the budgets they set would not be capped. Thirty-five English councils were subject to capping between 1991–92 and 1998–99.

In its 1997 election manifesto Labour promised the removal of ‘crude and universal’ council tax capping, while retaining ‘powers to control excessive spending’. The Local Government Act 1999 introduced new legislation requiring the Secretary of State to determine a set of principles to decide whether an authority’s budget requirement is excessive. The new rules allow the Secretary of State to take decisions in the light of budgets which have already been set and provide a choice of actions: capping in year or the following year, or setting a notional budget against which future increases will be measured for capping purposes. There was an indication, confirmed in Parliament in 2003, that Government did not intend to cap councils that received an excellent or good rating under the Comprehensive Performance Assessment. Despite the new legislation, no councils were subject to capping between 1999 and 2003.

However, in 2003–04 council tax increases averaged 12.9 per cent leading to considerable public concern, especially from pensioners, and to pressure from the Government on authorities to reduce their council tax increases in the following year. The Audit Commission report on the 2003–04 council tax increases suggested that spending by councils went up by more than had been allowed for in the grant settlement and the effect of gearing magnified these increases. The Audit Commission found that the causes of increased spending by councils included cost pressures such as pay and price increases, additional demand pressures including the need to provide social services to increasing numbers of elderly people, national priorities such as schools, waste recycling and local priorities, and that the changes in the level of grants to local authorities had also caused some local authorities to raise their council tax. This work concluded that these rises were justifiable but not in all cases unavoidable, and that local authorities had felt under less pressure to keep down spending increases than in previous years.

Following the large increases in 2003–04, the Government made it clear that it considered the trend in council tax rises to be unsustainable and that it was prepared to use its new capping powers, even for those councils previously categorised as excellent or good under the Comprehensive Performance Assessment. In 2004–05 the Secretary of State used the new capping powers for the first time when six councils were capped in year and notional budgets were set for eight nominated authorities. The six authorities capped in year were each required to re-bill householders – bill reductions to council tax payers in band D properties ranged from £15.51 per year in Shepway District Council to £2.48 in Nottingham City Council.

In the two years that have followed, a total of eight local authorities have been capped in year and three have been set notional budgets.

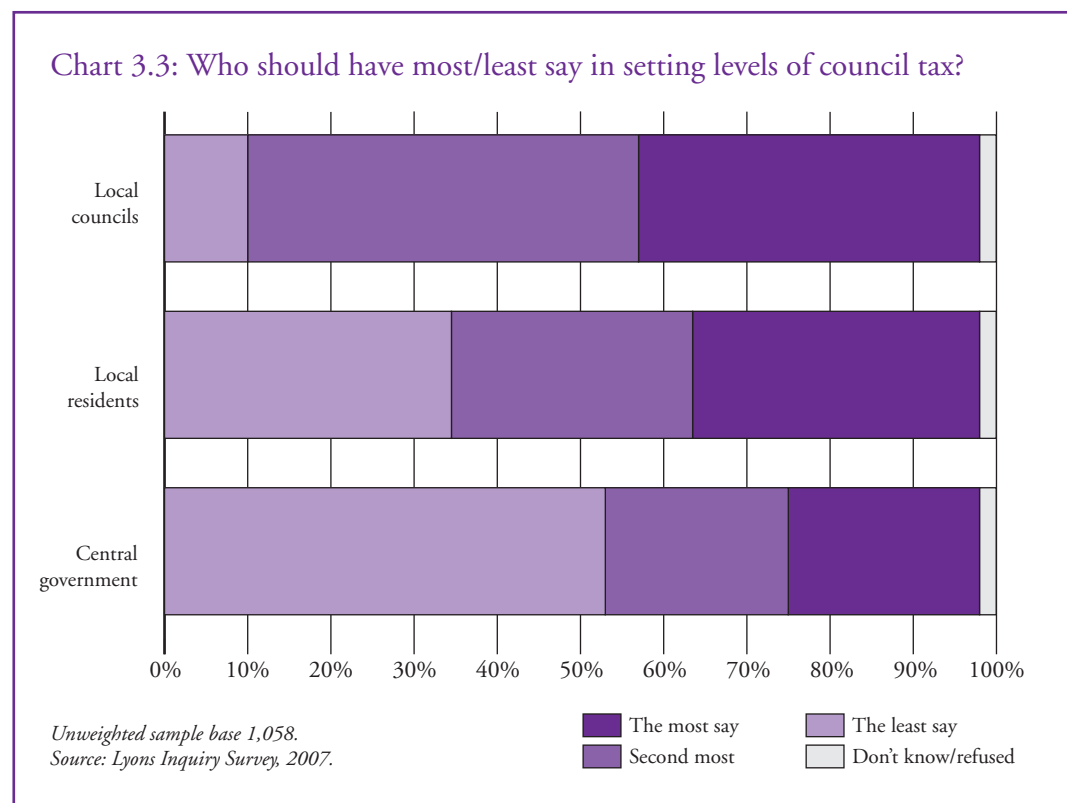
3.45 As this history suggests, capping is the result of successive central government attempts to control increases in an unpopular tax. Central government is responding to popular pressure, often expressed through the media, to protect taxpayers from the impact of high council tax rises. Recent experience, particularly increases in 2003–04, have reinforced their concern about the consequences of removing this pressure and allowing council tax to operate without capping.

However, capping is not without cost. Leaving aside the invidious impact it has on accountability, which is discussed later, I am convinced capping is the wrong response to concerns about council tax increases for the following reasons.

3.46 Capping a local authority carries strong connotations of inefficiency on the part of that authority. Such a simplistic message is counter-productive to creating an understanding of the pressures on budgets which would enable the causes of the pressures, rather than their effect, to be tackled. The Audit Commission work, referred to in the box above, found that the increases in 2003–04 council tax were caused by a variety of factors. Capping cuts across this complexity and, in particular, I consider it counter-productive to constrain local taxes without reference to the adequacy of national funding and the wider system affecting the pressures themselves. It does not support the need for the public to be engaged in, and understand, the complex and difficult trade-offs outlined above.

3.47 Capping also restricts the ability of local authorities to deliver on local needs and preferences. The protection afforded to national priorities through the associated targets and inspection regimes means that they are more protected from cuts than local priorities when an authority is threatened with capping. For example, there is evidence that people value local policing highly and where there are local concerns about community safety and cohesion they may choose to ‘buy’ more police via a local tax – under capping, such choices are restricted.

3.48 Although council tax remains unpopular, and objections to high council tax rises are widely voiced, local government responsibility for determining the level of council tax is one that is supported by the public. The survey work for the Inquiry found that two-fifths of respondents considered that local councils should have the most say in setting levels of council tax, while under one-quarter thought that central government should fulfil this role. More telling, perhaps, is that only one in ten of the respondents thought that local councils should have the least say, but over half thought that central government should have the least say.



3.49 Furthermore, even though there is a more sophisticated capping procedure in operation it is still a relatively blunt tool applied to a small set of diverse local circumstances. This has had perverse consequences in individual cases. For example:

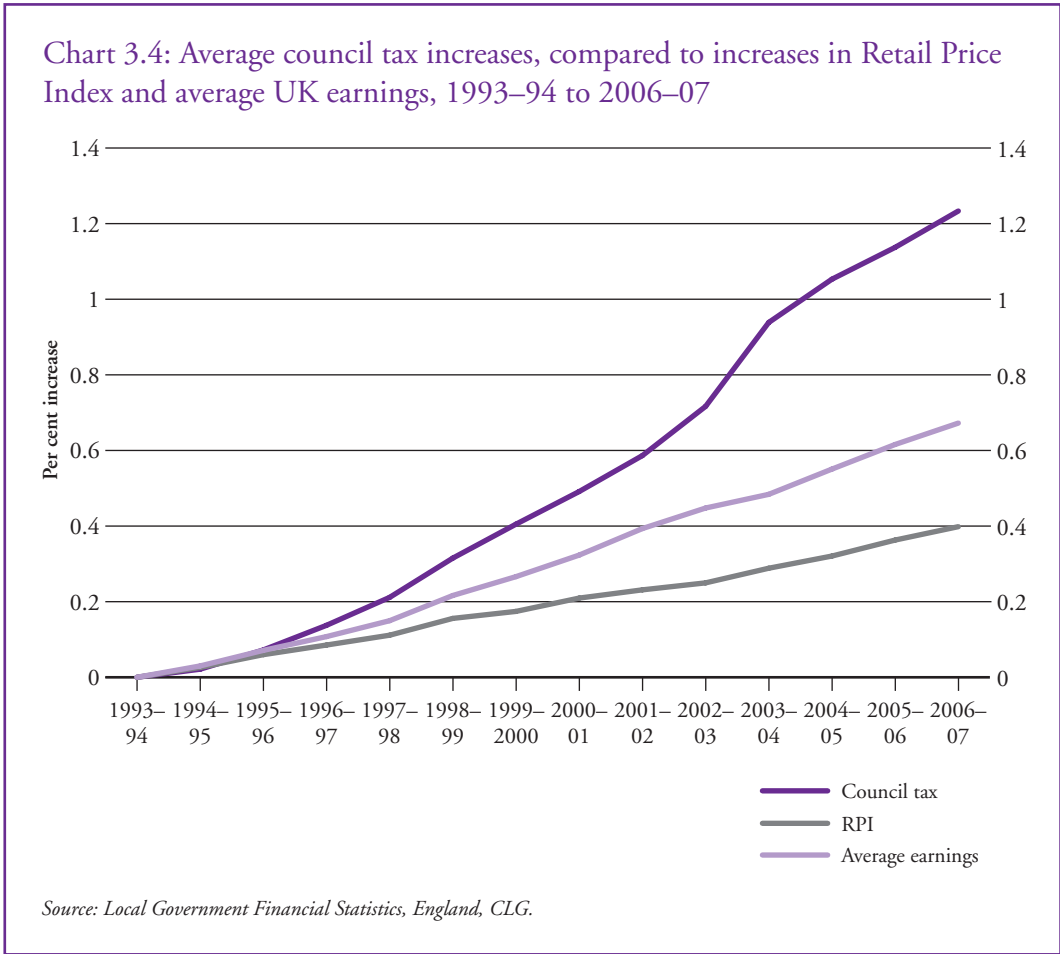
- **Nottingham City Council** was subject to capping in 2004–05. The implications of that year's threshold for them could not have been known before the tax was set. However, the council was capped even though the cost of issuing new council tax bills was larger than the tax savings of £2.48 per band D household.
- **Telford & Wrekin Council** were given a 'notional budget requirement' which meant the starting point for the 2005–06 budget was £31,000 lower than the actual budget for 2004/05 – to reflect the Government's judgement that their 2004–05 budget increase had been too high. This avoided re-billing and other costs estimated to be around £250,000, but is arguably a disproportionate response when the adjustment for each band D household was 64 pence on their annual bill.

3.50 Finally, capping thresholds are set for and within a given year, but have longer-term implications. For example, capping prevents authorities with historically low tax rates from increasing their tax levels towards the average, even if such changes are locally supported, necessary or have a relatively low cash impact. This can be seen in the experience of Mid-Bedfordshire District Council. This council was capped in 2005–06 despite being a historically low-tax authority with the tenth lowest district council tax at the time, having used reserves to hold bills down in the past. The cap called for a reduction in band D bills by £7.04 per household, while re-billing costs were estimated at £85,000.

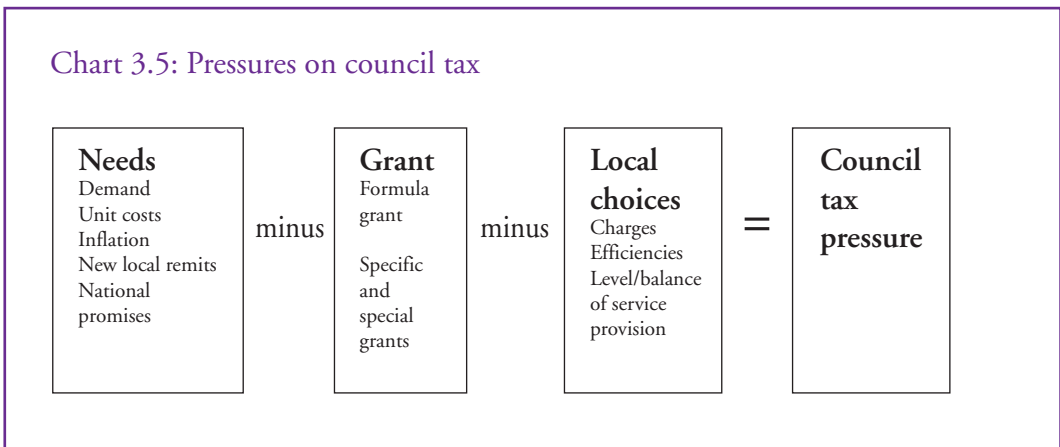
3.51 This militates against expecting local government to be prudent managers of the local tax base. It could also provide a perverse incentive for local authorities to maintain as high a level of increase as possible within a potential cap in case they require extra resources in future years that may go above the cap. I discuss capping further in Chapter 4.

EXPECTATIONS AND PRESSURES ON SERVICES

The pressure on council tax 3.52 As set out above, one of the most well-rehearsed concerns about council tax relates to the rate at which bills have been increasing, at an average of around 6.4 per cent per year since council tax was introduced in 1993. Despite significant increases in grant at times during the period, average band D bills have risen faster than either Retail Price Index inflation or earnings over the period, which can prove particularly difficult for those on low or fixed incomes. However, solving the council tax 'problem' is not just about tax: it is necessary to understand what drives council tax pressures, what measures can be used to manage them, who (whether central or local government) is best placed to do so, and whether they have the right tools to manage them effectively.



3.53 Chart 3.5 shows, in simplified terms, that council tax tends to operate as the ‘balancing item’ in local budgets, absorbing any spending requirements that are left after grant, charging, efficiency savings and any local choices about service provision have been taken into account. The impact of rising needs, costs or expectations may be allowed for through central government grant, and can to some extent be managed or responded to through a range of options open to local government, but at a certain point it tends to become concentrated on council tax. If funding and local flexibility are too restricted, council tax can become a ‘safety valve’ for pressure on local public services.



3.54 Many have argued that pressures on local budgets could continue to impact on council tax in the future, potentially driving further above-inflation increases. However, the extent to which this happens will depend on a range of factors including the level of central government's contribution to local funding and, crucially, on local government's ability to influence the level of overall spending growth by having greater flexibility to manage pressures and find efficiency savings across their budget and to deliver services in line with local priorities.

The nature of future pressures

3.55 There is much debate and analysis about the causes of cost pressures at the national level and at individual authority level, and a wide range of predictions of how significant future pressures will be. Whilst always a difficult debate, the importance of managing pressures effectively is likely to increase in the next few years, as the money available for public spending is likely to grow less quickly than over the past decade. The Government has signalled that grant growth is likely to slow over the coming Spending Review period. Through the Comprehensive Spending Review (CSR) the Government is working with local government to identify pressures across the sector until 2010–11.

3.56 The Local Government Association last year identified waste and adult social care as the two areas of greatest pressure in the coming Spending Review period (up to 2010–11).²³ Analysis by other commentators reinforces the argument that these pressures could be significant, both during the CSR period and into the medium term:

- the Wanless Review of Social Care predicted a 53 per cent increase in the number of older people with some social care needs over the next 20 years, and a 54 per cent increase in the numbers of those with a high level of need.²⁴ For care provision to continue at current levels, this would imply average annual growth in social care budgets for older people of more than six per cent a year. This assumes that the level of voluntary effort provided by carers remains constant, and that we remain able as a society to rely on the care and compassion of friends and family to look after many older people who might otherwise require greater support from the state;²⁵
- the Commission for Social Care Inspection (CSCI) suggests that rising demand for, and expectations of, social care, combined with rising wage costs, are already having an impact on the level at which eligibility for care is set, with councils increasingly rationing care to those with the most acute needs;²⁶ and
- the Department for Environment, Food and Rural Affairs (Defra) has predicted that rising waste volumes, and EU requirements that the UK find alternatives to landfill, could contribute to average growth in waste budgets of just under 6 per cent a year (cash), with steeper increases in the short term.²⁷

3.57 There are also indications that social care provision for disabled adults and for children may be subject to many of the same pressures as provision for older people: the Commission for Social Care Inspection reports growing demand for intensive care services across these groups.

3.58 Aside from pressures within particular services, local authorities face other corporate pressures. These include legislative and policy changes such as the move to single status on pay for

²³ Local Government Association, *Meeting the Challenges Ahead*, 2006.

²⁴ Wanless, D., *Securing Good Care for Older People: Taking a long-term view*, King's Fund, 2006.

²⁵ There are no definitive estimates of the value of voluntary care although the Wanless review estimated the replacement cost of care to over-65s at £3.5 billion a year.

²⁶ Commission for Social Care Inspection, *The State of Social Care in England 2005–06*, 2006.

²⁷ Defra, *Review of Waste Strategy*, 2005.

male and female employees for local authorities that have not already addressed this issue and deficits in the pension funds for retired local government employees.

3.59 There are other sources of pressure, driven by public expectations over what services should be delivered, and to which standard. At times these are the subject of national promises and ministerial commitments which make it difficult for local authorities to modify services in light of local priorities, with little scope to balance national requirements against other needs and preferences. There is a tendency for local budgets, including those funds which are notionally un-hypothecated, to become 'spoken for' by national promises and the expectations they generate, leaving only limited scope for local communities to shape their own spending plans.

[Central direction of services] disempowers local councillors and distorts the use of local government finances because these 'national' services have to be resourced to national standards which means that when resources are reduced the locally preferred services are disadvantaged. A recent example of this effect is the decision by government to extend the scheme for concessionary bus fares. (Eastbourne Borough Council)

3.60 Other pressures include the strong demands, often led by the business sector, for improvements in infrastructure. This is often driven by population increases in growth areas, but also the need to support investment in regeneration, or to provide better transport infrastructure. Local authorities, such as Kent County Council, also argue that investment in maintenance of highways has had to be squeezed over time to pay for more essential services, resulting in a backlog of maintenance needs.

3.61 In addition, there is a wide range of pressures which can affect a small number of local authorities. I have received a range of representations from individual authorities, and groups of authorities, addressing particular circumstances which they argue require special funding, or changes in the national distribution of resources.²⁸ Such pressures are arguably most appropriately considered in terms of how grant is shared between authorities, rather than in determining the overall total.

3.62 However, these future pressures must be set against savings from services where needs or costs may be reducing over time. Such savings are likely to be captured through overall efficiency processes which can, as local government and others have demonstrated, yield improvements and cost savings year on year. The Chancellor announced in his Pre-Budget report that the Comprehensive Spending Review would include the expectations that three per cent year on year value for money savings will be achieved by central and local government.

Managing pressures in the future

3.63 I have not sought to duplicate the detailed analysis being undertaken in the Comprehensive Spending Review. Modelling likely costs across the whole range of services provided by local government is extremely challenging. Moreover, many of the pressures faced by local government are affected by central government's decisions about priorities and targets (which are decided in Spending Reviews), and the framework it sets for local government, as well as by external factors and local choices. However, in order to understand the impact of possible future changes on council tax the Inquiry has modelled some simplified scenarios for future local spending and revenues over the next 20 years, as set out in Annex B. This modelling examines the possible impact of changes in some of the key variables determining pressure on council tax, and the potential

²⁸ For instance, some commentators have argued that services may be under pressure from population growth associated with internal migration and immigration. The Audit Commission in a recent report *Crossing Borders* argued that while migrants on the whole bring net economic benefits to areas, some local areas were experiencing a degree of 'strain' on public services. A recent report for London Councils (Travers, T. et al., *Population and Mobility and Service Provision*, 2007) also highlights the challenges facing local authorities with highly mobile populations.

implications of a range of possible futures, including different trends in revenues, spending growth and value for money savings.

3.64 The results of that modelling, based as they are on possible scenarios, change to a great degree depending on the assumptions that are made about overall growth in service budgets. Even allowing for known pressures on waste and social care, council tax rises at inflation, or even real terms reductions, could be delivered if overall spending was kept down. This might involve a number of measures – reduced demands from central government, efficiency savings or local choices to reduce the quality or scale of some services at the local level.

3.65 Looking more broadly, long-term trends such as demographic change and the need to manage impacts on the environment create pressures for public services in general and local government in particular. Unless managed effectively by central and local government, these could result in pressures on council tax. However, this is not inevitable, and even then the measures outlined above, perhaps alongside additional national spending, could help to manage them. In local government as elsewhere there has naturally been debate about the role of and scope for efficiency savings, and how they can be achieved in the context of long-term contracting arrangements. More independent analysis could help to build on the work done by central and local government and provide a more secure basis for consensus.

3.66 All of this serves to emphasise the value of allowing local government greater flexibility and local choice – to find ways to improve efficiency and value for money as well as to provide greater local public satisfaction by focusing more closely on local priorities.

3.67 Central and local government share the desire to manage pressures on the finance system to avoid unsustainable increases in council tax and to maximise value for money. They therefore have a shared interest in making it possible for local government to make choices which find the best set of outcomes for local citizens. This means allowing greater space and powers to change behaviour to reduce costs and improve effectiveness, and to make local choices which, where necessary, place less emphasis on those services and outcomes which are not a high priority locally. It also means giving local authorities the power and credibility they need to engage with their communities in setting priorities and taking responsibility for making realistic (and difficult) choices which take account of resources available and the full range of pressures on them.

CONFUSED ACCOUNTABILITY

3.68 Clear lines of accountability are a precondition for an effective relationship between central and local government, and are essential to allow people and communities to engage with, understand and challenge the decisions which affect their lives. Without such clarity local communities cannot know who to hold responsible for taxation and spending decisions, which can then become a major area of friction and public disquiet when spending is tight and pressures on services are high. As research for my Inquiry with the public concluded: “There was a strong and pervasive feeling that those charged with spending public money should be held to account”.²⁹

3.69 All levels of government need to be accountable for their actions. This drives the requirement for local government to act in the interest of all its citizens. Accountability is determined by the way in which communities can understand and challenge the decisions that local authorities have made on their behalf. This is most easily understood through elections, but also encompasses the more general processes through which local authorities receive ‘customer’ feedback such as ongoing engagement, complaints and lobbying by special interest groups. The

²⁹ Palmer, A. and Thompson, M., *Qualitative Survey into Public Attitudes to Taxation and Public Services*, Lyons Inquiry, 2005.

current system of local government – both in terms of function and finance – obscures proper accountability due to:

- a lack of public understanding of how the system works, which enables both local and central government to blame the other for problems;
- complexity in both function and funding; and
- a poorly understood link between local businesses and local services.

Lack of understanding of local government finance system

3.70 Research for the Inquiry, which I reported on in depth in my December 2005 Interim Report, showed high levels of confusion and misunderstanding of the current finance system. This led me to conclude at that time that there is “both a weak knowledge of the actual finance regime, and a poor understanding of the cost of public services”.³⁰

3.71 There was confusion over what council tax paid for – the general view being that it paid for a very large range of services and that most funding for local services came from council tax, yet still only a minority thought it represented value for money. This demonstrates a fundamental misunderstanding of the costs of services which, I believe, can only lead the public to be dissatisfied with both local and central government. There was also only limited awareness that local authorities received grants from central government to support services and, while there was a high awareness of council tax, people did not know which council tax band their property was in.

3.72 This poor understanding both facilitates and is compounded by local and central government blaming each other for increases in costs which lead to tax increases or difficult spending decisions. This obscures any balanced analysis of drivers for tax increases and also contributes to a confrontational approach to issues that are rightly of both local and national concern. It leaves complex societal issues – such as how we should care for the frail elderly – over which there should be a mature public debate, to be resolved at the local level in the context of febrile debates about the rate of local tax.

3.73 It also means that the lack of understanding of the costs of services contributes to unrealistically high expectations of what local government should be able to deliver for an average annual council tax bill of under £1,300.

3.74 The National Audit Office, in their submission to the Inquiry, summarised this lack of understanding of local government:

To put all this briefly: local government is to most people a mystery. Few understand how it works; what you can do to influence it; whether it is really local at all, or just a set of covert Whitehall agencies.

A system with unclear accountability

3.75 The current system of local government finance does not help to clarify which level of government should be held to account for which decisions. This can be most clearly seen in relation to the capping of council tax. In essence, central government controls what is supposed to be a local tax, taking away a key aspect of local accountability, to the detriment of both local and central government. This issue was raised by many contributors to the regional events that I conducted in 2005. The main concerns were about the use of capping cutting across accountability to the local electorate and the impact it had on services that were wanted locally, ranging from more policing to cleaner streets and to free bus passes for needy groups.

³⁰ Lyons Inquiry into Local Government: Consultation Paper and Interim Report, Lyons Inquiry, 2005.

Complex governance 3.76 There is an increasing, and laudable, emphasis on delivering services in a cross-cutting way via partnerships, based on an understanding in recent years of the need to join-up services to improve effectiveness for those who use them. However, if this is not done within a clear framework it also has the potential to complicate governance. Submissions to my Inquiry have indicated that multiple accountabilities can increase the risk of drawing the focus away from local communities and their needs and responsibilities.

The complexity of the existing governance and administrative structures can act as a barrier. In terms of the complexity of governance structures, we mean not only the different tiers of local government, but also the numerous agencies which operate at national, regional and sub-regional levels ... [this] can mean that there is less clarity about who is accountable, more negotiation is needed and decision-making is often slower. (St. Edmundsbury Borough Council)

3.77 There are also instances of partners having to respond differently to different government departments. In the case study research, councils attempting to tackle employment issues via their Local Strategic Partnership cited problems with Learning and Skills Councils and Job Centre Plus having nationally set targets which did not align, exacerbated by a mismatch in the eligibility criteria each partner was using for skills-related interventions.³¹ This also manifests itself in budget and performance management arrangements, which do not align, for example between social services and primary care trusts.

Structural complexities 3.78 The local government arrangements in England add complexity to our finance system with particular impacts on the public understanding of how the council tax bill is made up. Fire and police authorities operate as major preceptors, parishes operate as minor preceptors and various other bodies levy funds from the council tax bill. In parts of England the two-tier arrangements also add a further layer of complexity with shire counties receiving council tax funds via a precept on district authority bills and the Greater London Authority precepting on London borough bills.

³¹ Entwistle, T. et. al., *Perspectives on Place-shaping and Service Delivery: A Report of Case Study Work*, Lyons Inquiry, 2007.

Precepting

Of the 478 principal local authorities in England,

- 354 are billing authorities, that is the primary issuer of the council tax bill to householders – these are all lower tier (district) or unitary authorities;
- 102 are major precepting authorities – major precepting authorities include the GLA, county councils, police authorities and fire authorities; and
- 22 authorities levy a charge on another authority for the services they provide. Levying bodies include waste authorities, national parks authorities and passenger transport authorities.

The main difference between a precept and a levy is that precepts appear as separate elements on the face of the council tax bill and levies form part of either the billing or precepting authority's budget.

There are also over 8,700 parish and town councils and a further 1,500 parish meetings (where there is no council because there are fewer than 150 electors) which are classed as local precepting authorities. Central government does not collect information directly from such councils, although information on the total amount of council tax required for parish councils in each billing authority's area is collected from returns provided by billing authorities.

3.79 During the course of my Inquiry I have received many suggestions about how to improve this situation including: calls to move from two-tier arrangements to unitary government across the country; the possibility of the major revenue user in two-tier areas – the county – becoming the billing authority with the districts precepting; there being separate bills for each preceptor – something that was advocated by some police authorities; and calls for council tax bills to more clearly reflect the fact that they support a range of agencies other than the billing authority.

3.80 There has also been discussion about whether the public is further confused by two-tier government because they do not understand the respective responsibilities of counties and districts. These are issues that I discuss further in Chapters 4 and 5.

**A poor link
between local
business taxes and
local services**

3.81 I am also concerned about how central and local government are accountable to local businesses. When the business rate was locally variable there was a clear understanding that this tax was used to support services in the locality but the nationalisation of the business rate and the introduction of Dedicated Schools Grant mean that there is some confusion about the purpose of the business rates system. Because of its history and the way it is collected, it is still perceived by many businesses as a local tax, but it is actually used in great part to fund the provision of services according to national expectations and requirements. Since the removal of schools funding from RSG in 2006–07 business rate revenues have become an essential source of the funding required to allow equalisation between authorities for needs and resources.

3.82 This has led to concerns about the status of business rates in the current finance system and the question of whether business rates are a national or a local tax. These are reflected in businesses' concerns about the weakening of the link between their sector and local authorities as reflected in the following quotes:

Government decision makers continue to regard the capital's economy in terms of subsidising 'poorer' regions. Residents and businesses in central London provide billions of pounds annually.
(Central London Partnership)

*My borough is economically vibrant but residents don't really benefit from this because business rates go directly to central government. We suffer from issues such as congestion and parking in residential areas but receive little benefit.*³² (Councillor Engagement Event).

Economic prosperity

3.83 Recent work comparing the UK economy with those of the USA and Europe has concluded that the lack of devolution and local discretion in the UK is a constraint on economic performance, particularly in the cities. It is argued that too many decisions on issues like transport, planning and skills are still taken at a national or regional level without sufficient flexibility or responsiveness to the situations of local economies. For example, the Centre for Cities has found that it is a “lack of autonomy in the areas of physical regeneration, transport infrastructure and skills development that most constrains cities in their pursuit of growth”.³³

3.84 This disadvantages English cities compared with their counterparts in many European countries and North America. The *State of the English Cities* report states:

*Many English cities ... are not performing as well as their competitors in Europe and beyond. In this context the framework set by national government matters a great deal. Although there are differences, the trend in continental Europe is to decentralise and regionalise decision-making, placing powers at the lowest level. The evidence suggests that where cities are given more freedom and resources they have responded by being more proactive, entrepreneurial and successful.*³⁴

3.85 There are a number of economic arguments which suggest that the devolution of powers and responsibilities to a sub-national level can have economic benefits. Identifying whether the level of devolution and decentralised decision-making is optimal is challenging – while theory shows there is a role for some level of devolution it is not easy to judge what that level is. There are benefits and drawbacks to devolution. One study of high-income countries over a 30-year period found that an intermediate level of decentralisation is associated with higher growth than either extreme.³⁵ Other cross-country studies which attempt to identify whether decentralised countries experience high levels of economic growth have come to a mixture of conclusions. However, given that the UK is recognised as one of the most centralised developed countries, we must give serious consideration to whether there are advantages to be had from greater decentralisation and devolution of decisions in this area of policy.³⁶

3.86 Economic theory suggests that decisions on issues relevant to economic activity should ideally be taken at a spatial scale which reflects the pattern of that activity if they are to take into account all of the costs and benefits, and there are widespread concerns that since the current structure of local authority boundaries does not reflect economic geography, local authorities are not appropriate bodies to which to devolve greater powers.

³² *Report on the Councillor Engagement Events*, Lyons Inquiry, 2006.

³³ Centre for Cities, *City Leadership*.

³⁴ Parkinson, M. et al., *State of the English Cities*, vol. 1, Office of the Deputy Prime Minister, 2006.

³⁵ Thießen, U., ‘Fiscal Decentralisation and Economic Growth in High-Income OECD Countries’ in *Fiscal Studies* 2003, vol. 24, no. 3.

³⁶ Turok, I., ‘Local and National Competitiveness: Is Decentralisation Good for the Economy?’, Lyons Inquiry 2005.

3.87 Analysis in a host of recent publications including that of the Centre for Cities and various Government documents illustrates this point, though it has been a live issue at least since city-regions were raised in the context of the Redcliffe-Maud report of 1969. To give just one example, the 2001 Census shows that 40 per cent of people crossed at least one local authority boundary when travelling to work, and that number is higher if one looks just at highly skilled individuals.³⁷ Decisions made solely on the basis of an authority's administrative boundary will not therefore usually reflect the reality of where local people actually work, or where local firms find their employees. Issues like this provide the rationale for making a number of decisions related to economic development at the level of the region or even the nation as a whole.

3.88 However, it is worth reflecting on the fact that while local authority boundaries may be too small a level at which to make these decisions, the regional and the national level may well be too large. The Local Government Association's *Prosperous Communities II* illustrates that point very clearly, showing the variety of different economic patterns and markets that exist within England. It argues that a pattern of sub-regions is more useful in explaining economic and market connections, and that "there is a distinctive sub-regional layer of the real economy, as evidenced in markets for labour, goods and services, in industrial clusters and in relative economic performance".³⁸ The complexity and variability of these economic relationships is, of course, something that has already been recognised by the Regional Development Agencies and by local authorities, who have in many cases established sub-regional partnerships of various kinds to tailor approaches more effectively. Some, however, have called for new types of local authority to be created, which would better reflect sub-regional economic geography and could have greater powers devolved to them.

3.89 There clearly are issues to be addressed here, though this should not lead us to quickly assume that we can find simple structural solutions to these complex issues by creating a new tier of government. Functional economic boundaries are not precisely defined, are different for different kinds of activity and different types of people and businesses, and they change over time. It is by no means clear, for example, that the old metropolitan counties – which for some seem to be the obvious model for new city regions – do now reflect the reality of economic activity and transport patterns in all of the metropolitan areas. While we can argue about whether nations, regions, sub-regions or localities are the best spatial level on which to consider these issues, the truth is rather more complex and, in fact, as the OECD argues:

*We are not witnessing a shift from nation-state to wholly independent city and region governments, but the emergence of multi-level government that requires coordination between cities and regions, nation-states and international agencies.*³⁹

3.90 It is also important that the arrangements maintain local knowledge and the trust and engagement of local citizens. This is especially true when dealing with contentious issues like planning, where there is the potential to create real dissatisfaction and disengagement with governmental and political processes if handled poorly or if people do not accept decisions as legitimate.

3.91 We therefore need to recognise the complexity involved in these issues and not seek simplistic solutions to what are complex problems. The debate should focus on the key goals – how to achieve a prosperous, cohesive and sustainable society – and how to enhance behaviours and working relationships to deliver responsive and accountable decision-making arrangements.

³⁷ *Devolving Decision Making: 3 – Meeting the Regional Economic Challenges: The Importance of Cities to Regional Growth*, HMT, DTI and ODPM, 2006.

³⁸ *Prosperous Communities II: vive la devolution!*, 2007, Local Government Association.

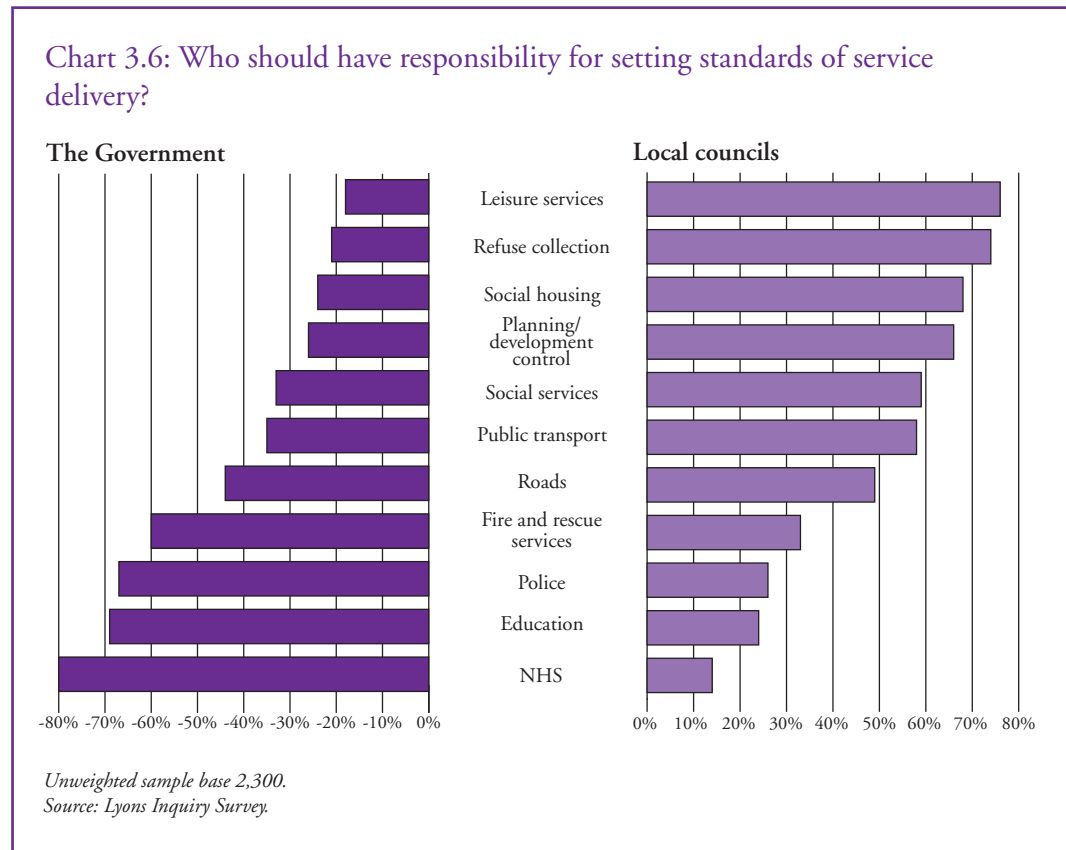
³⁹ *Devolution and Globalisation: Implications for Local Decision Makers*, OECD, 2001.

PUBLIC ATTITUDES

Public attitudes to central control over local government

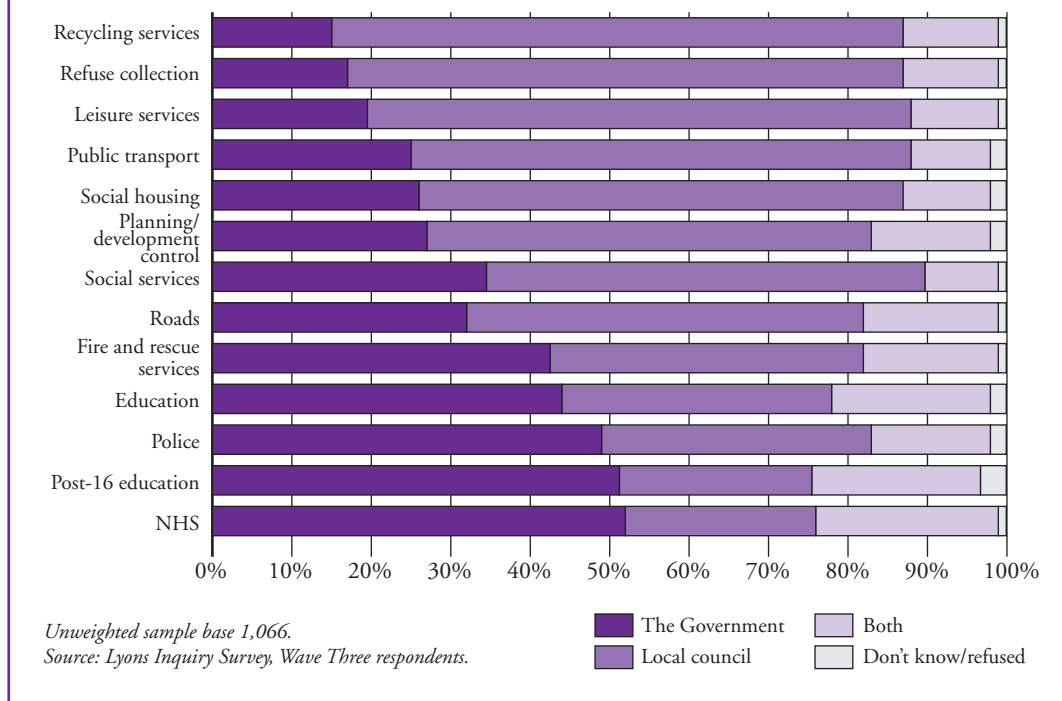
3.92 Public opinion and, in particular, concern about the ‘postcode lottery’ – the concern that there should be similar standards of outcomes in services areas in all parts of the country – is sometimes used to justify the need for central action.

3.93 As already noted however, research for my Inquiry shows, that public opinion is more complex than this suggests. Chart 3.6 shows that the majority of respondents believe that central government should have responsibility for controlling standards in health, education, police and fire and rescue services. This was mirrored in the results of focus group work for my Inquiry which concluded that central government should set national standards for ‘core’ services, including social services, in addition to those listed above. However, even in these core services there was a recognition that they needed to be able to reflect local circumstances.



3.94 The survey work also found a clear view that, for the majority of services asked about, local government should have a greater role in setting priorities than central government (see Chart 3.7).

Chart 3.7: Who should decide what should happen to a range of services if more money became available or cuts had to be made on public services in their local area?



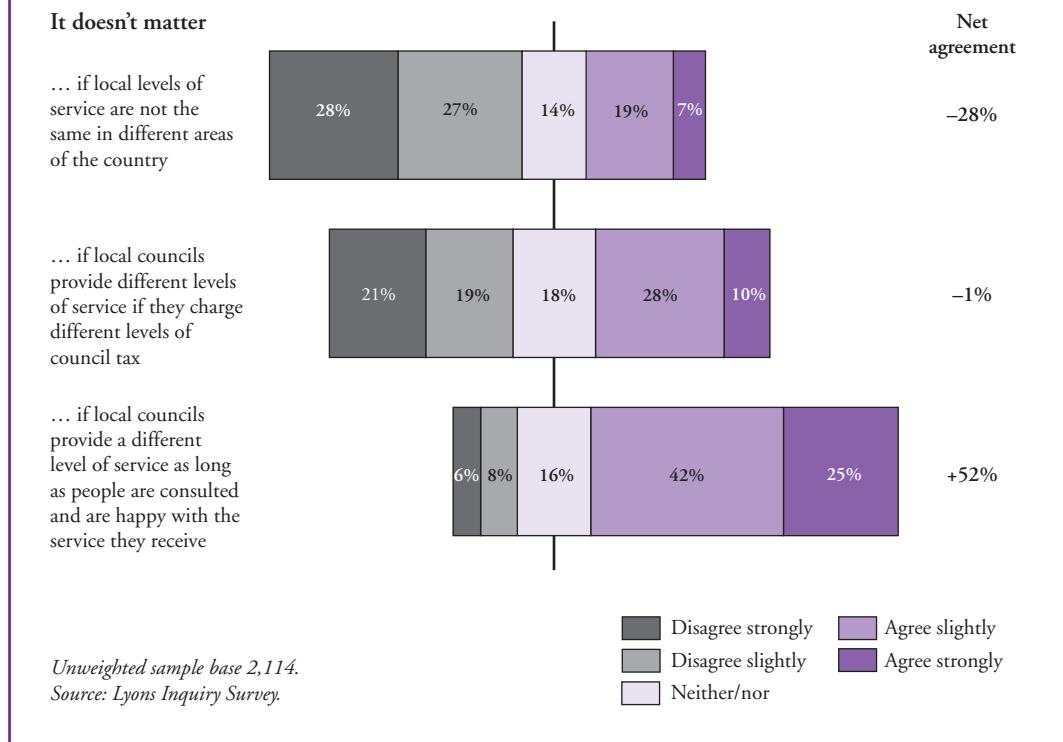
3.95 In public engagement events, participants firmly supported the idea that there should be neither total standardisation, nor total local flexibility, but rather minimum national standards above which councils could provide a better level of service where it was wanted or needed.⁴⁰ People wanted to ensure that there was an element of national fairness and protection via minimum standards, but also the flexibility to provide services in the way that best met local needs.

3.96 This appetite for what I call ‘managed difference’ is reflected in the survey results. There was a strong sense of disagreement with a proposition that levels of service should vary until the concepts of local consultation and satisfaction with the services were introduced. The proportion of respondents who agreed that service levels could differ changed from 26 per cent to 77 per cent once these conditions were added.

3.97 Striking the right balance in managing differences between areas and across services is a difficult challenge. It is particularly hard to conduct clear local discussion of priorities when people do not understand the true cost of local services. This will impact on negotiations of the different standards of service that can be expected for different levels of cost. However, local and central government need to confront this challenge in order to develop a better understanding of what taxpayers are buying or people’s dissatisfaction with local government will continue.

⁴⁰ Lyons Inquiry – Public Deliberation Events: Final Report for the Lyons Inquiry Team, Lyons Inquiry, 2006.

Chart 3.8: Level of agreement with statements relating to level of service delivery

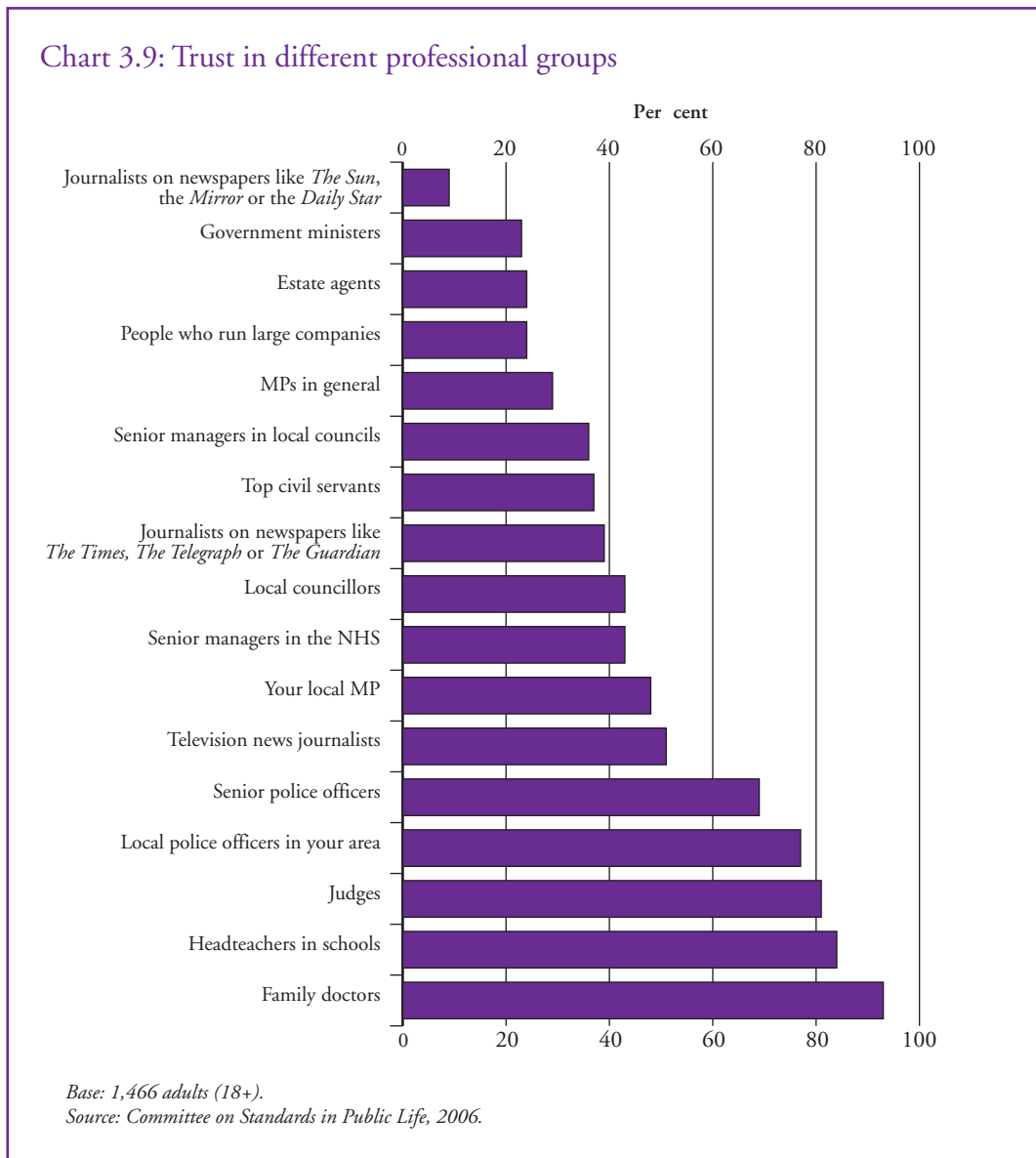


Lack of trust in the system of local government

3.98 Trust is the other crucial, but perhaps often understated, factor that is necessary for local government to be able to lead effective place-shaping. As Chapter 2 reports, local institutions and representatives tend to be more trusted than national institutions. In 2005, 58 per cent of people said they trusted their council a lot or a fair amount, whereas in contrast just 37 per cent of people said they trusted parliament.⁴¹ In a survey for the Committee on Standards in Public Life in 2006, 48 per cent trusted their local MP and 43 per cent their local councillors, compared to 23 per cent trusting government ministers and 29 per cent trusting MPs in general (see Chart 3.8).⁴² These figures do not offer room for complacency by either local or central government.

⁴¹ Kitchen et al., 2005, *Citizenship Survey: Active Communities Topic Report*, CLG, 2006.

⁴² Ipsos Mori, *Survey of Attitudes Towards Conduct in Public Life 2006*, Committee for Standards in Public Life, 2006.



3.99 Encouraging trust is a complex activity as trust is based at the same time on rational and emotional responses, yet it is a necessary aspect of dealing with the complex problems that face local services.⁴³ I believe that a major factor limiting trust in the system is the confused accountability described above. However, there are other issues limiting trust in local government:

- the concern about council tax and its fairness;
- an adversarial relationship between central and local government; and
- a disempowered local government sector leading to a lack of confidence in its relevance and ability to make change happen.

Concern about council tax and its fairness

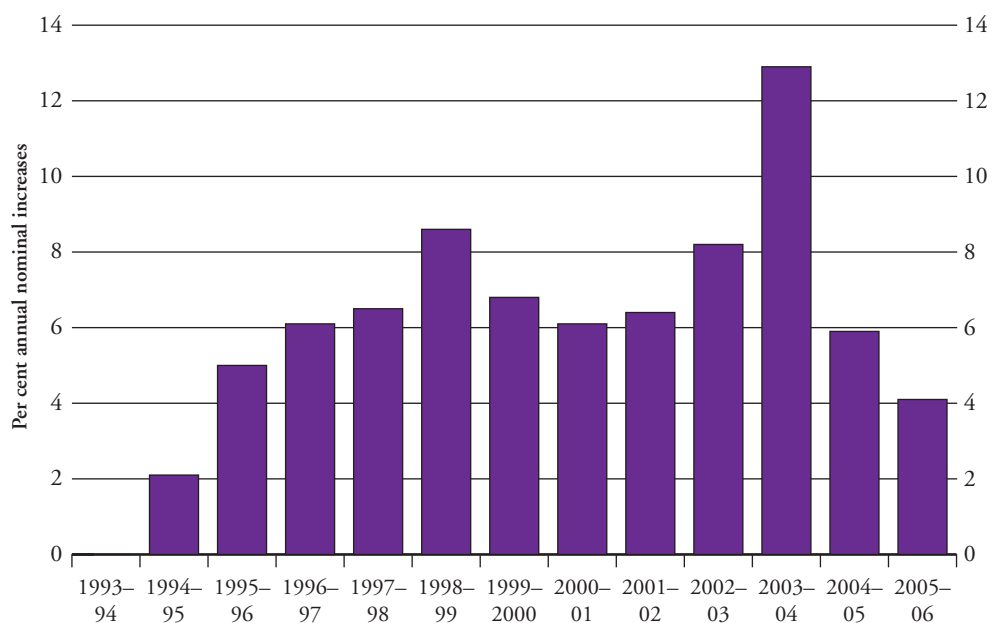
3.100 Over the past ten years, as shown in Chart 3.10, there have been instances of steep increases in council tax. Media coverage, submissions to the Inquiry and the Inquiry’s research have shown that there is ongoing public concern about overall percentage increases but there is also anxiety about the fairness of council tax, particularly in terms of ability to pay, which is most often equated to income.

⁴³ Taylor-Gooby, P., *The Efficiency/Trust Dilemma in Public Sector Reform*, ESRC, 2006.

3.101 This issue has been particularly picked up by older persons' representative groups but, as demonstrated in Chapter 7, it is not a simple task to decide what a fair tax would look like as different groups describe fairness in different ways.

3.102 Indeed, our survey work has analysed three different types of response to council tax. Nearly half of the respondents could be characterised as 'dissatisfied payers' of council tax but, more surprisingly perhaps, a third were characterised as 'accepting payers' with the other 20 per cent being more satisfied non-payers, as they were receiving benefits. So, although no tax will ever be 'popular', and non-payers have obvious reasons to feel benign towards council tax, these responses do show that compared to some of the perceptions of council tax portrayed in the media, the tax is not vilified by all payers.⁴⁴

Chart 3.10: Increase in council tax (in nominal terms), 1994–97



Source: *Local Government Financial Statistics, England, No. 16, CLG.*

3.103 That said, I am concerned about the impact of the perceived lack of fairness of council tax and the damage I believe it has caused to the relationship between local authorities and their communities. This may in part be, as Peter Smith argued in 1991, one of the legacies of the poll tax which he argued “brought into question the legitimacy of local taxation in the United Kingdom”.⁴⁵ Whatever the cause, the survey work for the Inquiry shows that only a minority consider that council tax represents value for money. This is important because the second most important driver for satisfaction with local government is perceived value for money.⁴⁶

⁴⁴ *Lyons Inquiry Survey*, Lyons Inquiry, 2007.

⁴⁵ Smith, P, Lessons from the British Poll Tax Disaster, *National Tax Journal*, Vol. 44, no. 4, (December, 1991.)

⁴⁶ *What drives public satisfaction with local government*, Local Government Association, 2004

3.104 Central government has a responsibility, alongside its overall responsibility for the finance and taxation framework for the country, to maintain a trusted, viable tax for local government. An impression can be gained too often, that council tax is a local problem which can be solved through ad hoc solutions and changes, rather than recognising that many of the pressures and unfairnesses associated with the tax require national action.

An adversarial relationship 3.105 Another key factor contributing to a lack of trust in our institutions of government is the current relationship between central and local government – at least as played out in public – which can be characterised as adversarial. It may be that this is an aspect of the generally adversarial nature of British politics. As Chapter 4 discusses, such poor central–local relations are not a clear feature of all other countries. As well as damaging accountability, the wider fall-out is a sense that poor relations damage the standing and credibility of both local and central government and politicians as a group.

3.106 The focus of attention in recent decades, as set out above, has been the performance of the local authority and the delivery of service improvements. These are undoubtedly important issues but this focus has arguably neglected the need to improve the relationship between central and local government, which is still allowed to be seen as one of competition and criticism. As John Stewart from the University of Birmingham argues:

The nature of central–local relations is critical to building effective local government, yet there were no proposals to modernise central–local relations alongside the proposals for modernising local government.⁴⁷

Lack of confidence and capability 3.107 The Inquiry’s councillor engagement events were marked by a general sense of disempowerment among the councillors who attended, reflecting the argument that one of the reasons people do not engage with local government as much as they might is because local councillors are perceived as having only limited powers. Some councillors argued that their credibility was undermined since, as they see it, they could not deliver for local people because central government overrides them. There was concern that central government’s lack of trust in local government had undermined public confidence and felt that they were often seen as merely doing the will of central government:

Unless the public see local councillors as having real power to make a difference, then they feel ‘what is the point?’.

3.108 This is further evidenced in research on councillors’ and former councillors’ views on their own role. In the IDeA’s last ‘exit survey’ of councillors standing down, one in four respondents cited the erosion of local government influence as their reason for leaving.⁴⁸ Recruitment of councillors, in particular younger people, is also proving difficult, with nearly half of all councillors over the age of 60.⁴⁹ This serves to reinforce the reputation of local government as unrepresentative and out of touch. This is an issue that the Government is rightly concerned about and is at the heart of the recent announcement to set up a new commission, led by Dame Jane Roberts, the former leader of the London Borough of Camden, to look at how local democracy can be revitalised and made both more representative and more responsive to local people.

⁴⁷ Stewart, J., *Modernising British Local Government: An Assessment of Labour’s Reform Programme*, 2003.

⁴⁸ *Exit Survey of Local Authority Councillors*, IDeA, 2003.

⁴⁹ *National Census of Local Authority Councillors*, Provisional 2006 results, Local Government Analysis and Research, 2006.

3.109 The case study research reinforced this sense of disempowerment; some councillors felt that at times, middle managers paid more attention to the direction given to them by central government departments and national inspectorates than they paid to the aspirations of the elected members in their local authority. There was a questioning of the worth of standing as a local councillor if such a role cannot make a difference.

3.110 Specific examples were raised by councillors of regulatory regimes being so heavily circumscribed – for example, planning and licensing – that decisions could not sufficiently reflect local considerations and concerns, leading to public disillusionment with local government. They cited the example of local people wanting new approaches to licensing to help tackle street drinking. They took the view that the detailed national framework restricts the scope for local tailoring, making engagement frustrating and sometimes pointless.

3.111 Later chapters discuss how to tackle this lack of trust in local government in detail, however I believe the two important factors for increasing trust in local government are improved understanding and clearer accountability. I am convinced that better engagement between local government and the public – at both political and managerial levels – is the key to improving understanding of local government, the frameworks in which it operates and the tough trade-offs which require decisions. This will, in turn, help to improve the accountability of authorities to local communities for decisions over which they have control.

Effective engagement

3.112 Chapter 2 argued that the key to making best use of resources for the well-being of local communities is to enable communities to make their own choices where possible and include them in the design and delivery of services through co-production. These will help to obtain better outcomes and improve understanding and satisfaction. This, in turn, relies on local government engaging with local communities to understand their preferences for services and other aspects of local government activities. This is currently limited by:

- central and local government frameworks on engagement having a focus solely on service improvement against formal targets at the expense of overall satisfaction and wider understanding of community needs and preferences; and
- too great a focus on the centre in terms of performance reporting and target setting, rather than a focus on the community.

Engagement too focused on service-specific improvements

3.113 Recent research has concluded that central government initiatives to enhance engagement and participation through initiatives such as Best Value have improved services.⁵⁰

3.114 However, there is a question of whether the current focus of community engagement enables the broader understanding that is required to judge whether the right services are being delivered in the first place, as opposed to services being delivered in the right way. This is essential to achieving the broadest type of ‘allocative efficiency’ needed to maximise well-being. Recent developments have moved the dynamic for participation towards individuals’ interaction with services as consumers, rather than gaining an understanding of community needs through the wider forms of democratic participation that are important to develop social capital and community cohesion. As Wilkes-Heeg and Clayton argue:

⁵⁰ *Long-term Evaluation of Best Value Regime: Final Report*, Communities and Local Government, 2006.

*The limitations of the more consumerist approaches to participation must ... be underlined. Substantial investment in market research, focus groups, consultation events, survey questionnaires and so on, has clearly not prompted participation in electoral politics. Indeed, there is little reason to suppose that 'individualised' approaches help enhance more collective forms of democratic participation or serve to reinvent, or even sustain, notions of democratic participation.*⁵¹

Too great a focus on the centre 3.115 Some commentators have raised concerns about levels of central control damaging local engagement. They argue that people will not engage with organisations that have no authority. The Electoral Commission's research into the 2002 local elections concluded that 60 per cent of respondents would be encouraged to vote at local elections if the council had more scope to make local decisions and 51 per cent if councils had more scope to determine taxes and spending.⁵² Such concerns can be typified in the following quote:

*The public is unwilling to engage with councils which they see as delivery agents of national government with little room for manoeuvre and therefore unable to make a real difference locally.*⁵³

3.116 Central controls also govern consultation and engagement processes. These often cover both the topics on which consultation must take place and, at times, the methods that should be used. This has had benefits in raising the priority of such activities and has led to methodological advances. However, it produces risks; central priorities are put above those of localities and the focus is on the centre – the Communities and Local Government work on performance measurement estimated that councils spend about 80 per cent of their reporting effort on reporting 'upwards' aimed at Government departments and ministers and less than 20 per cent on their local systems which are aimed at electors and taxpayers.⁵⁴

POOR INCENTIVES IN DISTRIBUTION OF NATIONAL RESOURCES

3.117 The place-shaping council should be clearly focused on the needs and wishes of its local community. In contrast, the current model in England is characterised by a centralised form of governance both with regard to finance and levels of control. This affects the behaviour of local government, particularly through the distribution of national resources through the grant system which can distract local government away from the concerns, needs and future prospects of its citizens and its local areas.

Impact of balance of funding 3.118 The impact of grant is sometimes articulated as part of the balance of funding issue, with commentators arguing that central government's provision of a large proportion of funding to local government in itself creates risks of dependency. This issue is summarised well in the following quote:

*In a system where local government was responsible for, say, 50 per cent of all public expenditure without commensurate local tax raising responsibility, the impact of changing levels of central support would be far greater than when the figure was, say, five per cent.*⁵⁵

⁵¹ Wilkes-Heeg, S. and Clayton S., *Whose Town is it Anyway? The State of Local Democracy in Two Northern Towns*, 2006.

⁵² *Public Opinion and the 2002 Local Elections*, Electoral Commission, 2002.

⁵³ *Implications of Local Devolution for Efficiency and Effectiveness in Service Delivery*, Martin, S., Lyons Inquiry Seminar: Greater Devolution: Evidence in Support, June 2005.

⁵⁴ *Mapping the Local Government Performance Reporting Landscape*, CLG, 2006.

⁵⁵ Travers, T., *International Comparisons of Local Government Finance: Propositions and Analysis*, Lyons Inquiry, 2005.

3 What is limiting modern local government?

Impact on central and local relations 3.119 However, the amount of funding provided by central government is not the only determinant of the effect of the grant system on central–local relations. The structure of that funding – the incentives it produces and the consequences that it has for control and for accountability – shapes the interface between local and central government and, by implication between local authorities and their communities.

3.120 The objective of both central and local government should be to obtain the best results and outcomes from existing resources without being distracted from striking the right local deal over taxation. Instead, the current process fosters, and is supported by, local government behaviours which are focused on lobbying government for changes to data, formulae and grants in order to gain marginal extra revenue from the centre. This absorbs energy amongst council members, officers, civil servants and ministers. It contributes to a sense that resources are seen not as citizens’ money to be used in their best interests but somehow as the property of central government handed out by ministers. There is a strong sense that lobbying for more grants is also free of political cost to local authorities.

3.121 It also results in local authorities being in competition with each other, individually or through representative bodies such as those that promote the case of different types of local authorities. I doubt it is possible to design a distribution system that is completely competition-free but it is useful to contrast our experience with that of other countries, such as Denmark and Germany, that operate horizontal equalisation systems. In these countries, authorities with high tax bases share their resources more directly with low tax base authorities, through arriving at consensus, without the need for the centre to become involved in orchestrating the transfers.⁵⁶

Current objectives of the grant system 3.122 The current grant system balances two objectives, which can often be in tension with one another. On the one hand, it seeks to deliver equity by taking local needs and local council tax resources into account when allocating grant, thus providing more generous grants to areas with the highest needs and lowest local resources.

3.123 On the other hand, the grant system also seeks to deliver some stability in grant allocations for local authorities. This objective has been given substantial weight in recent years through a system of damping. The emphasis has been put on minimum, or floor, levels of grant increase for all authorities, imposing ceilings and scaling back of grants to other authorities to pay for those floors. An example of the impact of damping can be seen in 2006–07, when 71 out of the 150 local authorities with responsibility for personal social services were protected by the ‘floor’ which was set to guarantee all authorities a minimum two per cent increase for this aspect of their budget. Further information about damping is set out in Annex A.

3.124 Clearly, a degree of stability is important to allow local authorities to plan. However, there is evidence that this focus on stability is also about controlling council tax increases as council tax may have to increase to compensate for shifts in grant. In doing this it limits the ability of the grant system to react to needs, which for those areas with high or increasing needs means that they need to put further pressure on council tax. In consequence, Government’s concern to control council tax without resolving how to deal with the underlying pressures on the tax risks distorting other aspects of the finance system.

⁵⁶ Loughlin, J. and Martin, S., *Options for Reforming Local Government Funding to Increase Local Streams of Funding: International Comparisons*, Lyons Inquiry 2005.

Limited incentives for growth 3.125 Such concerns need not be an issue, if one considered that the current grant system was delivering all that could be asked of it. However, examples from international systems suggest that grant should not be just about insulating local authorities from their particular circumstances or from change, or indeed from an unpopular local tax. The grant process should also be about providing incentives to support positive activities, as argued by the OECD:

*full equalisation removes the incentive to increase jurisdictional tax base by attracting new economic activity ... [as such] full compensation of differences in tax or service capacity may compromise the incentive to expand the tax base and should be avoided.*⁵⁷

3.126 As the above quote suggests, the question of incentives is of particular importance when considering the role of local authorities in pursuing and enabling economic prosperity and housing supply in their area. These are important aspects of their place-shaping role and so a link between the health of the economy and the size of local tax base is a key motivation for local authorities to take growth seriously.

3.127 Outside specific initiatives, local authorities can only share in the general growth of housing or business tax bases in a limited way. Neither growth in council tax nor business rates in England are rewarded in any way through the funding of the authority because the grant system automatically takes into account any growth in tax base. Housing growth does have some benefit for the local community in that it allows council tax increases to be spread across a larger tax base but the residents' use of services produces costs as well. Local government can only see a very long-term benefit from growth in business tax base in the form of more resources for central government to allocate.

3.128 The special initiatives that have been introduced to create incentives mainly relate to development, including Section 106 contributions and the proposed Planning-gains Supplement. There are proposals for a Housing and Planning Delivery Grant to provide incentives for the delivery of new housing and the recently introduced Local Authority Business Growth Incentives scheme aims to provide local authorities with general financial gains from a growing business tax base.

3.129 Such systems are important, but a concern remains that they are special schemes that operate outside the main local government finance system and are subject to specific and, at times, complex allocation criteria and changes by the Government. These factors reduce the degree to which authorities can successfully rely on such schemes and make long-term decisions. I discuss options for improving incentives in Chapter 9.

CONCLUSION

3.130 This chapter has identified the key problems limiting local government's contribution to place-shaping and local well-being as deeply engrained systemic issues affecting the confidence of people in local government, and the confidence of local government to act in the interests of its communities. Local government's own responses and behaviours are, of course, key to achieving change and these are discussed in Chapter 5. However, change is needed at central government level too.

⁵⁷ *Intergovernmental Transfers and Decentralised Public Spending*, OECD Network on Fiscal Relations Across Levels of Government, 2005.

3.131 As this chapter has shown, problems with council tax and the balance of funding for local government are important issues. The causes of council tax pressure, lack of trust in the system of government and the constraints holding local government back lie in a system which is over-centralised, which offers too little local flexibility and in which accountability is unclear and confused. Tackling such large-scale problems is a major task and will require central government working to support and maintain a trusted and viable local tax and, crucially, to create more space to respond to local choice.

3.132 The Government has made a real move forward in the Local Government White Paper and associated Bill. I share much of the Government's analysis of the problem, but believe that the objectives for reform are profound and broad, including:

- **clearer accountability** over who is responsible for what, including clarity over who controls tax and spending decisions so enabling a clearer understanding of the costs of services and who can and should be held to account. I see this as a good in its own right but also a necessary condition for local communities to fully engage in the process of determining priorities and choices within limited revenues;
- **greater flexibility** – this includes: financial flexibility, enabling local authorities to have more control over managing their budgets, raise revenue and take spending decisions to best meet the needs and preferences of their local communities; and flexibility to enable local government to manage local services in response to local needs and work with partners in new and innovative ways to improve how well services work for local communities;
- **better incentives** for local government to own and grow their tax bases and for both central and local government to develop a more productive relationship over time which recognises their shared objective for improvements in the system;
- **tackling perceived unfairness**, in order (along with other objectives) to improve satisfaction and trust in the system of local government as a whole. This is a difficult but important area and, in assessing my reform options, I have attempted to balance: competing views of fairness in terms of concerns about particular groups such as pensioners; issues around ability to pay, wealth and the link between the level of tax and the value of the property; and consideration of the benefit principle – that recipients of the service should bear the costs of that service; and
- **continued improvements in efficiency** – the overall efficiency of local public services is a key factor which could help to relieve pressures on council tax under the current system. It is therefore essential that public services are delivered in the most cost-effective way possible. However, in seeking to improve the well-being of local communities and manage pressures as effectively as possible it is also essential that public expenditure is allocated to best meet the needs and preferences of the community: delivering the right local priorities rather than just doing them as cheaply as possible. Both of these objectives require greater scope for local choice.

3.133 All these objectives need to be addressed if we are to move towards a more sustainable system of local government and local government funding. That means being able to adapt to changes and manage pressures caused by demographic, societal and global challenge as well as those brought about by policy and political changes, locally, nationally and internationally.

3.134 These themes will form the objectives against which I will appraise reform options presented in subsequent chapters.