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**England's Core Cities:
why financial freedom would drive improvement**

A prepared paper for the Core Cities

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This paper was commissioned by the Core Cities as a contribution to the Lyons Inquiry's debates about the future of local government finance in England. Much has been written on this subject over the past 30 or so years. There has been little substantial reform apart from the ill-fated experiment that occurred between 1990 and 1993. Lyons provides the Core Cities with an opportunity at a particular time in their development. There is a chance to return fiscal autonomy to England's major cities at precisely the time they are enjoying their greatest success since the Industrial Revolution. With such freedom there would be a chance that they could build upon the major improvements of the past two decades. The paper has been written for the Core Cities not by them.

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1. Introduction

The Lyons Inquiry presents local government with a rare opportunity. It provides a chance to re-position the funding and activity of councils so as to achieve more effective and accountable governance. For the Core Cities group, the opportunity is all the more important as it comes at a time when there is a wide recognition of the way in which these urban centres act as the essential element in regional, and thus national, economic success.

Many of the core cities are re-establishing themselves in a role that would have been unquestioned in the past. Britain's original industrial development occurred as a result of the ingenuity and dynamism of Manchester, Sheffield, Birmingham and other Victorian cities. Only the structural economic change that occurred between the 1960s and the 1990s – and which continues today under the banner of 'globalisation' – led people to question the capacity of Britain's cities to continue to lead the country's economy.

In fact, the reconfiguration of these cities since the late 1980s has provided convincing evidence that recovery is well under way that that, in the longer term, there is no reason why they should not rank among the most economically successful in the developed world. However, there are still blockages to the kind of self-determination and economic progress that are the policy goal of all British political parties.

Because of their complexity and unique attributes, cities are particularly dependent upon good decision-making and government. Major metropolitan centres depend on infrastructure and commonly provided services to an extent that is unimaginable in smaller towns and the countryside. Higher population and business densities are both economically productive and good for the environment, but to achieve them it is essential that large numbers of people can live and work easily alongside each other. In this sense, Paris is a better model than Los Angeles.

But, if England's core cities are to be able to deliver the attractive environment, common services and quality of life needed to secure the desirable outcomes outlined above, they must also be able to determine how to organise themselves and to fund their 'hard' and 'soft' infrastructure. It is for this latter reason that the Lyons Inquiry is a vital stage in the renewal and continuing economic success of the Core Cities group.

The report that follows is divided into four parts. First, the recent official and expert evidence on England's cities is summarised and analysed. Second, the governance and funding implications suggested by this evidence are outlined. Third, the report suggests ways in which the Lyons Inquiry could make proposals that would underpin the future economic and governmental progress of the core cities. Finally, the implications for Lyons's wider remit are evaluated. The focus is on existing administrative cities, not a wider area.

2. Recent evidence about England's cities

There can rarely have been a period of such intense official and expert interest in cities. The Callaghan, Thatcher and Major governments all pursued 'urban' programmes and sought to tackle poverty in the inner cities. The Blair government has maintained official concern and commissioned much research into the underlying performance of cities. New initiatives have produced intervention at part-national, regional, sub-regional, local and neighbourhood levels.

The earliest major intervention was the creation and report of the Urban Task Force (UTF), chaired by Lord Rogers, which reported in 1999. The UTF made the case for an 'urban renaissance' (DETR, 1999), arguing that local authorities needed access to funding sources if they were to be able to allow cities to invest to renew themselves. "We therefore need to recognise adequately the spending needs of local authorities in allocating national funding while at the same time giving local authorities some more flexibility to levy additional resources for specific urban regeneration and management purposes" (DETR, 1999, page 282). It was also proposed that local authorities should "retain a proportion of additional revenue generated from Council Tax and business rates as a result of regeneration in designated Urban Priority Areas".

The UTF also favoured Tax Increment Finance (TIF) was proposed as a possible method for urban areas to re-invest in their physical assets. The Task Force had found such mechanisms in use in North America and believed they could play a part in the "urban renaissance" Lord Rogers hoped to kick-start within Britain. Chicago and Toronto, in particular, has used mechanisms of this kind (Clark, 2003, page 191).

The UTF report has been influential in the seven years since it was published. The government's first response was an urban White Paper, which stressed the need to give priority to cities and their metropolitan hinterland. On the question of governance and finance, *Our towns and cities: the future* talked more about the importance of regional development agencies and the need to shape central programmes than about the need for stronger local financial autonomy. However, the importance of local leadership was stressed throughout the document (DETR, 2000).

In 2000, the Greater London Authority was created to restore city-wide elected government to the capital. The government explained that the reason for giving London a new form of government was, in part, to allow the Mayor to "draw up detailed strategies, set budgets and appoint people to run key services" DETR, 1998, page 9). Economic development and future success was tied to a local capacity for self-determination, particularly of the Mayor's budget. The Mayor of London, as the executive element of the new system, was given the power to raise a council tax precept, to determine fares for transport services and to introduce a congestion charge. The government was, by implication, stating that without the power to raise resources, the new city government would be incapable of operating effectively (Travers, 2004).

Subsequently, there have been a number of official and think-tank reports on cities and their economic progress. The Office of the Deputy Prime Minister published its proposals for 'Sustainable Cities' and the Northern Way. There have been local governance initiatives such as local public service agreements, local strategic partnerships and now local area agreements. The government has suggested that 'city regions' should play a role in developing the governance and economies of the regions. The Treasury, ODPM and the Department of Trade & Industry have each had a role in developing the approach to urban competitiveness.

The *State of the English Cities* reports included a vast amount of research and analysis of a number of aspects of the core cities and other urban centres. In the summary volume, a ministerial foreword concluded that "After years of industrial change, our cities are competing more effectively in a rapidly changing global economy in which capital, goods and knowledge travel faster than ever before...People and jobs are coming back into our city centres...a combination of sustained growth, increased investment through public private partnerships, and entrepreneurial local leadership means that our cities are better placed than at any time for a century or more" (ODPM, 2006, page 5).

The detail of both the summary and the two, longer, research volumes contained a number of messages that have important implication for any review of local government and its finance. First, the authors of the *State of the English Cities* argue that many English cities "are not performing as well as their competitors in Europe and beyond...the broad trend in continental Europe is to decentralise decision-making and place powers at the lowest level. Where cities have been given more freedom and resources there is evidence they have responded by being more proactive, entrepreneurial and successful" (ODPM, 2006, page 9).

Cities could become more competitive if they were given greater financial freedom. The *State of the English Cities* document proposes the local retention of 100 per cent of business rates generated by new knowledge-intensive industries and tax breaks for location in particular city regions. Authorities should be given greater influence over "the allocation and uses of national resources that already come into their areas...too many agencies with separate budgets that impact upon urban areas do not have sufficient urban focus...Giving English cities greater capacity would produce greater results" (ODPM, 2006, page 38). In particular, hard and soft infrastructure, particularly facilities around regional airports and multi-modal transport systems need to be developed.

In Volume 2 of the full *State of the English Cities* report, the authors cite a "raft of measures which will increase fiscal resources at the disposal of public organisation operating in our towns and cities". Such measures are:

- increases in health, education and housing resources;
- a number of fiscal incentives designed to encourage private investment, including stamp duty and VAT reductions;

- the ‘Prudential Rules’ capital control arrangements;
- increased charging and trading powers;
- reduced ring-fencing of grants;
- Business Improvement Districts;
- the Local Authority Business Growth Incentive (LABGI) Scheme, allowing authorities to retain a proportion of any non-domestic rate base increase;
- reforms to council tax to “address its impact on those on low incomes and also look into the impact of revaluation”.

The above initiatives constitute the full list quoted on page 89 of Volume 2. It is revealing for the modesty of what is revealed and also because only two of the examples listed (charging/trading powers and LABGI) are actually increases in the locally determined resources available to councils. Even these two sources are very small for most authorities and cannot be generated easily.

At the end of Volume 2, the authors accept that their report has not “undertaken a detailed review of the financial powers and resources of local authorities” although it is stated clearly that European and American cities have more freedom and resources. “American cities have fiscal tools and instruments which give local leaders greater leverage in promoting economic development. In England, many of the levers for increased competitiveness are not held by city leaders but by national departments. In particular, the fiscal capacity of English cities is much lower than those in many continental cities, with over 85 per cent of local income derived from national government” (ODPM, 266, page 152).

It is perhaps unsurprising that a government-sponsored report should stop short of drawing a direct link between the fiscal and wider financial autonomy of local government and the major cities’ capacity to achieve future development and economic success. But one thing the authors are clear about is that the core cities are where the government should address future attention. Policy should “maximise the contribution of Core Cities to their regional and national economies. Government should address the challenges and opportunities faced by the big nine in a coherent, concerted, fashion” (ODPM, 2006, page 149).

The Treasury has also published research about the devolution of decision making to regions and cities. The inter-relationship between cities and their surrounding areas was highlighted: “Cities draw on their surrounding hinterlands, which provide additional skilled labour and affordable housing for a non-metropolitan workforce. The hinterland benefits from increased investment in infrastructure, higher employment levels and

increasing prosperity. Often, the interactions between cities and their surrounding areas leads to a coming together of similar types of businesses and people in agglomerations. Agglomerations or ‘clusters’ of firms and skilled workers within cities have important implications for regional economic performance” (HM Treasury, 2006, page 3).

The Treasury also acknowledged the importance of cities to wider national economic performance: “Internationally, cities’ contribution to the national economy (in terms of GDP or income) is greater than their share of the national population, and the contribution of larger urban centres is proportionately greater. English cities have, in recent years, enjoyed a significant revival”. Looking ahead, “Cities will make the greatest contribution to regional and national economic performance if they focus on creating an environment that facilitates the agglomeration and consumption externalities that cities can provide” (page 28).

“One way to overcome spatial disparities in productivity and employment rates is to allow each region and locality the freedom, flexibility and funding to exploit their indigenous sources of growth” (page 57). The Local Authority Business Growth Incentive Scheme, the Local Enterprise Growth Initiative and the ‘roll out’ of Local Area Agreements are seen by the Treasury as evidence of stronger freedoms and incentives for local government.

Finally, the Treasury accepts that cities need to “build on their strengths, focusing investment and addressing constraints to growth in those areas that will support their competitive advantage, developing employment, market and growth strategies to respond to the circumstances they face. Addressing such constraints involves identifying any ways in which the market is not functioning smoothly and may be inhibiting economic performance...or creating pockets of disadvantage” (page 58)

Like the ODPM-sponsored *State of the English Cities* report, the Treasury does not quite get to the point of advocating additional fiscal freedoms for local government. But, in terms of the Lyons Inquiry’s wider remit, it certainly makes the case for the development of stronger city leadership and self-determination (described by Lyons as “place-shaping”). The Treasury argues for the delivery of local solutions that will allow urban economies to grow more strongly, and thus contribute to regional and national economic success.

The Centre for Cities, an independent think-tank, made a precise link between the capacity of cities to raise resources and the quality of their government. “Autonomy is clearly linked to the quality of government in cities and larger towns...City politicians who must balance the costs and benefits of their expenditures against the tax consequences for their local population will be more likely to use resources wisely and effectively than those who simply beg for funding from the centre” (Centre for Cities, 2006, page viii).

To summarise, the expert evidence derived from recent research suggests that cities are likely to be better governed and make more effective decisions if they have access to

locally-determined resources. Reliance on central government to fund major projects (and, indeed, most smaller programmes) will have the effect of transferring political power to the centre. For cities at a distance from the core of Whitehall, the fact that decisions about investment and other spending will be made by officials (and even ministers) who rarely visit them is problematic.

Only local politicians, reflecting the interests of their electors, are likely fully to appreciate the needs of a particular city. Moreover, the Treasury's conclusion that regions depend on the economic success of the cities at their core suggests that both cities and wider areas need autonomy. However, as the core cities already have the benefit of directly-elected councillors with tax-raising powers, they are the most promising place to start the re-building of urban and regional economies.

3. The local government finance issue

British local authorities, both core city and others, operate within a centralised system of government. This fact is widely accepted, but can be judged objectively by looking at official international statistics about the proportion of a country's taxation collected by local government. Table 1 below shows Britain in the context of a number of major countries which contain cities of the kind that are often compared with England's core cities.

Table 1 Tax revenues by sub-sector of government as a percentage of total tax revenue

	Federal/central	State/Lander	Local	Social Security
Canada	44.8	37.9	8.6	8.7
France	39.4	0	10.3	49.4
Germany	30.2	21.6	6.8	40.5
Italy	53.4	0	16.9	29.5
Japan	35.8	0	25.7	38.5
Spain	37.0	0	28.2	34.4
Sweden	55.0	0	32.7	11.6
United Kingdom	75.5	0	4.8	18.5
United States	38.8	20.2	14.7	26.4

(Source: *Revenue Statistics 1965-2004*, OECD, Paris: OECD Publishing, Table 132)

This table covers the whole of local government within each country shown – both cities and more rural authorities. But there is likely to be very little difference between the average percentage shown for the UK and the individual figures for each of the English Core Cities.

The figures in Table 1 make baleful reading. The centralised nature of British democracy is all too clear. Under five per cent of all tax and social security revenue in the UK is collected by local government. Put the other way round, some 95 per cent of all revenues are determined by central government. Germany and Canada also have local government systems where a relatively small proportion of tax revenue is collected beyond national government, though in each case there is a substantial 'regional' level of democracy.

The consequences of these numbers for the Core Cities are clear enough. Although the cities are major centres of economic activity and tax-generation, their leaderships must look to the Treasury and other parts of Whitehall to determine allocations of resources. Taxes paid in Birmingham and Sheffield are spent by ministers in London – in part on services and infrastructure in Birmingham and Sheffield. Although there are no figures for either expenditure or tax-take for individual local authorities in Britain, it is possible to generate stylised projections of the scale of the level of overall public expenditure (including central and local government and other publicly-funded bodies) in each of the core cities. The council tax yield in each city can then be compared with this spending total. The gap between the two numbers is a measure of the extent to which central government directs the city’s destiny.

Table 2 Total public expenditure and local domestic tax yield, Core Cities, 2004-05, estimates

	Estimate of total public expenditure £ bn	Council tax £bn	Gap £bn
Birmingham	7.3 - 8.0	0.275	£7.0 - £7.7
Bristol	2.7 - 3.0	0.128	£2.5 - £2.8
Leeds	5.4 - 5.9	0.199	£5.2 - £5.7
Liverpool	3.6 - 4.0	0.137	£3.4 - £3.8
Manchester	3.5 - 3.9	0.112	£3.3 - £3.7
Newcastle	2.3 - 2.5	0.086	£2.2 - £2.4
Nottingham	1.9 - 2.1	0.079	£1.8 - £2.0
Sheffield	3.8 - 4.2	0.156	£3.6 - £4.0

(Sources: Public expenditure totals are calculated as a per capita share of the government’s estimate of regional public expenditure (*Public Expenditure Statistical Analyses*, Cm 6521, London: HM Treasury, Table 8.1) with a range allowing for a 10 per cent ‘excess’ over the regional average to allow for city centre functions. Council tax figures are taken from *Finance and General Statistics, 2004-05*, London: CIPFA, Part 1)

Table 2 suggests that each of the core cities raises in council tax an amount that represents three to four per cent of the overall total of public expenditure in the city. Put another way, over 95 per cent of public expenditure in each of the Core Cities is funded by resources handed down from Whitehall. The impact of this highly-centralised way of distributing public money has never been studied. But the likely consequences are:

- city leaderships having to spend much time lobbying for formula-based resources;
- bidding competitions and public sector ‘beauty contests’;
- little need to balance off the local costs and benefits of projects such as tramways or other major investments;
- buck-passing between levels of government;
- long delays in making decisions;
- weak local accountability;
- sub-optimal and inefficient allocations of resources;
- much time spent by city leaders and chief executives on trains to/from London.

Moreover, there is good evidence to suggest that most of the Core Cities could support themselves – that is, they could raise sufficient tax resources – from a wider range of taxes – to provide a far wider range of public services than what is currently funded from council tax. Because there are no official figures for the taxes paid and public expenditure received by individual areas, it is not possible to make a precise calculation of the tax/spend balance in each city. But there are good data for the contributions made to the National Non-Domestic Rate pool and the receipts to each authority. Table 3 shows the position for each of the Core Cities in 2004-05.

Table 3 National non-domestic rate, contributions and receipts from national pool, Core Cities

	Contribution	Receipt	net payment
	£m	£m	£m
Birmingham	291	277	+14
Bristol	128	107	+21
Leeds	240	200	+40
Liverpool	114	123	- 9
Manchester	213	118	+95
Newcastle	95	73	+22
Nottingham	100	75	+25
Sheffield	143	143	0

(Source: *Finance & General Statistics 2004-05*, CIPFA, Part 1)

All but one of the Core Cities makes payments into the NNDR pool that are equal to or exceed its receipts. This is not surprising because major cities are, as observed by many of the reports quoted in the earlier sections of this report, key generators of jobs and economic output. The relative economic strength of the Core Cities is also suggested by figures for Gross Value Added (GVA). Table 4 below shows GVA per head for each of the Core Cities compared to the UK average.

Table 4 Gross Value Added per head, 2003

	(£)
Birmingham	17201
Bristol	22946
Leeds	19392
Liverpool	14619
Manchester (G Manchester S)	18523
Newcastle (Tyneside)	14993
Nottingham	21285
Sheffield	14487
United Kingdom	16485

(Source: *NUTS3 Gross Value Added GVA (1999 – 2003) Tables*, London: ONS, Table 3.2)

These figures underline the position suggested by Table 3. The position in Newcastle is, in reality, for Tyneside and almost certainly understates the GVA for the city alone.

Liverpool and Sheffield are only 10 per cent or so below the UK GVA per capita figure, suggesting that their taxpayers would be able to make a larger contribution to local taxation than the existing tiny one.

Table 5 considers what might happen if, as the Local Government Association has advocated, non-domestic rates were to be re-localised. Such a change would radically alter the balance of funding between central and local sources. Indeed, the government's decision to ring-fence schools' funding means that, for all other services, the sum total of an authority's existing council tax yield plus its local contribution to the non-domestic rate pool would be close to (and in some cases exceed) the council's revenue expenditure.

Table 5 Core Cities' revenue expenditure compared to existing local taxes paid (£m), 2004-05

	Expenditure		A-B	Council Non-domestic		A+B
	total (A)	education (B)		tax (A)	rate yield (B)	
Birmingham	1354	825	529	275	290	565
Bristol	412	212	200	129	128	257
Leeds	753	465	288	199	240	439
Liverpool	618	366	252	137	114	251
Manchester	601	316	285	112	213	335
Newcastle	333	169	164	87	95	182
Nottingham	317	182	135	79	100	179
Sheffield	596	339	257	156	143	299

(Source: *Finance & General Statistics 2004-05*, CIPFA, Part 1)

This table shows, for 2004-05, how much each Core City spent on all services, then subtracts education expenditure in the way that, from 2006-07, the government has chosen to ring-fence schools' spending. The residual total (A-B) is the authority's expenditure on all services apart from education. In reality, councils still have a small number of education expenditure responsibilities.

The new revenue expenditure total (ie with education removed) is then compared with the overall local yield of council tax and non-domestic rates. In every case except Liverpool, the total of the two locally-paid taxes exceeds the '2006-07' revenue expenditure total. Even in Liverpool, the two number are balanced. Leeds's total council tax and NNDR contribution was very significantly in excess of its expenditure.

Table 5 thus suggests that if the non-domestic rate were re-localised and then used, with council tax, to fund local services, all the Core Cities could support themselves. Of course, a straightforward reform of this kind, if enacted in all areas, would have major implications for some authorities' local tax bills. It would appear that these bills could fall in all but one Core City. Doubtless, the DCLG would argue that a new form of equalisation would be needed. However, the point remains that the Core Cities would, following the ring-fencing of schools, be able to fund all their remaining local services from council tax and business rates. In terms of Sir Michael Lyons's most recent report, (see below), such a reform would significantly aid flexibility and local incentives.

In summary, the Core Cities have economies sufficiently robust to tolerate substantially greater tax payments than those currently made. They could certainly be given greater access to the taxation already paid by local residents and businesses. In most cases, the relatively high GVA and NDR contribution figures suggest the areas concerned are likely to be making net contributions to the Exchequer. The arguments for greater autonomy in the determination of taxation and spending priorities are powerful. The question remains: what changes could reasonably be made to the local taxation system that would recognise the political independence and economic importance of the Core Cities?

4. Possible local tax reforms

Major revenue sources

The tables above suggest the Core Cities could raise a significantly greater proportion of the taxation to pay for local services – and not just those currently within local government’s sphere of responsibility. A series of unplanned historical decisions has put England’s great cities in a position where they have to negotiate with central government to be given back income from the taxes paid by their own residents and businesses. It is easy to see how power has followed money, draining decision-making away from the Core Cities and into Whitehall.

The Core Cities, in common with the rest of local government in England, face a number of obstacles to the re-localisation of the capacity to set and use taxes. The most obvious difficulty is the apparent unwillingness of the Treasury to allow the control of taxation to pass out of their control. Unless central government takes the simple decision to increase local government’s access to taxation, debates about local financial autonomy are a waste of time. The present debate about the future of local government finance takes place in heavily circumscribed circumstances. Most of those lobbying for reform do so on the assumption that little change is, in reality, likely.

Major British cities can point to examples of similar urban centres in other countries where there is greater freedom to make decisions over taxation and other matters. Places as diverse as Lyon, Hamburg, Boston and Barcelona have access to greater number of local taxes and/or greater yields. Such fiscal autonomy allows these cities a greater capacity to direct their own destinies in ways that are not available to the Core Cities. It is easy to see how such cities have modern and effective metro and/or tram systems by comparison with the limited public transport investments in most British cities. A failure to invest in new infrastructure risks companies being attracted to other cities with modern and fit-for-purpose facilities.

The financial freedom of English cities has become even more limited since the council tax ‘crisis’ of 2003-04, as the government has extended the use and threat of capping in such a way as to achieve, in effect, a re-introduction of universal capping. Authorities have taken the decision that, to avoid capping, it would be better to set council tax rises below a maximum level announced by ministers. This fear of capping has had the effect of restricting both revenue expenditure and also the use of prudential borrowing to fund additional capital spending.

Because of their economic strength and importance to the achievement of a number of government objectives the Core Cities, more than most authorities, are in a position to lobby strongly for access to (a) a wider range of taxes and (b) greater freedom to use their resources. Indeed, there is a risk that unless the Core Cities are given additional fiscal autonomy they will find it difficult to sustain the pace of development across the whole of their areas. Having said that, it is possible that Core Cities would use any new tax freedom to hold down taxation in order to make them attractive places for investment and residence. Greater autonomy would not necessarily mean higher taxes.

Council tax is an established and broadly tolerated local revenue. The Lyons Inquiry's *Interim Report* noted it had a number of 'positive attributes' and discussed council tax in terms that heavily suggested that the final report will recommend its retention. A number of authorities and commentators have proposed adding additional bands and/or regional banding to make the tax 'fairer'. Yet the Lyons Inquiry's calculations suggested that introducing additional bands would, at best, have only a marginal effect on impact in relation to income and thus, it must be assumed, the propensity of the tax to raise resources. It would appear that changes to the number of bands or the introduction of regional banding (which could be relatively disadvantageous to many Core Cities) would have only marginal impacts on the potential yield of the tax.

Most developed democracies have a property tax (usually set by municipalities), though it is very unusual to depend solely on a single local tax. Over-dependence on council tax has undermined its acceptability, as it did domestic rates before it. If the Core Cities are to enjoy the increased fiscal autonomy that would allow them fully to achieve their potential, a major additional revenue source will be required.

By far the simplest most logical and practical way to increase the Core Cities' fiscal autonomy would be to return the national non-domestic rate (NNDR) to local control. Such a change would be simple to achieve because virtually all non-domestic ratepayers are already on a regularly-updated local valuation list. Moreover, there are powerful economic development arguments for re-creating a link between the size of the NDR rate base and an authority's income. If such a link is to be created, it would be necessary not only for the NDR multiplier (poundage) to be set by each city, but also to allow at least a partial move away from full equalisation.

The interim Lyons report stated the inquiry would include 'further consideration of how changes in business rates could improve the ability of, and incentives on, local authorities to support and promote economic development'. The re-localisation of the NDR – in full or in part – would create a direct route to achieve such an economic development goal.

Perhaps the most acceptable to allow authorities to retain the benefits of growth in the NDR base would be to continue full equalisation for authorities with a static or declining tax base, but to allow growth in NDR values to be retained. Such an arrangement would, in reality, be a simplified version of the existing Local Authorities Business Growth

Incentives Scheme. Either the Exchequer could fund the ‘equalisation gap’ or a self-financing ‘damping’ mechanism could be put in place.

There would also have to be special arrangements, particularly in London, to take account of the NDR yield of authorities with very high rateable values. Regional or metropolitan ‘pooling’ arrangements would probably be the most appropriate way of coping with such authorities. Officials at the Department for Communities and Local Government have long been creative in inventing solutions of this kind.

Other, more radical, options could also be considered. A number of proposals have been made, particularly by the Chartered Institute of Public Finance and Accountancy to the pre-Lyons *Balance of Funding* review, to introduce a Local Income Tax – in addition to council tax. According to the interim Lyons report, research suggests the public would like to see a greater ‘ability to pay’ element in local taxation, but that there was also concern at the impact of a possible LIT on, amongst others, ‘working families’.

An LIT would probably be most easily introduced by the government initially attributing to local authorities a number of pence-in-the-£ of the existing national income tax basic rate, equalising for any variations in tax base. Authorities would then be free to move their tax rate away from the starting rate-in-the-£, with local yield changing accordingly. Such variations could be subject to equalisation, either partially or fully. A move to LIT, which would require significant administrative hurdles to be overcome, would probably form part of any move to give the Core Cities and other authorities the possibility of funding a wider range of services than those already provided by local government. In short, LIT would allow a more radical move towards local autonomy. It need not, however, add to the overall tax burden: there would be a compensating cut in central government income tax at the starting-point of any LIT system.

In any solution where one or more additional revenues were collected locally, it would be necessary to determine the scope and scale of equalisation. Some of the Core Cities would be in greater need of equalisation support than others. But the overall issue is whether or not the rapidly-growing cities of the Midlands and the North are to be allowed to capture a part of the additional fiscal yield that will have resulted from their resurgence. To allow them to do so would not only make it possible for them to re-invest in their infrastructure and services, but would also provide a practical incentive to encourage economic growth. At present, there are virtually no incentives for the Core Cities – or other councils – to develop their NDR or council tax bases.

Smaller revenue sources

Beyond the major revenue sources considered above there are a number of smaller revenues that might be considered by the Lyons Inquiry. In the Interim Report, the following possibilities were listed:

- localising existing national taxes such as Vehicle Excise Duty or corporation tax;
- litter, waste and other environmental taxes;
- congestion/road user charges and other transport related charges;
- payroll taxes;
- business activity taxes.

The Lyons *Interim Report* made clear that while some of these sources could provide a substantial yield, others would be small in relation to overall local government revenues. Moreover, in the case of, say, Vehicle Excise Duty, there would be a revenue loss to central government, though this could be dealt with by a £-for-£ reduction in grant to local government.

In fact, other possible smaller revenues could be considered by the Lyons Inquiry, some of which would make it possible for Core Cities to raise significant sums of new revenue. Such additional sources might include:

- An add-on to the NNDR (if not re-localised)
- Tax Increment Finance
- Planning Gain Supplement
- Tourist Taxes
- Off-street parking levy.

Most of the above smaller revenues are relatively straightforward. Tax Increment Finance (TIF) is probably the least known. It was proposed by the Urban Task Force in 1999 and would work by capturing part of the gain generated by rising land values in the immediate vicinity of an infrastructure development. This gain can be taxed in order to pay for new infrastructure or services related to the development. A Planning Gain Supplement, proposed by Kate Barker as part of her review of housing policy (HM Treasury, 2004) would make it possible for authorities to collect a levy from developers in recognition of the costs associated with services and infrastructure related to a development.

An add-on to the NNDR would be possible if the government decided not to proceed with the re-localisation of the non-domestic rate. The Centre for Cities made such a proposal in their recent report (Centre for Cities, 2006) and the idea has also been floated as a way of paying for major rail projects in London. A tourist tax would be a possible

additional local revenue (though its revenue would be limited) while a levy on off-street parking is already available to local government under existing powers.

Smaller revenues of the kind listed above could be introduced permissively. Authorities would not be obliged to use them. It might also be possible to link their use to the creation of funding streams to support infrastructure, particularly in cities. A number of the revenues listed above, notably a tourist tax, an NNDR add-on and TIF would generate a yield only if a city's economy was buoyant. By introducing such new revenues, it would be possible to provide sensible incentives to authorities while simultaneously generating a stream of resources to re-invest in the local infrastructure.

5. The Lyons Inquiry's latest thinking

In May 2006, Sir Michael Lyons's team published its current thinking on the wider remit announced for it by the government towards the end of 2005 (Lyons Inquiry, 2006). The key feature of this second report was 'place shaping' – the idea that councils should have sufficient capacity to deliver a range of social and economic benefits for its people. In order to succeed in this new role, authorities would need to be able to bring a number of other local institutions along with them and be able to demonstrate how they could jointly benefit their residents.

The May report listed three key priorities for reform of the functions of local government, in relation to the forthcoming Local Government White Paper:

- greater clarity about the roles of central and local government;
- greater formal recognition of local government's role in place-shaping and 'convening' across local public services; and
- the need for local government itself to recognise that it must do more to improve its capability to develop its place-shaping and convening role.

Linking these priorities to local government finance, the new report states that local government needs to be appropriately funded for the roles it is expected to take on. This means:

- making sure that the requirements placed on councils by central government are adequately funded, exploring ways in which the expectations placed on local government could be evaluated after the event and corrected in subsequent financial settlements if they turn out to be inadequate, perhaps with a greater element of independent assessment to reduce disagreement;
- providing local government with sufficient financial flexibility to undertake place-shaping effectively including over funding investment and infrastructure

projects. Lyons states the debate about greater local discretion over business rates as relevant to this issue;

- finally, the funding system should be set up so that it provides appropriate incentives for the functions it supports, such as enabling local authorities to share in the financial benefits of housing growth and economic growth.

These new priorities and funding requirements apply powerfully to the Core Cities, particularly in the context of the analysis above. Core Cities are obvious ‘place shapers’. Each has a powerful and long-developed civic identity stretching back to the mid-19th century. People from all over their respective regions look to their own major city as the shaper of local and regional economic progress. This, after all, is how these urban areas originally developed.

Place-shaping, according to Lyons, requires financial flexibility if it is to be undertaken effectively. The importance of local discretion over the business rate is explicitly seen as a vital element in securing such flexibility. For Core Cities, greater access to non-domestic rates would not only allow more regeneration and economic development, it could also provide a powerful incentive for authorities to build up their local tax base.

6. Conclusion

The Core Cities have been recognised as places where greater fiscal devolution would be likely to increase economic success. To quote a major study commissioned by the then Office of the Deputy Prime Minister:

‘The nature of central-local relation matters. Although it is not a straightforward relationship the evidence does suggest that where cities are given more freedom and autonomy they have responded by being more proactive, entrepreneurial and successful. Decentralisation in France has invigorated provincial cities during the past 20 years. The most successful cities in Europe have been German, which is the most decentralised country in Europe. The renaissance of Barcelona in part stems from the move towards regionalisation and the lessening of the grip of the capital city, Madrid.

..... There are constant debates about the impact of financial dependency or autonomy of cities. The balance of evidence from the literature, our survey of local officials and our case studies is that the greater the fiscal independence of cities - the greater their capacity to experiment and be proactive. The UK is one the most centralised systems in this regard. Continental cities on balance have more financial independence from national government and more ways of generating resources locally through income tax, sales taxes and business profits taxes’. (ODPM, 2004)

The difficulty Core Cities have faced is that during the period of their economic resurgence during the 1980s, 1990s and 2000s, there has been no major effort to move fiscal and financial powers away from the centre. If anything, the opposite has occurred, with significant steps towards greater central funding of local authorities, additional

ring-fenced and specific-purpose funding, on-and-off capping and also greater central involvement in demands for the achievement of particular outcomes.

The Lyons Inquiry offers an opportunity for the Core Cities to make the case for financial autonomy that would allow them to re-assert their capacity to deliver government solutions without the need to refer most decisions to Whitehall. All the evidence suggests such solutions would result in better government and improved economic performance. This is an opportunity not only for the Core Cities but also for their regions and the rest of the country, who would benefit from the consequences of decentralisation.

The Core Cities are among the world's best-known and most influential cities. In a range of fields, including business, culture and sport their influence is – like Britain's – greater than GDP or population size might otherwise suggest. The government faces a once-in-a-generation opportunity to allow the cities to build on their own resurgence. Fiscal and financial autonomy would be a key step towards achieving long-term success.

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