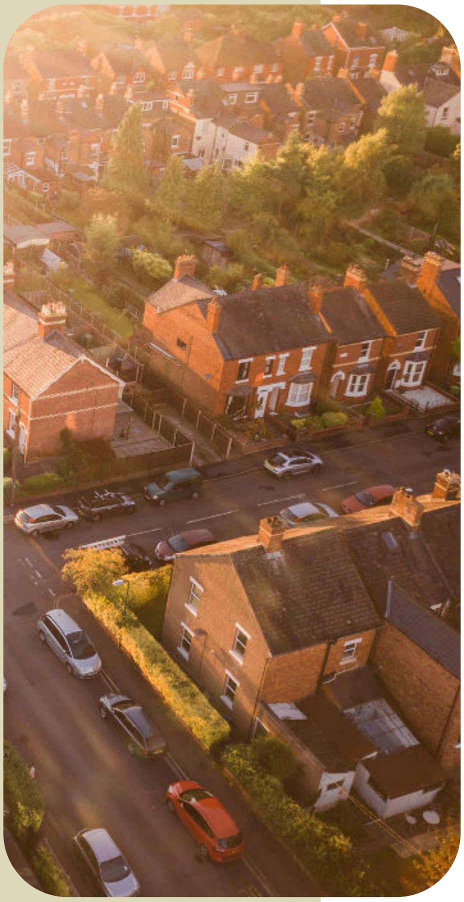
The limitations of local government finance in England: A system wide perspective



LOCAL DEMOCRACY RESEARCH CENTRE

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Foreword

For the last ten years we have been asking council leaders, chief executives, cabinet members for finance and section 151 officers their opinions on how local services are financed in England.

We know from our survey this year that only 14% of senior council figures are confident in the sustainability of council finances. We know that around 8% say pressures on their finances could leave them unable to fulfil their statutory duties – meaning they will be incapable of providing the essential services relied on by local people across the country. We know they are doing everything in their power to make ends meet – raising taxes, cutting services, spending their finite reserves.

Over the last ten years, the evidence that there has been a major sustained failure to properly fund local services in England has become undeniable. The next question is: how could local government finance be different?

This research, the first in a series of reports on international systems of local government finance by experts at the University of Northumbria, takes the next vital step – examining how the local government finance system could be improved. By building our understanding of the different ways local services are funded across the world – especially outside of the English-speaking world – we can identify the most effective ways to ensure local governments work for their citizens.

This report is an essential assessment of how local government is financed in England, the historical context, the peculiarities of the system and the reasons it has come under sustained criticism. Over the next few months we will release reports on Germany, Italy and Japan, each of which will reveal more about the options available for funding local governments – useful not only to readers in England, but to anyone working in or interested in local government around the world.

Jonathan Carr-West
Chief Executive, LGIU

1. Research overview

There has been continual discussion about how the financing of local government works. Particular attention has been devoted to options for fiscal devolution; funding shortages, originating in the UK Government's 'austerity' policy of the early 2010s; and controversies over large-scale borrowing, resulting in a small number of English local authorities experiencing severe financial difficulties. Analyses of these situations typically focus on a single element of the finance system, rather than a wider connected system approach to local government finance. For example, considerations of the local authority take place without consideration of its relationship with central government, or local government autonomy without consideration of equalisation between location. The aim of this research is to counter this situation by placing local government finance in a wider complex system perspective that includes the functions of local authorities; capital finance and its regulation; audit and budgeting practice; funding redistribution and socio-economic variations; and the often-uneven culture of central-local relations.

This system is made up of multiple agents: for example, local government officers, civil servants, politicians, thinktanks, audit authorities, lenders and financiers who all have their own objectives and decision-making frameworks. All of these elements interact with each over time to form a whole that is more than sum of its individual agent objectives. It is this complex system of actors, regulations and institutions that enables and constrains local government finance. Calls for additional funding or tax-raising powers, and more recent unorthodox borrowing practices, often emerge from, and are constrained by, this broader and connected context. However, the relationships between the different elements of the system are often disregarded, resulting in a partial understanding or misrepresentation of the local government finance challenge. This research maintains it is not possible to comprehend local government by focusing on one component, authority, or agent. A holistic approach is necessary.

Many of these individual aspects of the system are characterised by relatively minor procedural reforms that in turn impact and restrict other elements of the system, often disproportionately. It therefore follows that more considerable changes to individual features in that system – such as a new tax-raising power or a changed approach to redistribution – could have considerable knock-on effects elsewhere within the system. Witness the pains in 2013 when 50% Business Rate Retention was introduced in parallel with unreconciled Business Rate revaluations. Understanding local government finance as a system implies that significant changes, such as new taxation powers or a new redistribution formula, would be implemented and potentially restrained within that system, not in isolation. This also implies that the local government finance system consists not only of legal and bureaucratic authority, but also of embedded practices and cultural assumptions that influence how any substantial change is absorbed and managed. Therefore, the contention in this research is that the local government finance discussion, and indeed all of the agents involved in this complex arrangement – all of whom have a stake in resilient local government finance – would benefit from a whole system perspective.

1.1 The research project

In order to reflect upon this situation in England, this project aims to provide a more in-depth understanding of the systems of local government finance in three countries: Germany, Italy and Japan. These countries have been selected for two reasons. First, all feature local authorities with broad responsibilities, a wide range of revenue-raising powers, and an established role within the territorial governance of the state. Elements of practice within those countries are frequently presented as options for change in the English context. Second, these countries are all non-Anglophone. Local government and local government finance systems in Anglophone countries have a common ancestor in English practice and share many historical similarities. These include local revenue consisting primarily of property taxes; a lack of constitutional protection; limited functions; and more restrained legal or financial supervision by central officials.

It is hoped that examining the operation of these alternative systems will provide new contextual information for future proposals to reform the local government finance system in England. Examples of isolated practices that can be seen in each of the case studies have been featured at points in the English debate; for instance, tax powers and shared revenues in Japan (Kimura, 2015; Bessho, 2016; Breach, 2019), and redistribution in Germany (Werner, 2018; Thöne & Bullerjahn, 2020). However, we are not aware of any analysis (in English) of these systems as systems. Without such understanding, it is not easy to comprehend the role and significance of individual elements of these systems, how they interact and, in turn, how they could inform new practices in England.

Previous examinations of international local government finance have typically drawn out features that are exotic by Anglophone standards. That approach provides little sense of how those features operate in the originating national context and financial system, nor how they can be compared to the local government finance system in England. This project is the first known recursive application of such research to the system in England, to inform potential reform. The system focus will provide new understanding for practitioners, policy makers and academics engaged with the financing of local services and those seeking a broader understanding of sub-national governance systems and their relationship with the state and politics. The intention is that the insights in the research can be taken forward by local government practitioners and policy makers to help to articulate how new approaches to local government finances could be implemented effectively in England. In turn, the same insights have relevance for the international research locations, which may not have adopted a system-wide perspective before, and indeed any international location that is struggling to finance the increasing demand on local services.

This project examined the following features in each country:

- the structure of sub-national governance
- local authority functions.
- local authority expenditure
- legal requirements regarding financial management
- sources and quantum of revenue, including central transfer grants
- powers concerning capital finance
- systems of equalising funding between territories.

2. Methodology

In order to examine this situation, a mixed research methodology has been developed and utilised within a cross-disciplinary perspective, blending insights from policy, territorial governance, finance, and real estate studies. Taken together, the empirical and secondary information products lay the foundation for creating a total system perspective of each location that is rarely seen in international literature.

The foundation of the empirical research is a multi-phase interview process. Respondents were identified in each study location (England, Germany, Italy, and Japan) based on their expert knowledge (derived from experience in various tiers of Government, oversight organisations and academia) of the respective local government finance systems. Identifying respondents in each location was not straightforward due to the relative dearth of stakeholders with system-wide knowledge and the generally hidden nature of the sector. In order to overcome this issue, the research made use of knowledge brokers including the Local Government Information Unit, the Japan Local Government Centre in London and the Chartered Institute of Public Finance and Accountancy.

The interview process included:

- initial scoping interviews to provide context for the research and direction towards relevant resources and information on practice within the local government finance system in England;
- subsequent scoping interviews with local government finance experts in the study locations to provide context and direction to relevant information sources;
- the research team then returned to the respondents in the respective study locations with findings, to cross-reference and sense-check the evidence leading to a valuable process of draft refinement and gap analysis;
- panel meetings were then held in each study location to discuss draft findings, to consider the respective system in totality and to understand how system change has been implemented in each country – in order to inform potential change in England;
- the research team then conducted a panel meeting with experts in England to highlight how the international findings could be applied in this context and to highlight opportunities for dissemination and policy impact. This same group was also an invaluable co-production resource throughout the project, helping to design, review and revise the research objectives.

Alongside interaction with the stakeholders in each location, the research examined information from secondary academic literature, government documentation and legislation regarding the legal structures and institutions underlying local government finance systems in Germany, Italy, and Japan. Concurrently, data was sourced from Government ministries and allied organisations to reflect the quantity and proportion of income sources in each location and to provide an opportunity for comparison. Reflective of the fragmented situation in England, obtaining detailed and accurate information on the operation of local government finance systems was complicated, with sources sometimes providing contradictory information. In such cases, the panel members were used as a validating mechanism for stress testing the information sources.

3. Outputs

Reports will be published that provide a system-wide analysis of the local government finance systems in Germany, Japan, and Italy. A final report will be published that compares the system-wide perspective in each location, in order to reflect upon practice in England.

This first report provides a system-wide analysis of the English local government finance system. This is to facilitate and foreground comparisons between it and the German, Italian and Japanese systems. In itself, this is an original contribution to the local government finance debate in England. System-wide analysis in England has hitherto been difficult to obtain because of the cross-disciplinary and fragmented nature of the topic area. The report therefore provides a backdrop to frame and better understand the context of local government finance pressures. It places particular emphasis on the limitations of local government finance, and the constraints this puts on development of themes of local place, choice, and inclusive growth.

The conceptual structure that features in each report was developed via a 2-phase process. First, existing local government finance typologies were examined to determine the key issues and mechanisms that form the local government finance system, for example the OECD Making Decentralisation Work Handbook for Policy Makers (2019). This was then updated and validated with the respective panel of experts to form the interrogative structure of the reports.

4. Political and institutional context

This research takes place in the context of long-standing practitioner discontent with funding and finance policy, from the English local government sector itself. The main sources of this discontent are:

- Severe reductions in central transfer grants for English local government since 2010. Analysis from the Institute for Government states that central government grants, including retained Business Rates, were cut by 37% between 2009/10 and 2019/20 (Atkins & Hoddinott, 2020). Local governments have been unable to replace these funding cuts with local income sources, with the overall spending power of local governments, if funds raised from council tax are removed, reduced by 50% between 2010/11 and 2020/21 (NAO, 2021). This has mainly been implemented by reducing the Revenue Support Grant from £15 billion in 2013-14 to some £2 billion in recent years. The Local Government Association (2022) now indicates that local authorities have a collective £2.4 billion shortfall in 2022, with this projected to increase to £3.4 billion in 2023-24 and £4.5 billion in 2024-24 (LGA, 2022). In parallel, a longer-term shared understanding that central government should pay for local authorities to undertake statutory duties required by Parliament has disappeared.

- Successive rounds of competitive funding and short-term funding settlements that leave little room for medium to long-term planning. Considerable sums of money are distributed via competitive bid processes, which create a bureaucratic overhead (in terms of cost and time) for local authorities with no guarantee of success.

- Marginal control over local revenue. Local authorities have little scope in practice to increase revenue from the two nominally local property taxes, Council Tax and Business Rates. A number of other local revenues are available, but the levels of income are peripheral in most locations. (Examples include transport levies, Community Infrastructure Levy, and increased Council Tax on empty and second homes). The Government has shown little inclination to consider new forms of local taxation.

- An indefinite pause for the 'Fair Funding Review', in effect, a review of the needs and resource assessment underlying part of the central transfer grant system. This has implications for the relative funding levels for local authorities in more and less deprived areas of England.

5. England: Local Government finance structures

In 1974, a symmetrical two-tier system of local government was created across all of England. All areas had both a county council and a district council. The intention was for counties to be responsible for large-scale public services (such as education, social care, or transport), whilst district councils hold responsibility for matters such as housing, environment, or waste. The division of functions was slightly different in six metropolitan counties (established in England's largest conurbations) and Greater London. Table 1 below shows the standard division of functions between the two tiers, which has changed only marginally since 1974.

Table 1: Division of functions in two-tier system

Function	Tier
Arts and recreation	County / District
Births, deaths and marriages registration	County
Building regulations	District
Burials and cremations	District
Children's services	County
Coastal protection	District
Community safety	District
Concessionary travel	County
Consumer protection	County
Council tax and business rates	District
Economic development	County / District
Education, including special educational needs, adult education, pre-school	County
Elections and electoral registration	District
Emergency planning	County
Environmental health	District
Highways (not trunk roads), street lighting and traffic management	County
Housing	District
Libraries	County
Licensing	District
Markets and fairs	District
Minerals and waste planning	County
Museums and galleries	County / District
Parking	County / District

Function	Tier
Passenger transport (buses) and transport planning	County
Public conveniences	District
Public health	County
Social services, including care for the elderly and community care	County
Sports centres, parks, playing fields	District
Street cleaning	District
Tourism	County / District
Trading standards	County
Waste collection and recycling	District
Waste disposal	County

Source: Sandford (2022) Local Government in England: Structures

The Local Government Act 1972, which introduced the standardised two-tier system, also restated the functions of local authorities in general terms. Local authorities in England exercise functions assigned to them by Parliament. Many of those functions are augmented by detailed statutory duties in numerous different Acts of Parliament.

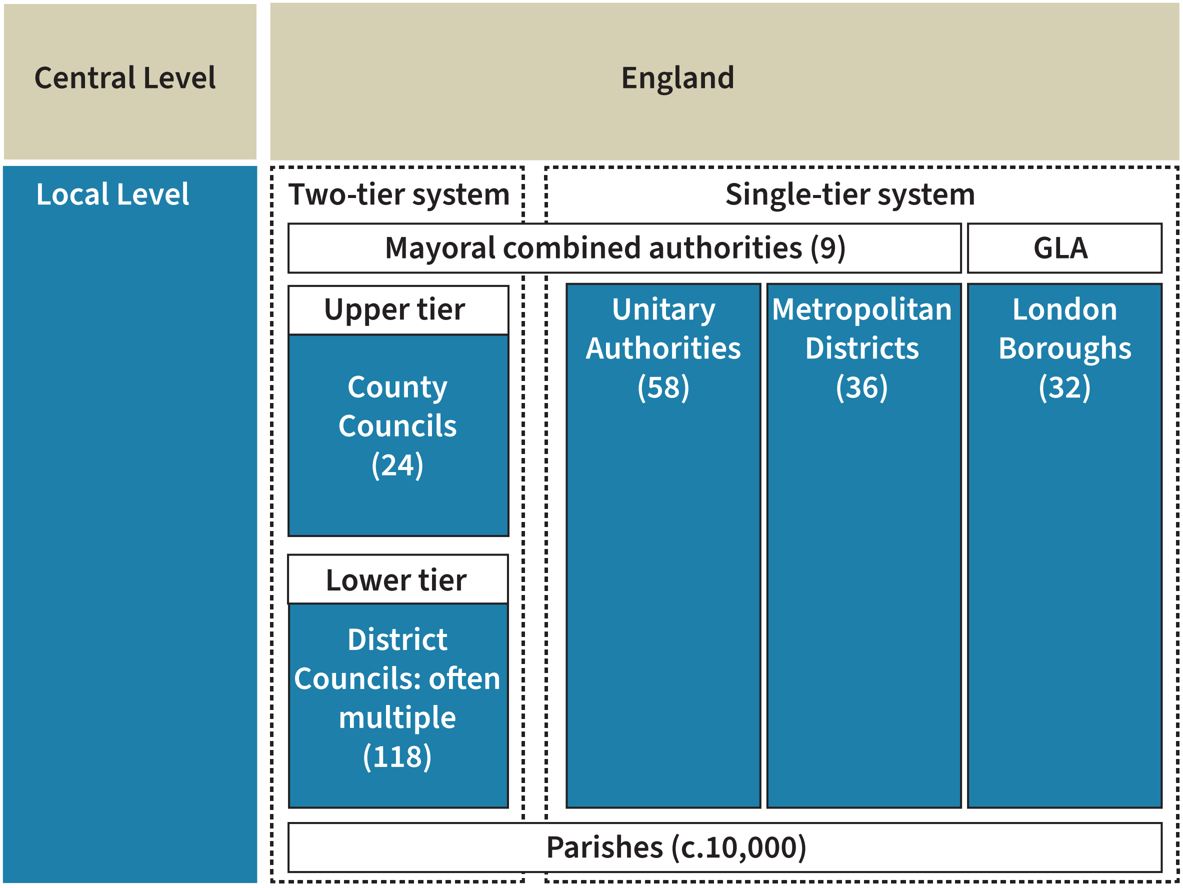
Reforms to the local government structure introduced in 1972 have largely been territorial in character. The metropolitan county councils have been abolished and their functions passed to district councils in their areas. In other cases, district councils in large cities have obtained county-level powers; in others, councils have been merged into single units. Most of the changes have been symptomatic of a reflex preference for unitary local government at central level.

The Local Government Association is a representative membership body covering almost all local authorities in England. However, England has no formal standing intergovernmental structures through which negotiation can take place. Consultation on policy matters is ad hoc and takes place at central government discretion. Likewise, the UK has no written constitution and there is no concept of constitutional protection or 'constitutional statutes' that serve to protect local government's status or interests.

In 2023, a two-tier local government system – county and district – remains in place across much of England. Across these areas, there are 24 county councils (upper tier) and 181 district councils (lower tier); each county contains several districts. Responsibility for services is split between the two tiers in these areas. In other areas, a single 'unitary authority' takes on the responsibilities of both tiers. These come in slightly different forms: 58 unitary authorities, 36 metropolitan districts and 32 London boroughs[1]. Figure 1 describes this situation in England.

1 There are two additional authorities: the City of London and the Isles of Scilly, which have unique governance structures for historical and geographical reasons. Their financial arrangements are unique and cannot be easily compared to other local authorities.

Figure 1: Sub-national governance structure in England



There is a further tier of around 10,000 parish and town councils in some parts of England. These are the smallest tier of governance, covering 91% of the geography of England but only around 36% of the population. They have minimal funding and powers. They do not correspond with, and should not be compared to, municipality governments in other states that cover small geographical areas or populations. Nine mayoral combined authorities and the Greater London Authority exercise certain strategic functions. These cover the same areas as the 1974 metropolitan counties, in addition to a small number of additional areas.

Local authority councillors are elected every four years. Some are elected on a rolling basis, with one-third of councillors elected each year and a ‘fallow’ fourth year. Others are elected at four-yearly elections. The public has no right to recall councillors or mayors during their terms of office. Councillors have no power to express no confidence in a mayor or a fellow councillor, or to expel them for misdemeanours. Similarly, though the central government has substantial powers to intervene in local authorities, it cannot dissolve councils and order early elections. Importantly for the local government finance situation, it also has no legal obligation to assist councils that encounter financial difficulties.

6. Responsibilities (shared and exclusive)

Some local government services are statutory: Parliament has created a legal duty for councils to provide them. Many of these are subject to statutory requirements or guidance, or provisions derived from case law, and they will often be subject to national inspection or monitoring regimes. They can be distinguished from mandatory services: these are services which local authorities only have a general duty to provide, but to avoid legal challenges they must be provided to a certain standard in practice. Discretionary services are services that local authorities may choose to provide: these include leisure centres, street lighting, recreation grounds, or public toilets. The distinction between statutory, mandatory, and discretionary services does not equate to the distinction found in some states between local functions and "agency functions" carried out by local authorities on behalf of the government.[2]

Some responsibilities are known as 'concurrent' and can be undertaken by either tier of government. Additionally, Section 101 of the Local Government Act 1972 allows counties and districts to delegate functions to one another.

These different types of function are not reflected in finance arrangements for local authorities. There are no distinct funding arrangements for statutory and mandatory functions and for discretionary functions. Where ring-fenced funding is provided, this is largely for historical reasons, for instance:

- Single-purpose fire and rescue authorities and Police and Crime Commissioners receive direct funding from central government;
- Local authorities must pass school education funding directly to schools;
- Local authorities administer housing benefits in accordance with national entitlements;
- Public health funding, which was transferred to local authorities in 2013, is ring-fenced;
- Councils that provide council housing must ring-fence the proceeds of asset sales, rental income, and spending on maintenance in a separate 'housing revenue account';
- The National Health Service operates entirely independently of local authorities. A small amount of funding is provided to the NHS for joint use with local authority partners.
- Ring-fencing of funding for the remaining local government functions is rare. By 2013-14, 91% of other sources of central government funding to local authorities was not ring-fenced. The UK Government sometimes provides grant programmes intended for use on specific purposes but without insisting on authorities using it for that purpose. These have been referred to as 'visible lines of funding'.

Local authorities have only limited powers to create 'laws' at the local level. They have

2 See David Wilson and Chris Game, Local Government in the United Kingdom, 5th edition, 2011

statutory powers to pass byelaws in a range of matters. These typically concern local issues such as regulation of markets, children's employment, or tattoo parlours. Local authorities also have the power to promote bills in Parliament to provide them with additional regulatory powers over similar matters.

The distinction between statutory, mandatory, and discretionary functions has implications for local authorities' reaction to reductions in transfer grants. Research from the National Audit Office, showed larger reductions in funding for discretionary services as transfer grants fell (NAO, 2021). This is a rational response, as local authorities that failed to discharge statutory duties could be open to legal challenge.

7. The regulatory regime

Local authorities must produce an annual budget, by specified dates. This must include details of their forecast income for the following financial year, including any funds taken from or transferred into their reserves. It must also specify the amount to be raised from Council Tax (domestic property taxation). This is a statutory requirement: if the process is not followed, the council is legally unable to collect Council Tax, which would in practice paralyse its finances. There is no central supervision of the budget process, nor does central government have any sanctioning powers in the event that a budget is not passed.

There is no requirement for the budget to be inspected or signed off by the Government or any independent body. The Chief Finance Officer must report to the Council on the robustness of estimates made and the state of financial reserves assumed in budget calculations. If there is or is likely to be unlawful expenditure or an unbalanced budget, the Chief Finance Officer is under a statutory obligation to issue a report. The Council then is required to meet within 21 days to discuss and rectify.

Four statutory codes of practice regulate local authority financial management. These cover:

- Treasury management;
- Investment guidance (how the council makes decisions about which financial institutions and assets it invests or deposits funds with);
- Minimum revenue provision (the amount to be set aside annually to repay borrowing);
- Borrowing (the Prudential Code).

These codes have the status of statutory guidance. Local authorities must publish a strategy document for each, which must “have regard” to the guidance. This approach permits them to deviate from the statutory code providing that they explain why they are doing so. There is also no regulatory body tasked with ensuring that local authorities follow the codes, nor do statutory sanctions exist for local authorities or officials that fail to do so.

Local authorities must undergo annual external audits. These are collectively commissioned by local authorities from private sector audit firms. They must include an opinion on the council’s arrangements for securing economy, efficiency, and effectiveness in resource use. The auditors have the right to investigate individual items of spending, to declare spending unlawful, and to apply to a court for a declaration if an item in the accounts is unlawful or to prevent unlawful spending. These legal rights are used very rarely.

Section 3 of the Accounts and Audit Regulations 2015 requires the council to have a sound system of internal control to ensure that financial and operational management is effective. Controls are documented in a council’s Financial Regulations. Every council is legally required to publish annual financial statements that follow a standardised format set by CIPFA’s Code of Governance and Audit.

The flexibility available in financial management, and the lack of any monitoring authority, has enabled some English local authorities to pursue unorthodox practices. These have risen in profile following financial pressures emanating from reductions in transfer grants since 2010 (see below). For instance, some have transferred sums from their capital to their revenue accounts. This must normally only be done for specific purposes and in line with a published strategy, but some local authorities have not followed that requirement. This practice has been discovered through post-hoc Government intervention in authorities that have suffered financial or service failures: that is, after the event. In contrast to the international locations in this report series, the English local government finance system does not have a systematic or proactive monitoring regime. Rather, local governments are largely required to self-report their practice within a system of guidance.

8. Capital finance

The English system requires local authorities to clearly distinguish between revenue and capital spending. Capital spending is "spending to purchase or improve physical assets that may depreciate in value over time, such as property or infrastructure (land, buildings, rail, road, utilities)" (Muldoon-Smith & Sandford, 2021). Capital funds cannot be used to fill gaps in revenue spending: they must be kept separate. This also applies to 'capital receipts' – funds obtained by selling properties or assets. However, revenue funding can be transferred to capital funds. Local authorities may borrow only for capital investments, not revenue spending.

In 2019-20, local authorities spent £18.7 billion on capital projects (Muldoon-Smith & Sandford, 2021). Around half of all capital spending was on housing or highways and transport services. Most of the capital spending (80%) was spent on buildings, land and infrastructure for the purpose of constructing new assets or renovating existing ones.

Capital spending can be funded in two ways: funding it upfront or financing it over time using borrowing. Upfront funding can come from various sources, such as government grants, the sale of capital assets and revenue income. Borrowing can be sourced internally from areas such as temporary surplus cash holdings or externally from the Public Works Loan Board, commercial banks, or other local authorities. Local authorities can also issue bonds, alone or via the Municipal Bonds Agency.

It is very rare for local authorities to invest in joint projects with private or other public sector partners. Infrastructure projects that are constituted as a partnership with central government (and which therefore have joint funding arrangements) are almost unknown.[3] There is no provision in England for allowances to be made in grant funding for the costs of repaying infrastructure borrowing (unlike in Japan, for instance).

According to National Statistics, in 2021-22, capital grants were the largest financing source for capital expenditure at £10.2 billion, making up 38.4% of total resources used to finance capital expenditure. Prudential borrowing accounted for £9 billion (33.9%), followed by revenue resources at £4.9 billion (18.7%) and capital receipts at £2.3 billion (8.9%) (DLUHC, 2022). Some 75% of local authority borrowing comes from the Public Works Loan Board (PWLB), which typically is able to offer interest rates close to sovereign debt levels. Local borrowing is largely self-regulated within a system of underlying legislation complemented by the Prudential Code. This allows local authorities to borrow funds within borrowing limits that they set themselves. The Government does not place a cap on individual or total borrowing levels and does not need to approve borrowing in advance. There is no limit on local authority borrowing related to the local authority's income or its income from local sources (as you would commonly see in private or commercial financing). In the wake of a small number of local authorities experiencing severe financial difficulties in the early 2020s, the Government is introducing legal powers to cap borrowing levels and to direct local authorities to dispose of specific assets under certain circumstances.

3 The Crossrail project in London is a very large and high-profile exception to this rule.

9. Sources of revenue

The UK Government is responsible for local government finance policy in England. The central government determines allocations of central grants and the transfer of Business Rates back to local authorities. An annual funding round known as the 'local government finance settlement' is determined before the start of the UK financial year in April. These primary funds are supplemented by a smaller group of conditional grants.

In general, councils have access to four main revenue sources: Council Tax, the settlement funding assessment (includes locally retained Business Rates and the Revenue Support Grant), other central government grants and incentives and sales, fees, and charges. As noted above, these funding sources are not ring-fenced: their revenue forms one single spending fund. The sources of local government spending power can be seen below in order of their overall contribution in the 2019-20 financial year.

Council Tax is a tax on domestic property set by local authorities, which retain its revenue. Annual increases are subject to central caps, which can only be overruled through a local referendum. However, only one referendum has been held to date. In 2020-21 council tax accounted for 19% of total local authority income (DLUHC, 2022). The Government has instituted minor extensions to the council tax system since 2010, principally to permit higher charges on second homes and empty properties.

Business rates are a tax on non-domestic property. In 2020-21, business rates accounted for 10% of local authority income (DLUHC, 2022). Since 2013-14, under the Business Rate Retention Scheme (BRRS), local authorities have been able to retain 50% of Business Rate income. Local authorities have no control over the valuation of properties for Business Rates purposes (the rateable value is set by the National Valuation Office Agency) and cannot alter the national tax rate in the form of the national multiplier.[4] Mandatory reliefs are set by the UK Government, while billing authorities can grant additional discretionary relief. A small number of areas (Greater Manchester, Liverpool City Region, West Midlands, West of England, and Cornwall) have piloted the retention of 100% of business rates growth, whilst also foregoing some grant revenue.

Transfer grants accounted for 48% of local authority income in 2020-21 (DLUHC, 2022). In addition, local authority reserves also play a significant role in the system and are often used to make up the shortfall between income and expenditure to balance budgets.

Sales, fees and charges, and **trading and investments**. Fees and charges are largely set by central government at levels that reflect the cost of providing the service for which they are charged. Since 2011, English local authorities have also had broader powers to operate discretionary services on a commercial basis. Initiatives include providing training services, establishing trading companies, providing loans to third parties at commercial rates and undertaking joint ventures with private developers. In a related development, some have borrowed substantial sums of money to invest in commercial property, which is then rented out, and the profits invested in local services. In 2020-21, income from sales, fees and charges totalled £11.1 billion (DLUHC, 2022). Between 2010 and 2018, the National Audit Office found that local government investment in land and buildings increased four times to over £3.5 billion.

4 Some councils can establish a supplementary multiplier (a business rate supplement), which is subject to a confirmatory referendum of rate-paying businesses. Only one supplement has ever been established. Authorities may also establish business improvement districts, at the demand of local businesses, which can charge a supplementary multiplier in a defined locality, either on all businesses or businesses in a specific sector.

Forms of **Land Value Capture** are also used. The most common form is “Section 106 agreements” between developers and local authorities, where developers provide benefits (normally in kind, such as roads or other infrastructure) as part of planning permission requirements. The cash value of section 106 agreements is not regularly recorded but was estimated at £5 billion per year in 2016/17 (MHCLG, 2017). Local authorities can establish a **Community Infrastructure Levy** (CIL) on new commercial floor space. CIL generated £375 million in England in 2021/22 (at the time of writing there is a consultation to create a holistic Infrastructure levy that will subsume both Section 106 and CIL). These funds must be spent on ‘infrastructure’ and cannot be repurposed to supplement public service spending. Other small-scale forms of land value uplift are used, such as Tax Increment Finance districts (currently known as Accelerated Development Zones) to repay the borrowed cost of development property value uplift (for example in Newcastle upon-Tyne). Local authorities also have the power to introduce **road pricing schemes** and a **levy on workplace parking**. A number of local authorities introduced road pricing in the early 2020s, normally to improve air quality (for instance, ‘Clean Air Zones’ or ‘Zero Emissions Zones’).

These smaller charges are ring-fenced. Revenue from the transport-related charges is ring-fenced to transport spending. CIL revenue must be spent on “infrastructure”, which is broadly defined but covers capital expenditure, not public service spending. “Section 106” monies are paid in respect of the sites of large planning projects, and when they consist of cash payments the funds should not be spent on services.

English local authorities have little control over the tax rates of their major sources of local revenue. This reduces the incentive for them to take action that would increase the tax revenue from those sources: there are few options available to them. Levies such as road pricing or CIL generate smaller amounts of revenue and cannot substitute for property taxes or for large reductions in transfer grant funding.

10. Degree of own budgeting and accounting

In 2019-20, local authorities spent £64.4 billion of revenue funding in support of public services. Spending was dominated by statutory services, with adult and children's social care accounting for 50% of revenue expenditure. Table 2 describes the various local government income sources in comparative and percentage format. While the table indicates that grant and local income contribute broadly similar amounts, local authorities have very little control over the generation, alteration, and use of the local income. Nor is there a clear relationship between central grants and local needs.

Table 2: Summary of local authority income 2020-21

	2020-21 (£ million)	% of total income
Grants for General Funding Purposes		
Revenue Support Grant	1,613	1%
Grants for Restricted Purposes		
Police Grant	7,776	4%
Specific and special grants inside Aggregate External Finance (AEF)	49,827	28%
Local Services Support Grant (LSSG)	21	0%
Grants outside AEF	16,489	9%
Housing Revenue Account Government Grants and Assistance	230	0%
Grants towards capital expenditure	9,017	5%
Total grant income	83,929	48%
Locally Funded Income		
Council tax	33,141	19%
Retained Income from Rate Retention Scheme	16,856	10%
External interest receipts	1,483	1%
Local funded income for restricted purposes		
Capital receipts	2,049	1%
Sales, fees, and charges	11,184	6%
Council rents	7,229	4%
Total locally funded income	71,942	41%
Other income and adjustments	20,766	12%
Total income	176,638	100%

Source: Local Government Financial Statistics England 2022

This is because the English system has no shared framework within which local and central government can negotiate new responsibilities and assess the funding required to deliver them. There is no provision in statute for how the amounts, and distribution, of transfer grants should be calculated. This means that there are no legal or formal means for local authorities to challenge the amount of transfer grant funding they receive, as it is given entirely at the discretion of the Government and largely without formal parameters to inform any given transfer. This system also lacks any incentive or mechanism for local and central government to work in beneficial partnership to tackle the dynamic issues impacting local areas.

This lack of control over funding has been accompanied, since 2010, by severe reductions in transfer grants – principally the general-purpose Revenue Support Grant, which has fallen from £15 billion in 2013-14 to some £2 billion in 2022-23. Analysis from the Institute for Government states central government grants were cut by 37% between 2009/10 and 2019/20. These funding cuts have been sufficiently large that local governments have been unable to replace them with local income sources, and the overall spending power of local government has therefore been reduced by 50% between 2010/11 and 2020/21.

Levels of funding of local government in England have no legal or institutional link to local authority functions. Historically, an informal understanding existed that the UK Parliament should provide local authorities with the funding required to undertake responsibilities that Parliament itself had imposed on local authorities. However, this understanding has withered since the early 2010s when liability and need has become uncoupled from financial provision. In other countries, the concept of "unfunded mandates" – local authorities being required to undertake tasks that they lack the funding to do effectively – forms a significant part of analysis of central-local relations. It is almost entirely absent from the debate in England, to such an extent that it can be contended that amounts of central government grant funding have little or no connection with the tasks for which they are provided.

The ensuing financial pressure has incentivised local authorities to seek new sources of revenue. Two principal sources have been pursued in recent years. One is competitive funding, in the form of central government funds for short-term projects. Funding available through this source has totalled several billion pounds per year in recent years. Another is the use of borrowing and capital spending to generate commercial revenue.

11. Territorial equalisation methodology

Historically, English local authority grant funding was calculated via a complex and exhaustive process of needs and resource assessment. This operated between 1959 and 2013 and used various methodologies. In each case, multiple indicators relating to the core functions of local authorities (for instance, housing and homelessness; environmental services; waste; planning and regulatory services adult social care; children and young people's services; public health; highways maintenance) were assigned a weighting, leading to an allocation of funding in respect of each service area. Local authorities' capacity to collect Council Tax was also taken into account, as was population.

This needs assessment varied in approach over time and was given varying names. For instance, between 2007 and 2013, it was known as the "Relative Needs Formula", and from 1990 to 2007 as the "Standard Spending Assessment". The needs assessment was re-run each year, and allocations of the Revenue Support Grant were based on the outcomes.

Since 2012-13, no needs assessment has been operated. This was a deliberate choice: the intention was for local authority revenues to be driven more strongly by the retention of growth in Business Rates revenue – thus incentivising the growth of local businesses and related economies within local authority boundaries. Regular needs assessments could have led to changes in grant allocations that cancelled out some or all of the effect of changes in Business Rates revenues. Business Rate revenue is still redistributed between local authorities, but this is based on the 2012-13 needs assessment, which has in effect been frozen. Business Rate Retention was intended to be subject to regular 'resets', where the 'frozen' needs assessment from 2012-13 is updated. However, the first reset is not now expected to take place before 2026.

As noted above, since 2013, the Revenue Support Grant has been reduced substantially. This means that the residual effects of the needs assessment have less and less effect on total local authority budgets over time. A number of additional grants have been introduced since then: whilst most of these are not ringfenced, they have often been distributed according to specific criteria that relate to only one element of needs. For instance, a Rural Services Delivery Grant of £85 million has been distributed since 2016-17 to local authorities according to measures of sparsity.

The ring-fenced grants described above, for education, police, fire, and housing benefit, are provided for in statute. The Government can decide to ring-fence additional grants without the need for further legislation.

There is, therefore, no statutory requirement for any territorial equalisation to be applied to funding for English local government. Equalisation policy takes place entirely at the discretion of the UK Government - local authorities themselves have input via consultation, but no statutory role.

12. Conclusion

In recent years, the financial sustainability of local government in England has been subject to ongoing scrutiny. A growing number of councils have declared bankruptcy, attributed mainly to spending cuts sustained by local governments in the past decade. Centralised control over local economic policy has become synonymous with England's current approach to local government finance. Despite some powers being transferred to localities via a series of devolution deals, the 'Whitehall knows best' model continues to dominate the English system. In the domain of local government finance, the current system has recently been described as a "bidding and begging bowl culture" by Conservative Mayor Andy Street. That is, central government continues to control the purse strings of local authorities, which have little tax raising revenues of their own. As a result, local authorities are forced to depend on funding from central government to provide public services due to their inability to finance these services independently.

This dependence casts doubt on the rhetoric in recent years in favour of autonomy for local government, indicating that while local authorities have more liability for funding various demands, they are operating in a system that does not support the financing of these requirements in terms of quantum nor certainty in the medium to long term. In addition, while central government has moved away from needs based funding in favour of local autonomy, in comparison to other countries it has not put in place a system to systematically support and monitor local authorities' activities. In short, local government is largely untethered within a system of apparent autonomy where it does not have the power to exert its own intentions. Compared with pre-2013, it can even be contended it has less power and room to innovate as the burden of local needs has increased.

The following observations can be made about the inter-relationships between the different aspects of the English local government finance system:

- The reductions in transfer grants since 2010 have incentivised increases in local tax revenues to only a limited degree. This is because English local authorities lack control over the core levers of the property-related Council Tax and Business Rates system. In addition, the buoyancy of property markets across locations is not uniform, with some locations far more lucrative and responsive to policy initiatives than others.

- The struggle for funding resulting from reductions in transfer grants has incentivised English local authorities to seek additional revenues from the capital finance system. In international terms, this system is relatively unregulated. Some English authorities have been able to generate considerable commercial revenues and bolster their finances. The absence of a general-purpose financial regulator for local government also catalysed this practice.

- There is recognition that locations have distinctive characteristics and development pathways that require place-based approaches. The lack of shared taxes present in other countries – for instance, income tax, corporation tax or capital gains tax – disincentivises local authorities from investing in their places. The advantages of connecting tax revenues with policy in this way were noted by the 2009 Calman Commission, which laid the ground for the current fiscal devolution structures in Scotland.

- Reductions in transfer grants, and hence in budgets, have incentivised local authorities to protect statutory services – as they are open to legal challenge if they do not do so. Many discretionary services have been reduced substantially in coverage as a result.

- The absence of constitutional protection and the range of central government discretion over funding disincentivises local authorities from long-term planning. Grant funding is normally provided on an annual basis, and no longer-term structure exists. The absence of agreed data on need for local government services, or a framework in which to address that need, means that conversations about 'unfunded mandates' cannot even begin.

- The regulatory system for English local government is largely law-based. This disincentivises regular, formal central-local relations. This has consequences that appear contradictory at first glance. For instance, local authorities in financial difficulties in England cannot expect direct central government support; but central government also shies away from financial oversight. This calls to mind Bulpitt's 'central autonomy thesis' (1983), that central government's core aim is to avoid responsibility for the actions of lower tiers of government, not to control those actions.

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