Not Even Wrong

local government finance in England

January 2015

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Not Even Wrong!

At the end of 2014, two reports were published that focussed on differing aspects of the vexed question of local government finance in England. The first report, by the National Audit Office (NAO)[1], damned with the faintest of admonishments the apparently insouciant approach of the Department for Communities and Local Government (DCLG) towards the financial sustainability of English local government. The NAO got it wrong. Their critique was too muted. They counterposed the prospect of Councils facing the "risk of financial failure" with the "service pressures" that these same Councils faced. Their suggestion was that DCLG should "monitor the impact of funding reductions on services in a more coordinated way" - ouch!

Here are two reasons why the NAO got their commentary wrong. First, they did not pay attention to the real possibilities of service failures. If Councils' fiscal and legal obligations over-ride their service responsibilities then Councils don't just face increased "service pressures". There is a very real prospect of systemic service failures. Of course some service failures are worse than others - in terms of the risks they create for service users or for the public at large. And it is the prospect of these comparative risks that are currently occupying the attention of Councils across the country as they desperately try to balance their fiscal, legal and service responsibilities in ways that are fair and ethical locally. A library service fails and a large number of people don't get books (or free wifi); a child protection service fails and the outcomes are so much worse for an admittedly smaller number of young children. Charging the DCLG with the criticism of not doing enough monitoring seems somewhat mild in the circumstances.

Second, they pulled their punches in respect of what was the precise nature of the DCLG's stewardship of local government. Surely if they are allocating £ billions in public money for local services then the Department has to have commensurate regard to the consequences of allocating resources one way rather than other ways. This simply reflects the requirement of "public reason"[2]. It doesn't mean that political choices are subordinate to public ethics but that the reason of these choices needs to be explained publicly. At its kindest, the NAO report suggests that DCLG are under staffed and under powered with people who are unaware of the consequences of the impact of their decisions; and that what's needed is for them to have more discussions across Whitehall and do better monitoring. This is a subtle understatement.

Arguing local government's case against spending reductions is not to deny the importance of reducing the deficit. It is entirely coherent to argue against the depth of planned cuts to local government while accepting the need for large public spending reductions. The sheer scale of the public deficit, following the Great Recession, and the ever rising tide of government debt, demands tough actions. But what is not sensible is for a sector where one-half of its service spend is on adult and children's social care to receive the highest level of public spending cuts. That was evidently a bad judgment in 2010. It looks a worse judgment with every passing quarter. So well done to the NAO for reporting on the frailties of English local government. A pity they chose understatement to get their point accepted.

The second report published at the end of 2014, "Public Money, Local Choice"[3], was the interim report of the CIPFA sponsored independent commission into local government finance. It was set up because "the local government finance system is in need of urgent reform". With such a stellar array of economists and accountants on the commission what could they get wrong? Unfortunately their interim report is "not even wrong".

That's because "Public Money, Local Choice" starts with Councils' revenues and searches for solutions to the obvious iniquities of local government finance system. This is completely the wrong place to start. It avoids any focus on what local government is for - on the character of its core service functions. It generates a number of interesting solutions; and at one level this bias for solution is commendable. Rather unfortunately though, most of the solutions canvassed in the report are to problems other than local government finance. The report does suggest important solutions to problems of low economic growth in local areas. And it rightly argues for a boost in the current pattern of low investment in social housing. The need for Councils to be able to orchestrate the building of large numbers of social and affordable homes is palpable in many parts of the country. And this task presents real challenges to Councils' borrowing and investment plans. But while these are important problems, they are not at the centre of the most urgent challenges facing local government finance. The report attempts to weave a narrative about self sufficient local government with less constrained tax raising and borrowing powers. But it does not focus on the pressing and urgent issues. For as the NAO report stated, "the government will reduce its funding to local authorities by 37 per cent in real terms between 2010-11 and 2015-16." Many Councils are now focussed on a further 35 per cent reduction in their spend to 2018-19.

Instead the report addresses contemporary public policy suggestions and simply assumes that they are best solved through the prism of making the English local government finance more self sufficient. An interesting two-tier equalisation scheme is proposed without any regard to what the revenues raised are supposed to support! Few reasons and very little rhyme is given for the over-arching suggestion of "self sufficiency" - even though the report accepts that some degree of resource equalisation (within regions and nationally) is required. The report simply contains "solutions" to the problems of local government finance without regard to its core service functions. It would have been better if the report argued for a change in these core service functions to link them more coherently to the finance system. Instead, self sufficiency is vaunted as a public good in itself without any critical examination or even proper description of what is meant or intended.

In an attempt to influence the final draft of what could become a ground breaking report for the future of local government, six suggestions are set out below for the commission to consider.

First, a case for the redistribution of resources across England should be made. The wholesale rejection, by the current government, of area based redistribution in English local government based on a geographical assessment of needs and resources (standardised spending and resource equalisation) should not be accepted as part of an irreversible trend. The decision was made arbitrarily without the benefit of any prior discussion across the local government sector. It was a major departure from an established consensus stretching back to the late 1920s. Indeed, the Thatcher government did not seek to alter resource equalisation nor dispense with locality based needs assessment.

The case for resource equalisation and locality needs assessment remains powerful in 2015, and ought not be completely discounted because of decisions made in 2010. How is it sensible to argue for progressive forms of taxation on people and homes but to argue for regressive approaches at a geographical level? Moreover, these issues about the fair allocation of public resources should not become entangled in slippery assertions about "localism and devolution". In a country as densely populated and as geographically varied as England, local authority resourcing needs to balance central and local tensions.

A decade ago the economists Timothy Besley and Stephen Coate suggested that the competing arguments for centralisation or decentralisation depended upon the interplay of two factors. First, whether there are marked differences or similarities between localities; and second, whether there are strong "spillover" effects in respect of the local public good in question[4]. A spillover effect exists if, for example, a locality decides to invest in a facility that is then used by people from neighbouring localities. Basically, they argue that if local public goods are to be organised from the centre, it requires a style of governance that balances interests across regions or localities. Centralised systems tend to produce 'one size fits all' approaches that are unable to reflect the variety of all local needs.

Decentralised systems by contrast are more susceptible to 'free rider' problems - which occur if one locality provides a public good or service that can be used or consumed, at no or lower cost, by people in a neighbouring locality. According to Besley & Coate, when it comes to public goods and services, the case for decentralised decision-making is strong when localities are markedly different and when spillover effects are small. By contrast, they argue that the case for centralised decision-making is strong when localities are markedly similar and when spillover effects are large.

This points to the need for very careful handling of fiscal devolution within England. Dealing with fiscal devolution to the 10 million people across Scotland, Wales and Northern Ireland is proving difficult. Doing it for the 54 million people across England is not going to be any easier. That's because England's localities are markedly different from each other. And yet the "spillover" and "leakage" effects between them are quite large. How similar are Cornwall, Camden, Coventry and Chesterfield? And is there a place where the Greater Manchester area ends and the Liverpool city region begins?

Second, local government should not pretend that resource poor areas can or should be self sufficient. Local government should be encouraged to embrace self determination as a goal and Councils should be helped to be as self-sufficient as possible; but don't pretend that poor localities can simply pull themselves up by their bootstraps. Produce instead a list of the twenty localities with the weakest tax base and the highest social needs and work out what practically they can do to boost their revenues and lower aggregate social needs. Of course, Councils in every locality can find unique and distinctive capabilities in their midst. Capabilities that they can turn to their comparative advantage. But they need to deal with the realities of their relative position rather than delude themselves into thinking that they can resolve everything through local action.

Third, in discussing the revenues that should support local services, it is best to start with the functional responsibilities of local government. This is what Sir Michael Lyons did in 2007. He started by asking the public what service functions they thought should be financed locally and with the degree of service variation they would accept across localities[5]. It is astonishing how many papers and reports on local government finance are produced that fail to mention the basic functions of local government. International comparisons are only helpful to a point. For local government in the UK is so very different from local government elsewhere. It is not sensible to suggest revenue raising options devoid of any discussion as to the character of the services that these revenues are supposed to support. And yet this is what we get in "Public Money, Local Choice".

Unfortunately this error is widespread. Many Councils are currently entering into discussions about "combined authorities" mainly for purposes of economic growth and regeneration, when in practice they may more urgently need to consider combined arrangements for securing social care services with their (sub)regional health service partners. Local government in the UK is very unusual. Few nations expect their local governments to direct half of their spend on securing social care for adults as well as protection services for children. But in England, over £22 billion of Council spend is on adult (£14.4bn) and children's (£7.7bn) social care. This is why central government in the UK has historically provided substantial revenue support to local government.

Has anyone found an economically respectable argument for supporting the entirety of social care service costs on a less than buoyant (and politically frozen) local property tax? Give it a few moments thought ... it is simply not sensible to suggest revenue raising options for Councils that are empty of any discussion as to the character of the services that these revenues are supposed to support.

Fourth, a consideration of the aggregate yield of current taxes would help focus the attention of the debate on local government finance. The table below shows the forecast receipts in £ billion for the current year and the forecast for 2019-20.[6] It shows clearly that for every £1 people pay in Council Tax they pay almost £6 to the central exchequer in income tax. By contrast for every £1 that businesses pay in business rates they pay about £1.50 to the central exchequer in corporation tax. This contrast suggests several contrary conclusions but it also explains why businesses across the nation are engaged in intensive rate appeals. The visibility of property taxes is their advantage; but it is also the reason why all of all taxes they are the least preferred.

Table 1

	Current Receipts forecast by OBR	
	2014-15	2019-20
people pay		
income tax	£163.0bn	£213.9bn
Council tax	£27.8bn	£31.5bn
businesses pay		
corporation tax	£41.7bn	£45.9bn
business rates	£27.1bn	£32.6bn

(NB over the same period Stamp Duty is forecast to rise from £11.5bn to £19.5bn)

Fifth, the commission is right to focus on stimulating local economic growth - but sustainable solutions are rarely local. The connection between local economic growth, planning powers and business rates is not as straightforward as many in local government suggest. And the simple idea of "incentives for growth" misses the range of feasible local economic growth strategies, which includes:

- City regional spatial strategies: development and physical regeneration
- Infrastructure development: basic utility & high value infrastructure (eg. super fast broadband)
- Networks, connections and nodes: amplifying the impact of transport and network connections
- Labour market interventions: local job creation, vocational, employability and employment strategies
- Supplier based interventions: direct investment in local supply chains and localised purchasing
- Stimulating smart innovation led growth: enabling the scaling up of start-ups and SMEs
- Industrial sector interventions: focussed on building on existing strengths or dynamic "clusters" in local and regional economies (encouraging business development and growth in situ)

The process of business segmentation and dislocation (with headquarters, production, logistics and distribution being organised from very different localities and countries) and the continual process of capital accumulation via different asset classes (including physical development and housing) is what's fuelling disjointed economic development across the UK. The spatially uneven outcomes of these processes is evident to the casual observer, and is why the different tiers of state action (national, LEP, city regional and local authority level) need to develop complementary strategies if they are to encourage smart and sustainable growth[7].

However, in truth the average Council most probably invests 100 times more in its regional economy through the (blind and indirect) actions of its pension fund than it does through its direct economic development activities. For if just five per cent of the average Council's pension fund is invested in venture capital and infrastructure in the regional economy that would be 100 times the scale of the average Council's economic development function. What's more it may surprise many Councils that the total expenditure by English local government on economic development is relatively small (£377m). By way of an absurd but insightful comparison, spending on economic development by English Councils is only just over one-half of what they spend on sexual health services (£671m)[8].

Sixth, there is an overwhelming case for an independent body, such as the Office for Budget Responsibility, to examine the overall sustainability of English local government. And especially given the incredibly tight fiscal squeeze in which they are caught. This is for two reasons. First, it would serve to elevate the debate above the day to day fray of politically contentious claims and counter claims. On the day of the announcement of the local government settlement, the Minister at DCLG (Kris Hopkins, MP) claimed the settlement was "fair for all parts of the country", whereas the Local Government association used stronger language. Indeed, the Conservative Leader of Buckinghamshire, Cllr Martin Tett, said that Councils had "reached a tipping point"; and the Conservative Leader of Surrey, Cllr David Hodge, said that, "it would be extremely difficult to continue" with spending reductions.[9] These counter claims were then themselves countered by Ministers who claimed that Councils had collectively established some £20bn in reserves, inferring that this was an over provision that could be used to offset the spending reductions.

And second, it would enable the proper impact of service and fiscal failure by local government to be soberly evaluated. Consider the case of an an average urban authority with net revenue spending of, say, £250m, It is likely to have a gross turnover nearer to £800m with investments of some £600m. In short, it is responsible for securing a much wider array of public services and investments than is implied by its "spending power". The withdrawal of central taxpayer support (through RSG) to these Councils, if done too swiftly and too steeply, would most likely jeopardise a range of public purposes that are much broader than is simply secured through the Council's net revenue budget.

At a very simple level, the commitment of all political parties to direct additional resources to the NHS could be completely sidelined by the failure of Councils to align their adult social care budgets (which amounts to about one-third of their net revenue spend) suitably and swiftly with local NHS services. Building on the NAO report and the broader issues raised by *Public Money, Local Choice* the commission of a special report by the OBR on local government's overall sustainability would be a very welcome addition to the debate.

Exactly thirty years ago this year there was a "rate capping rebellion" by 15 Councils against the then Government. At the time these Councils initially refused to set a rate although they all eventually did so - the last being Lambeth on 3rd July 1985. Ultimately, it proved a misdirected and misguided campaign that failed to change the then Government's policy of limiting rate rises and restricting the spending of Councils. But this set the mould for the following three decades. The powers to restrict Council budgets have remained in place ever since.

In structuring the debate about the future of local government finance in England, *Public Money, Local Choice*, does raise some interesting suggestions and solutions. The problem is that the real challenges that are pressing urgently on local government require much more urgent solutions. The planned profile of cuts needs to be tapered over a longer period to enable sustainable change to be generated and implemented. It is not enough for the government to invoke the scale of the cuts; they need to be managed and implemented in a sensible fashion.

The problem with local government finance is that while it invites intelligent enquiry, it seems destined to end in bitter disputation. To use a phrase from another era, it is

> *"neither a vineyard nor an olive-ground, but an intricate wood of briars and thistles, from which those who lost themselves in it brought back many scratches and no food."*

By asking their readers to address twenty-five questions, *Public Money, Local Choice* simply invites them into an intricate wood of briars and thistles. At this juncture, they are desperate for food, all that's offered are scratches.

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1 National Audit Office (2014) *Financial sustainability of local authorities*, November 2014

2 Rawls J (2000) *The Law of Peoples with the Idea of Public Reason Revisited,* Cambridge MA

3 CIPFA (2014) *Public Money, Local Choice*, interim report of the independent commission on local government finance

4 Besley T & Coate S (2003) Centralized versus Decentralized provision of local public goods, *Journal of Public Economics* 87, 2611-37

5 Lyons M (2007) *Lyons Inquiry into Local Government*, http://www.lyonsinquiry.org.uk

6 HM Treasury (2014) *Autumn Statement 2014*, table B.3, p100, forecasts from OBR

7 Mazzucato M (2013) *The Entrepreneurial State: debunking public vs. private sector myths,* Anthem

8 DCLG (2014) *Local Authority Revenue Expenditure and Financing: 2014-15 Budget,* England (revised), ONS, 22 Oct 2014 [9] P

9 Pickard J, Cuts to council grants 'fair' says coalition, *Financial Times,* 18 December 2014

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