Final Report

Financing English Devolution

INDEPENDENT COMMISSION
ON LOCAL GOVERNMENT FINANCE

Financing English Devolution

Foreword *by Darra Singh OBE*

The Independent Commission on Local Government Finance was set up because the local government funding system is in urgent need of reform. The Local Government Association and the Chartered Institute of Public Finance and Accountancy asked the Commission to recommend changes to the system which will allow local government to meet the needs of its citizens, and in particular support the delivery of five key national policy objectives: grow the economy, increase the housing supply, integrate health and social care, promote work while protecting the vulnerable, and support families and children through early intervention.

Our programme for reform lays the foundations for a local government funding system which is stable for the long term, stimulates economic growth and enables local people to invest in the priorities for their community. It offers the next government a way to break the impasse over reform of local taxation while freeing ministers from the detail of funding decisions for individual councils. Above all it builds on local government's determination to shape its own future, confident and independent.

There is now near-universal consensus that our system of government has become over-centralised, and that power is best exercised close to the people whose lives it affects. The Smith Commission's proposals for Scottish devolution and the City Deals are showing the way. The time has come to liberate the potential of England's cities, towns and counties.

This Commission offers a practical programme for the next government to lay the foundations for that change. We believe these proposals would win widespread public support. All the main political parties have expressed a strong commitment to devolution in England; they should seize this chance to act.

The era of austerity cannot simply mean continual depletion of vital services as demand grows. It has to be a time when public services find different ways of working which build the resilience of our communities — intervening early in troubled families, keeping the elderly living independently and well, matching the skills of our young people to the needs of local businesses, reducing dependency on welfare and providing the homes and infrastructure to make our towns and cities great places to live and work. This is the route to delivering these vital reforms.

I would like to thank all the Commissioners for their commitment to the project and the quality of their analysis, as well as all the organisations and individuals who gave their time and expertise so generously.

Darra Singh OBE
Chair
Independent Commission on Local Government Finance

Executive Summary

The case for change

The problems with the local government finance system have been considered by a number of reviews over the last 50 years. The Layfield Committee report in 1976 spoke of the lack of buoyancy in local property taxes and the need for regular revaluations, the need to find other forms of local funding, the rigidity of central government grants and the need to balance equity across the whole of local government with accountability at the local level. From Layfield, via the Balance of Funding Review, to the Lyons Inquiry and more recently the London Finance Commission in 2014, the issues have remained largely the same. There has also been a broad consistency in the solutions that these reviews have put forward. However, the wholesale reforms that have been put forward have not been adopted. This is the background to our review. We are mindful that the pace of reform has been slow and the changes to the local government finance system have been piecemeal.

Two developments have given reform a new urgency. Faced with the long term reductions in local government funding, councils and their partners could be far more efficient, effective and creative in their use of the totality of public money if they had the freedom. Meanwhile, the debate over more powers for Scotland and the near universal acceptance that decisions are best taken as close to the citizen as possible, have created a rare opportunity to secure devolution within England.

The plans announced in the 2014 Autumn Statement continue the pattern of the sustained real term funding reductions of the last Parliament. The impact on adult social care is profound, with 500,000 people already losing support. Without reform, in the next Parliament, adult social care will take a sharply increasing proportion of local government funding. By 2020, councils will have to find an additional £4.3 billion just to manage care services at the current levels.

Review the functions and sustainability of local government

The projections in the Office for Budget Responsibility's Economic and Fiscal Outlook published in December 2014 show that in the next Parliament local government is facing one of the toughest spending reviews in living memory.

In these circumstances we must listen to those who are experiencing the pressures of delivering outcomes for individuals and communities and ask whether there is enough money in the system. The Commission calls for a full review of the financial sustainability of local government in preparation for the next spending review.

The Commission's vision

Fundamental to securing good quality public services, is a finance system which provides choice and opportunity to be creative and enables different local authorities to determine how ambitious they want to be.

The Commission's vision is for a finance system that:

- Promotes self-reliance and self-sufficiency
- Encourages entrepreneurialism and innovation
- Promotes local decision-making on service delivery
- Is transparent in how it works and in the division of responsibilities between central and local government
- Maintains support for the most vulnerable.

Approach to reform

The leaders of all three main parties have called for devolution in England. The recommendations in this report provide a blueprint for how that might be financed. One size does not fit all; centrally determined policies and programmes will not work. Local authorities operate in different places under different contexts; they have different priorities and will fund different services depending on their communities' needs. They will collaborate in different ways and with different partners. The principle of variability has been accepted already; the City Deals negotiated by combined authorities have begun to change their responsibilities and funding regimes to suit local circumstances.

The Commission has a vision that councils as a whole can achieve self-sufficiency. This does not mean the absence of government grants, but rather stability in grant allocations and control over directly raised revenues (and possibly in the future assigned resources) such that councils can shape the destiny of their area without dependency on central government. We believe that not only is this better for local accountability, but is essential to underpin the new methods of working needed to protect service outcomes to residents at a time of public funding austerity.

Reforms

The core of the Commission's proposition is, over a 10 year period, devolution of powers, funding and ultimately taxes to sub-national entities that are ready for that step. We expect the number and scope of these to grow over time. This could lead to more than £200 billion in annual public expenditure being controlled at a sub-national level. Different agencies working together at the sub-national level would redesign services and capture better outcomes by collaboration across traditional service boundaries. The expectation is that within these areas councils and their partners will work collaboratively to manage differences in capacity and resources between their constituent parts. National government's role in this context is primarily to establish equalisation of resources between the sub-national areas. It is in that context that local areas are to become self-sufficient and lead the destiny of the areas they represent.

The variable speed approach leads the Commission to make two broad sets of proposals for change to the local government finance system. The first will apply to all local authorities and the second set of additional changes will support those authorities which we term 'Pioneers' that are able to and wish to reform at a faster pace.

Reforms for all include:

- An independent body to: review the functions and sustainability of local government assessing the capacity of the sector to meet its key responsibilities including those on adult social care in advance of the next spending review; and advise central government on funding for local government — reporting to Parliament on the reasonableness of central government's decisions
- Freedom to set council tax and council tax discounts and the retention of 100 per cent of business rates and business rate growth.
- Multi-year settlements
- The ability to raise additional revenue through relaxation of the rules on fees and charges.

Reforms for Pioneers include:

- Single place-based budgets covering a full range of public services
- The opportunity to manage equalisation across a sub-national area
- Further council tax reforms including the ability to vary council tax bands and to undertake council tax revaluations
- Newly assigned and new taxes such as stamp duty, airport taxes and tourism taxes
- The establishment of Local Public Accounts Committees to oversee value for money across the totality of the place-based budget.

Benefits for central government

The proposals outlined above, if steadily rolled out across the country, would allow central government to reduce in size with a rationalisation of the number of departments and the need for offices, ministers and senior officials. The costs of central government could be reduced further.

Recommendations

The Commission recommends that an independent review of the functions and sustainability of local government be undertaken in advance of the next government's first spending review, to assess whether local authorities are appropriately funded to meet their statutory duties and to certify that all places are sufficiently funded.

The Commission recommends the establishment of an independent body to advise government on the funding needs of local government and on the allocation of funding to local authorities and sub-national areas.

The Commission recommends that the incoming government ends the policy of setting referendum limits on council tax and leaves the decision to local politicians.

The Commission recommends that the incoming government should devolve council tax discount setting and the power to determine who receives council tax support to local authorities.

The Commission recommends that 100 per cent of business rates and business rate growth should be retained by local government.

The Commission recommends that the incoming government consults on the detail of the business rates retention reset as a matter of urgency, exploring options for a partial reset.

The Commission also recommends that the independent funding body should advise government on the reset and report on the reasonableness of the government's decisions.

The review of business rate administration that has been announced by this government must look at the appeals process and propose ways to reduce the time it takes to resolve an appeal, as well as proposing options for reducing the time from valuation in which an appeal can be launched. This needs to be done in advance of the 2017 valuations.

The Commission recommends that as part of the review of business rates, the government should consult on options for the localisation of business rate relief.

The Commission recommends that the incoming government commits to full and clear multi-year settlements to enable effective long-term planning for local authorities and other public sector services.

One of the key roles for the proposed independent review of the sustainability of local government will be to assess the required level of social care funding and to advise government on the amount of money that will be required to fund social care appropriately in the next spending round.

The Commission supports councils having the freedom to determine fees and charges locally.

The Commission recommends that the incoming government commits to the introduction of place-based budgets for sub-national areas that are willing and able to take on this reform.

The Commission recommends that sub-national Pioneer areas should be given the power to determine the number and value of council tax bands and when properties are revalued.

The Commission recommends that the incoming government should work with local government to agree a timetable for fiscal devolution, adopting the Smith Commission's principles as a basis for reform.

Local Public Accounts Committees should be established in Pioneer sub-national areas to scrutinise value for money for all public services.

The government should develop additional freedoms for Pioneer areas in support of national policy objectives such as economic growth and increasing the housing supply. These could include enabling Pioneers:

- To develop new approaches to health and social care integration
- To collaborate with Local Enterprise Partnerships in being entirely responsible for further and adult education, skills and apprenticeships, regeneration and employment support
- Ultimately to take on responsibility for some welfare to working age adults and some fiscal devolution.

1 About the Commission

The Independent Commission on Local Government Finance was set up because the local government funding system is in urgent need of reform.

The Local Government Association and the Chartered Institute of Public Finance and Accountancy asked the Commission to recommend changes to the system which will allow local government to meet the needs of its citizens, and in particular support the delivery of five key national policy objectives: grow the economy, increase the housing supply, integrate health and social care, promote employment while protecting the vulnerable, and support families and children through early intervention. These priorities form the context for the Commission's recommendations on the local government finance system.

The Commission's aim is to provide recommendations that will be valuable regardless of the quantum of funding in the system.

Darra Singh OBE — Chair
Darra is head of local public services for the UK and Ireland at EY. He was Chief Executive of Job Centre Plus and Second Permanent Secretary at the Department for Work and Pensions. Prior to that he was Chief Executive at both Ealing and Luton councils. In 2011 he chaired the government-appointed Communities and Victims Panel, which investigated the causes of that summer's riots.

Alan Downey
Alan was a partner at KPMG from 1997 to 2014. Since retiring from KPMG he has taken up a number of non-executive positions on the boards of public sector and charitable organisations.

Anita Charlesworth
Anita is the Chief Economist at the Health Foundation and a non-executive director of Whittington Health NHS Trust in London. Previous posts include Chief Economist at the Nuffield Trust, Chief Analyst at the Department of Culture, Media and Support, and a Director at HM Treasury.

Bridget Rosewell OBE
Bridget is an economist and business woman. She chairs Volterra Partners and is Chair of Audit for Network Rail, Chair of Risk for Ulster Bank and is chair of the With Profits Committee for the Co-operative Bank.

Jonathan Portes
Jonathan is the Director of the National Institute of Economic and Social Research (NIESR). Previously he was Chief Economist at the Cabinet Office, where he advised Cabinet Secretary Gus O'Donnell and Number 10 Downing Street on

economic and financial issues. Before that he held a number of other senior economic policy posts in the UK government and was secretary of the external evaluation committee of the International Monetary Fund.

Paul Gray CB
Paul is the Chair of the Social Security Advisory Committee. He was formerly Executive Chairman of HM Revenue and Customs and the Second Permanent Secretary in the Department for Work and Pensions.

Stephen Hughes
Stephen has just been appointed Interim Executive Director at the Local Government Association. Previously he was Chief Executive at Birmingham City Council after a number of senior roles in local government.

Steve Lewis
Steve is CEO, UK & Western Europe, RSA Insurance Group. Prior to that he was CEO, UK General Insurance & Shared Services, for Zurich, after holding a number of senior roles there in Europe and Asia.

Professor Tony Travers
Tony Travers is Director of LSE London, a research centre at the London School of Economics. He is also a Visiting Professor in the LSE's Government Department.

The Commission would like to thank:

Eamon Lally for supporting the Commission and
Richard Vize for his work on this report.

All Commissioners are members of the Commission in a personal capacity.

2 Case for urgent change

This section describes the reasons why change in the system of local government finance is needed. It sets out:

- The Commission's views on the current arrangements
- The implications of the local government funding position
- The need for a financial response to devolution of functions.

The problems with the local government finance system have been addressed by a number of reviews over the last 50 years. The Layfield Committee report in 1976 spoke of the lack of buoyancy in local property taxes and the need for regular revaluations, the need to find other forms of local funding, the rigidity of central government grants and the need to balance equity across the whole of local government with accountability at the local level. From Layfield, via the Balance of Funding Review, to the Lyons Inquiry and more recently the London Finance Commission in 2014, the issues have remained largely the same. There has also been a broad consistency in the solutions that these reviews have put forward. However, the wholesale reforms that have been put forward have not been adopted. This is the background to our review. We are mindful that the pace of reform has been slow and the changes to the local government finance system have been piecemeal.

Two developments have given reform a new urgency. Faced with the long term cut in local government funding, councils and their partners could be far more efficient, effective and creative in their use of the totality of public money if they had the freedom. Meanwhile, the debate over more powers for Scotland, and the near universal acceptance that decisions are best taken as close to the citizen as possible, have created a rare opportunity to secure devolution within England.

Changes to the finance system can have a transforming effect on local government and the delivery of wider public services. With more freedom to act, local government and its partners will be in a better position to do the best for local people. A good finance system would allow local authorities to keep the rewards of their investments, whilst ensuring that those areas facing more difficult social and economic conditions are secure. The finance system should support local authorities and partners to deliver better value for money while supporting national policy objectives such as growing the economy and protecting the vulnerable. Financial and administrative devolution will enable local authorities and partners to solve key social and economic problems in all parts of the country by responding to each area's unique circumstances and needs.

In our view the existing funding system does not meet these standards and is no longer sustainable. The finance system lacks accountability to the communities it serves; it makes integration of services that could lead to better and more cost effective outcomes difficult to achieve; and it restricts councils' ambition. The plea made to the Commission during its consultations was for a system fit for an era of much lower funding and rising, more complex, demand. Local authorities are best placed to understand the needs of the communities they serve, to prioritise resources to meet those needs and to react to changing circumstances.

To meet the needs of the future, the finance system must provide better incentives for growth, allow for longer term decision-making, reduce central control of individual funding streams and end central control of council tax. It also requires a better understanding across central government of local government's priorities and pressures.

There is demand for councils to be given greater freedom from central government in raising and spending money, with the ability to set taxes to meet local needs. There is a strong desire for more long-term certainty in funding levels to improve planning and financial management. It is important to say that there have also been pleas for more money and a fairer distribution of funding.

The commission has considered the implications of its reforms on five priority areas: growth; welfare reform; housing; health and social care; early years and early intervention. The commission has received written evidence on these issues and held workshops with expert practitioners and commentators. The challenges in these areas are immense. We set out some observations and highlight where those at the forefront of reform — which we call Pioneer areas — might negotiate for further fiscal and administrative devolution.

Local Government Funding

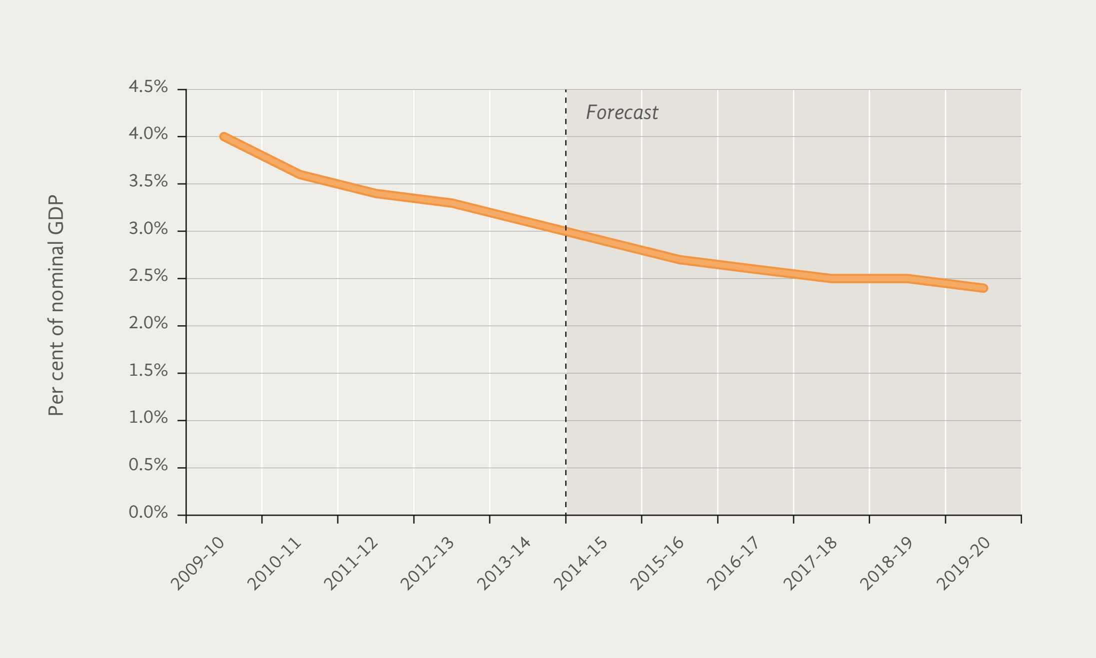
"What will local government, the defence force, the transport system, look like in this world? Is this a fundamental reimagining of the role of the state? One thing is for sure. If we move in anything like this direction… the role and shape of the state will have changed beyond recognition."

Paul Johnson Institute for Fiscal Studies, 2014

The comments by Paul Johnson, following the publication of the Autumn Statement in December 2014, articulate the likely scale and impact of reductions in public sector funding during the next Parliament. The plans announced in the Autumn Statement continue the pattern of sustained real term funding cuts of the last Parliament. The 2010 Spending Review planned a 26 per cent real terms reduction in local government funding from central government by 2014-15 (excluding funding for schools and benefits claimants). An extra 2 per cent reduction in 2014-15 was announced in the Autumn Statement 2012, while the 2013 spending round included a further 10 per cent real terms reduction for 2015-16. The government has cut core grant funding to local government by 40 per cent from April 2011 to April 2016. According to the National Audit Office, more than half of local auditors for metropolitan and unitary councils are concerned that these authorities will be unable to meet their medium-term savings targets.[1]

The projections in the Office for Budget Responsibility's Economic and Fiscal Outlook published in December 2014 show that in the next Parliament local government is facing one of the toughest spending reviews in living memory. As a proportion of GDP, local government current spending in England will have fallen from over 4 per cent in 2009-10 to 2.5 per cent in 2019-20.

Fig 1 Local authority current spending in England (percent of nominal GDP)



Source: DCLG, OBR

Total current spending excludes education, public health and housing benefit. Total spending from 2016-17 is derived on the assumption that central government grants to local authorities decline in line with total implied PSCE (public sector current expenditure) in RDEL (resource departmental expenditure limits)

As the OBR's data demonstrates, without any changes to local communities' freedom to determine their own priorities and how much they wish to invest in them, services such as adult and children's social care, police, fire and culture face reductions of a similar magnitude to those seen during the 2010-15 Parliament.

1 Financial Sustainability of Local Authorities 2014, National Audit Office

Councils have managed the reductions in the 2010-15 Parliament effectively. But continuing satisfaction with the quality of local services should not be confused with an absence of impact. For example, data from the Association of Directors of Adult Social Services (ADASS) shows that approximately 500,000 people no longer receive care services that they would have qualified for five years ago. All local communities are entitled to essential services that meet acceptable national standards, and should have the right to determine what investment they wish to make in additional services.

Adult social care

The challenges of adult social care have to be addressed as part of a wider set of reforms to local government finance, because it represents a significant proportion of local government expenditure. The service is facing two trends which will have an impact on the capacity of services to deliver effective outcomes. The first of these is the demographic change; an ageing population is leading to significant increases in demand for services and the complexity of need. Secondly services have come under pressure from the reductions in central government funding for local government.

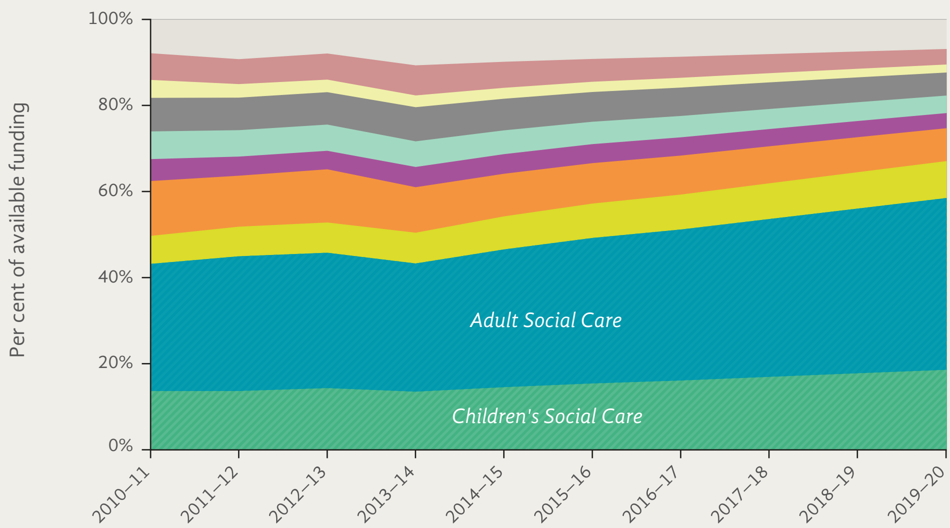
The context for many local authorities is dominated by financial crises in adult social care. In the next Parliament, as funding continues to fall, adult social care will take a sharply increasing proportion of local government funding. See Fig 2.

Adult social care spending has been kept under control through a combination of: budget savings of 26 per cent (the equivalent of £3.53 billion over the last four years); the NHS transfer (amounting to £3 billion from 2011-12 to 2014-15); and at least £900 million of savings from other council services. However, it is still facing financial crisis with minimal scope for further efficiencies.

Social care is undergoing substantial change. The Care Act 2014 has been described as the most significant piece of legislation in the sector since the establishment of the welfare state.[2] It puts the well-being of the individual at the heart of social care, introducing new responsibilities and new standards. The challenge is to make this vision a reality. Local authorities expect a rise in demand for assessments because of the changes to funding and entitlement and they have concerns about the affordability of the reforms. The Care Act has been broadly welcomed, but the funding implications should be recognised in the next Spending Review.

2 Social Care Institute for Excellence 2014

Fig 2 Service expenditure as a percentage of available funding



Source: LGA

ADASS estimates that since 2008 the amount spent on adult social care has fallen by £3.5 billion; meaning that there are half a million people who are now not eligible for the care they need. As more of us need social care support, fewer of us get it.[3]

In June 2013 the government unveiled the Better Care Fund to support transformation and integration of health and social care. It is a £3.8 billion pooled budget that shifts resources into social care and community services for the benefit of the NHS and local government. The fund has had a mixed reception; it is not new money and the decision to ring-fence £1 billion of it for NHS out-of-hospital services and reducing emergency hospital admissions is a departure from its original aim of stimulating integration.

Nonetheless, councils are embracing the opportunity to integrate services with the NHS and other providers and efficiencies are being achieved. For example, Sunderland's 'fast track' Better Care Fund plan commits to pooling £150-160 million in 2015-16, far exceeding the minimum £24.8 million required.

3 Adult social care funding: 2014 state of the nation report, Local Government Association and the Association of Directors of Adult Social Services, October 2014

Integrated Personal Commissioning, which will give high-need individuals control over their combined health and social care support, extends personal budgets for four defined groups: children and young people with complex needs; people with learning disabilities; mental health service users; and people with long-term conditions — in particular frail, elderly people. Integrated Personal Commissioning will be tested in 10 to 15 areas from April 2016 and it provides a significant opportunity to change health and social care provision radically.

The Better Care Fund and Integrated Personal Commissioning are promising initiatives but they do not provide a solution to the funding issues of adult social care.

Devolution

The leaders of all three main parties have called for devolution in England. Prime Minister David Cameron has stated that there is now a political consensus around the need to devolve power and money from central government, arguing: "The debate now is about how far and fast it can go." Labour leader Ed Miliband has backed the devolution of powers covering housing, transport and skills, while Liberal Democrat leader Nick Clegg wants local authorities to have the legal right to demand powers.

Reports from respected political figures for the government and Labour have argued for devolving power and money to councils. In 2012 Lord Heseltine, in his report for the government No Stone Unturned, called for the creation of a locally controlled, single funding pot worth £50 billion to stimulate economic growth, alongside a reorganisation of central government so that it focussed on strategic issues rather than managing narrow funding streams. In 2012, Lord Adonis called for cities and counties to be given major responsibilities for the planning and delivery of infrastructure.

The deal which has been struck on the scope and pace of further devolution to Scotland shows what can be achieved in devolving power from Westminster in a way that enhances rather than diminishes accountability and sound decision-making. The Smith Commission has proposed giving the Scottish Parliament complete power to set income tax rates and bands, a proportion of VAT raised in Scotland, increased borrowing powers, control of a number of benefits and all powers of support for unemployed people such as those currently delivered through the Work Programme.[4] Expenditure by the Scottish government and Scottish local authorities accounts for 70 per

4 Report of the Smith Commission for further devolution of powers to the Scottish Parliament, 27 November 2014

cent of all expenditure in Scotland; under the Smith Commission proposals around 50 per cent of this expenditure will be paid for from taxes over which they have control.

The same vision and unity of purpose now needs to be demonstrated over devolution to local communities in England. It cannot be the case that Scotland is so exceptional that devolution carries no implications for England. The Scottish proposals provide a benchmark for the scale of administrative and fiscal devolution to which sub-national areas, such as combined authorities in England, could aspire. Combined authorities are of a significant size, comparable with the devolved administrations of Wales and Northern Ireland. And in terms of gross value added per head of population, combined authorities such as West Yorkshire are the equivalent of Scotland.

Fig 3 Populations and per capita GVA in the Devolved administrations and combined authority areas

Source: ONS

Devolution and reform of the local government finance system need to go hand in hand. The national and local benefits from reforming the finance system broadly fall into three categories:

- Growing the economy — local authorities have a key role in shaping the conditions for economic growth in the area, from providing infrastructure to supporting local firms and working with businesses to develop the right skills in the workforce. This is not a zero sum game in which local authorities simply compete for the distribution of a set growth rate; local authorities' collective efforts can increase the overall national growth rate and contribute to greater economic resilience. Local authorities focus on infrastructure, skills and other place-based investment, so they have a sustained economic impact in a way that consumer spending and house price led growth do not. But, as the reports from Lord Heseltine and Lord Adonis affirm, local government's effectiveness in supporting economic growth is inhibited by central decision-making which lacks understanding of specific local needs, while the multiplicity of funding sources and controls from different government departments — one looking at broadband, another at benefits, another at skills, another at transport, another at housing — prevent local authorities from addressing in the round the full range of local issues.
- Transforming service delivery — the reductions in funding to both local government and central government departments mean service delivery cannot continue as before. Funding changes of this magnitude require new ways of working, such as supporting older people to live independently for longer,A and securing early, co-ordinated interventions to support troubled families. But again, numerous silo-based central government initiatives and the difficulty of creating the financial headroom to move from crisis management to prevention is putting a drag on local government's attempts to deliver the changes. The scale of required reform is not achievable under the current system.
- Strengthening accountability for the spending of public money — the closer to the citizen money is raised and spent, the greater the accountability to taxpayers. This has been a long-held view. The Layfield Report of 1976 noted that local tax-setting and tax-raising powers are essential to ensure local accountability. The Balance of Funding review published in 2004 took as a premise that an over-centralised system undermines accountability.

3 Functions, funding and sustainability

In this section the commission highlights the concerns over the current financial stress in the system

Successive reviews of local government and its financing, including the Balance of Funding review[5] and the Lyons Inquiry[6], looked at the relationship between local government functions and funding. Local authority core service responsibilities have remained largely unchanged, excepting the recent addition of public health. However, local authorities have statutory duties across an extraordinary variety of functions; a government review has found that there are approximately 1340 statutory duties required of councils.[7] They range from safeguards for children and adults to a plethora of building and environmental regulations to less obvious duties such as enforcing criminal offences relating to EU regulations on timeshare properties and collecting statistics on stray dogs.

Given how important local government services are to communities, including the most vulnerable in society, it is surprising that a review of sustainability has not been undertaken, particularly at a time when deep reductions are being made in local government funding and service pressures are growing. For example, by 2020, councils would have to find an additional £4.3 billion just to manage care services at the current levels.[8] The NAO has raised concerns about local authority sustainability[9], highlighting the risk of serious problems and the fact that the challenges to the financial sustainability of local authorities arising from government funding cuts have the biggest impact on the most deprived areas:

"Local authorities have worked hard to manage reductions in government funding at a time of austerity. At the same time, there is evidence of some service reductions. The Department [DCLG] really needs to be better informed about the situation on the ground among local authorities across England, in a much more active way, in order to head off serious problems before they happen. It should look for evidence of financial stress in local authorities to assure itself that they are able to deliver the services for which they are responsible. It should be clear about the knock-on effect of the various funding decisions taken by departments in Whitehall."

Amyas Morse Comptroller and Auditor General, NAO, 19 November 2014.

5 Balance of Funding Review – Report, July 2004

6 Place-shaping: a shared ambition for the future of local government, Lyons Inquiry, March 2007

7 Review of local government statutory duties: summary of responses, DCLG, June 2011

8 ADASS, LGA, October 2014

9 Financial sustainability of local authorities 2014, National Audit Office, November 2014

There are other factors that will influence financial sustainability such as the capacity of local authorities to raise resources from fees and charges and through the devolution of other taxes, which we discuss later in the report. However, it is our view that an important task for the next government is to undertake an independent review of local government financial sustainability.

The Commission recommends that an independent review of the functions and sustainability of local government be undertaken in advance of the next government's first Spending Review, to assess whether local authorities are appropriately funded to meet their statutory duties and to certify that all places are sufficiently funded.

4 Approach to reform

This section sets out the factors that have shaped the commission's approach to developing recommendations. It includes sections on:

- The Commission's vision
- The variable pace of reform
- Self-sufficiency and equalisation
- Placed-based budgets
- New burdens
- Principles for financial devolution.

The Commission's vision

The Commission's vision is for a finance system that:

- Promotes self-reliance and self-sufficiency
- Encourages entrepreneurialism and innovation
- Promotes local decision-making on service delivery
- Is transparent in how it works and in the division of responsibilities between central and local government
- Maintains support for the most vulnerable.

The core of the Commission's proposition is devolution of powers, funding and ultimately taxes to sub-national entities that are ready for that step. We expect the number and scope of these to grow over time, and the expectation is that within these areas councils and their partners will work collaboratively to manage differences in capacity and resources between their constituent parts. National government's role in this context is primarily to establish equalisation of resources between the sub-national areas. It is in that context that local areas are to become self-sufficient and lead the destiny of the areas they represent.

The variable pace of reform

Local authorities now match a focus on basic services with a resolve to build the local economy in partnership with business. There is determination to create jobs, improve training, reduce welfare dependency and intervene early with troubled families. One size does not fit all; centrally determined policies and programmes will not work. Local authorities operate in different places under different contexts; they have different priorities and will fund different services depending on their communities' needs. They will collaborate in different ways and with different partners. All of this is legitimate and is to be encouraged.
The principle of variability has been accepted already; the City Deals negotiated by combined authorities have begun to change their responsibilities and funding regimes to suit local circumstances.

Box 1 Greater Manchester Combined Authority; the deals

The Greater Manchester City Deals provide for:

- Expanded Working Well pilot supporting disabled people towards a job, with funding linked to performance
- Joint commissioning in the next phase of the Work Programme
- £2.6 million towards pilot supporting residents with mental health issues towards employment
- Devolved business support budgets, including Growth Accelerator, Manufacturing Advice Service and UKTI Export advice
- £4.4 million through the Regional Growth Fund for the city Business Growth Hub
- UKTI staff committed to joint project assessing scope for city to attract inward investment
- Control of reformed earn back deal, within current £30 million a year for 30 years framework — the Earn Back Model allows local retention of government proceeds generated by local delivery of growth, for up to 30 years with a maximum of £30 million per year
- Local business plan for integration of health and social care based on existing health and social budgets
- Devolved £300 million Housing Investment Fund
- Devolved Apprenticeship Grant for Employers
- Power to re-structure the Further Education provision, 16 to 18 skills
- Support for City Apprenticeship and Skills Hub, including tax incentive pilot and employer ownership proposal routing funding direct to SMEs, sharing of data, and development of labour market information
- Piloting of locally determined outcome measures in the national skills funding framework, set by the Skills Funding Agency
- New employer-routed funding model with a focus on the proposed Apprenticeships Credit model for local businesses
- Devolved and consolidated transport budget through multi-year settlement
- Responsibility for franchised bus services and smart ticketing across all transport modes
- Exploring opportunities for devolving rail stations across the city region
- Exploring potential to delegate concurrent highway, street and traffic authority powers
- Commitment from central government to explore possible freedoms and flexibilities to local highway regulations, and legislative changes to enable local bus strategy.

In the view of the Commission the finance system should be able to support a variable speed approach to reform so that those authorities capable of reforming at a faster pace can do so. We also need central government to embrace further reform, recognising that the challenges we face in public services are likely to need solutions which have not yet been tried. There is an urgent need to take action. This will require risk taking by seeking the evidence of what works best through practical experience rather than contemplation and research.

Self-sufficiency and equalisation

Many have argued that for decades local government finance has been dominated by a "dependency" culture. Local authorities are characterised by having "needs" or the cost of providing statutory and discretionary services. These are met partly from their own resources (the local yield from council tax and retained business rates); unmet need is then financed by government grant. As calculated "needs" and "resources" varied considerably between different authorities so did grant. It was distributed so as to enable each authority to provide a "standard" service level at roughly the same tax cost to every household (after taking into account the tax band of the property they occupied).

This is what is meant by "equalisation" of resources between areas. Tremendous energy and effort has been put in by government and local authorities to hone and refine the formulae to calculate needs. A consequence of this approach to funding is that when an area improved, either by reducing demands on public services or by increasing its local taxable resources, its grant was reduced. Conversely of course, when an area deteriorated it received more grant.

More recently, an alternative approach and culture is being seen in many local authorities; they have pursued policies to maximise local growth, to improve the local economy and reduce demand for public service interventions, encouraged by a range of new incentives, such as retained business rates, city deals and growth deals, to invest in their own areas to achieve these results. However, to work successfully councils need confidence that the gains they make for their place can be retained in order to afford the investments that create the benefits.

The Commission has a vision that councils as a whole can achieve self-sufficiency on the back of this cultural approach. Self-sufficiency does not mean the absence of government grant, but it does mean stability in grant allocations and control over directly raised revenues such that councils can shape the destiny of their area without dependency on central government. We believe this is better for local accountability and essential to underpin the new methods of working needed to protect service outcomes to residents at a time of public funding austerity. There is clearly a conflict between these two approaches — allowing areas to keep improvements in their fiscal position or redistributing them. In consequence areas that have less potential to grow are fearful of being left behind in a world of self-sufficiency. The Commission believes that a system can be devised which reconciles needed equalisation with grant stability.

If local areas are aggregated into groupings of sufficient size and economic coherence (what we describe as sub-national areas) we find that the variation in need between the areas is far less than the variation within them. The proposition is therefore that the national grant settlement is on the basis of the larger geographical area and remains largely stable (perhaps adjusted for changes in population). It would then become the role of the governance within the area to manage equalisation between component parts. In this way strong incentives can be managed at the sub-national level whilst individual authorities are protected to provide services regardless of need.

We see this as a process that will take place over time. First, it will require 100 per cent of business rates to be retained by the local government sector as a whole. Second, it depends on 'Pioneer' areas emerging to take up the opportunities provided and accept both a long term settlement and responsibility for managing grant distribution within their area. As individual areas succeed to take charge of their own future others will grow in confidence to follow and this approach to self-sufficiency could be achieved over a 10 year period of reforms. Other sections of the report develop these principles and ideas. The key point is that progress on greater autonomy for local authorities depends on resolving the tension between equalisation and self-sufficiency.

Place-based budgets

The pace of reform in the development of place-based budgets has been slow; this is despite early enthusiasm for this approach from the government and the establishment of Community Budget Pilots.[10] The Commission's view is that public services cannot continue to be delivered in the same way if there is less money in the system. Reform is required and the Community Budget Pilots have been demonstrating what can be achieved by bringing resources together across the public sector at a local level and applying them to common priorities.[11] The Commission is proposing an expansion of this approach, which requires a calculated risk, but in its view only a place-based approach to funding will secure the long-term financial sustainability of public services including those provided by local government.

10 Open Public Services White Paper, July 2011

11 Whole Place Community Budgets: A Review of the Potential for Aggregation January 2013, LGA

Box 2 Place-based budgets

A place-based approach involves:

- Understanding spending patterns and identifying fragmented, high cost, reactive and acute services
- Focusing on outcomes and selecting interventions that best deliver those outcomes, rather than being limited by existing organisational responsibilities
- Developing services that are user-focused
- Shifting the balance of resources in favour of 'early action' measures targeting prevention, early intervention and early remedial treatments
- Identifying investment from partners in new delivery models, including considering whether pooling or aligning resources could help maximise provision and minimise duplication and waste as part of a new service model

The place-based approach can be applied to a wide range of services: early years; school age children's support; community safety; youth skills and employment; adult skills and employment; economic growth; transport; housing; infrastructure; health and social care.

Not all sub-national areas could take on the place-based approach in the short to medium term. But, in a 10 year programme of reform, the commission would like to see the devolution to the sub-national level of those services or elements of services where:

- The local circumstances will influence the service that is provided, which could mean that the needs are specific to the local population or communities want to work with elected representatives to define the service provision or that costs of provision are influenced by the locality in which they are being delivered
- Locally determined services can benefit the local community without negative spillover effects impacting on neighbouring areas
- Working closely with service users in a particular area and across public service providers to design the service can deliver more effective outcomes.[12]

12 Place-shaping: a shared ambition for the future of local government, Lyons Inquiry, March 2007, p 63

This could lead to control at a sub-national level of over £200 billion (in 2013-14 prices) in annual public expenditure. More radical versions of this policy could go further, notably in relation to aspects of the welfare budget and fiscal devolution.

The place-based approach outlined here does not imply a local authority takeover; rather it requires the establishment of strong cross-organisational governance arrangements which respect the remit and expertise of all. There are radical opportunities for efficiency and effectiveness in such a reform.

New burdens

The 'new burdens doctrine' is a government policy which dates back to at least 1995. Its essence is that central government must fully fund the net additional cost of new burdens it places upon local authorities.[13] Some authorities have expressed concern that changes to the finance system, particularly moves towards a self-financing model, would weaken the fundamental principle of the new burdens doctrine and could make councils susceptible to unfunded additional responsibilities. The Commission is aware of these concerns and incorporates the new burden doctrine into the principles it proposes for financial reform set out below.

Principles for fiscal devolution

The Smith Commission identified the principles which should apply to fiscal devolution to Scotland. These principles provide a starting point for the detailed discussion which needs to take place on the approach and rules to apply to fiscal devolution in England. The principles include, in the context of England:

1. Sub-national areas should keep the financial benefits of their policy decisions and bear any costs.
2. The initial devolution and assignment of tax receipts should be accompanied by a reduction in the block grant equivalent to the revenue forgone by central government.
3. Where either the national government or the sub-national areas make policy decisions that affect the tax receipts or expenditure of the other, the decision-maker will either reimburse the other if there is an additional cost, or receive a transfer from the other if there is a saving.

13 New burdens doctrine — Guidance for government departments, DCLG, June 2011

4 The sub-national fiscal framework should provide sufficient additional borrowing powers to ensure budgetary stability and provide safeguards to smooth spending in the event of economic shocks, consistent with a sustainable overall UK fiscal framework. The sub-national areas should also have sufficient borrowing powers to support capital investment.

5 Once a revised funding framework has been agreed its effective operation should not require frequent negotiation.

6 The sub-national areas should seek to expand and strengthen independent scrutiny of public finances.

Box 3 Sub-national and Pioneer areas

Through the report we refer to sub-national and Pioneer areas.

By sub-national the Commission means areas which are formed by local authorities grouping together. This is already happening across England and in the view of the Commission this organic bottom up development is the right approach.

By Pioneer areas, the Commission means those sub-national areas that are willing and have the capacity to move forward more quickly with the reform agenda. The Commission is not in a position to say which areas these are, but they will certainly include both the non-metropolitan and metropolitan areas. The characteristics that these areas are likely to have are:

- A well-articulated business case setting out how better outcomes will be achieved
- An coherent and cohesive economic area
- An area with sufficient mass and scale to manage a wide range of public services
- Robust and visible leadership
- Mature governance arrangements
- Sound risk management
- Strong relationships across the full range of local public services.

5 Reforms

The variable speed approach leads the Commission to make two broad sets of proposals for change to the local government finance system. The first will apply to all local authorities and the second set of additional changes will support those authorities which are able to and wish to reform at a faster pace.

The section includes:

Reforms for all:

- An independent body to oversee the allocation of funding
- Reform of council tax
- Reform of business rates
- Multi-year settlements
- Securing social care
- Raising additional revenue.

Reforms for Pioneers:

- Characteristics of Pioneer areas
- Place-based budgets
- Self-sufficiency and equalisation
- Further council tax reforms
- Assignment of taxes
- Local Public Accounts Committees
- Governance.

Reforms for all

An independent funding body

We have outlined above the need for an independent review of the functions and sustainability of local government. It is sensible that the body that carries out this function should also have a broader advisory role.

A persistent concern raised by local government is that the financing system is not objectively applied — a complaint that is not confined to the present government. It is a strongly held belief that the funding system should be soundly based, transparent and effective in supporting desired local and national outcomes. In the Commission's view the advice and scrutiny from an independent body reviewing the allocation of funding and the application of transparent guidelines and formulae would support these aims.

It is the role of central government, working through Parliament, to set the total quantum of budgets and to have responsibility for its distribution. Establishing the funding total for a local authority or a sub-national area requires an assessment of need and the capacity of a local authority or sub-national area to raise income from local taxes. The role of an independent funding body, appointed by the sector and government together, would be to advise government as it carries out this task and to report to Parliament on the reasonableness of the government's decisions. The first task of the independent funding body should be to advise the government on the distribution of funding arising from the 2015 Spending Review.

Box 4 An independent funding body

An independent funding body should be established to advise government and scrutinise the distribution of government funding to local government, and to support the transition of local government to greater financial self-sufficiency.

This body will:

- Advise government on financial need and the distribution of government grants to sub-national areas and report to Parliament on the reasonableness of the government's decisions
- Advise sub-national areas on the method of equalisation between local authorities within their areas
- Assess the financial implications of devolving responsibilities and advise government on adjustments to funding, as we move to a place-based approach to funding sub-national areas and towards self-sufficiency
- The independent funding body will bring increased transparency and accountability to the local government finance system.

The Commission recommends the establishment of an independent body to advise government on the funding needs of local government and on the allocation of funding to local authorities and sub-national areas.

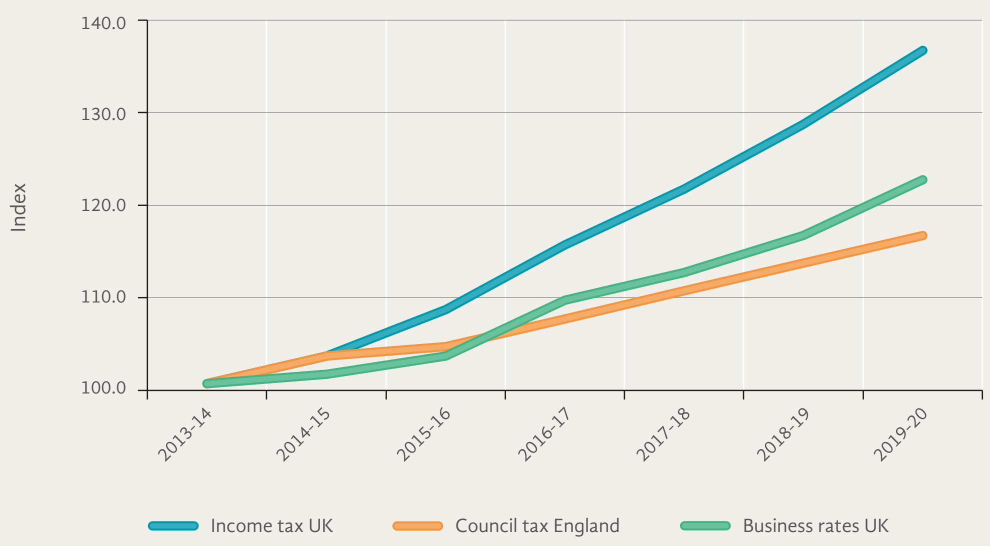
Reform of council tax

Fiscal devolution must begin with those taxes we already call local. A property tax is an important component of an effective local government finance system. We endorse the arguments put forward by Sir Michael Lyons in 2007 in his report on reforming local government finance, that a local property tax provides a strong connection between the tax people pay and their residence in the area. It reflects their financial stake in the community and its prosperity, and their interest in local services and investment which will themselves affect the desirability of local property.

However, council tax needs to be reformed. The tax in England is now levied on the basis of property values in 1991 and has decayed to the point where it lacks credibility with policymakers and the public. The system of national bands, operating uniformly from Hull to Kensington & Chelsea, fails to reflect local variations in property prices, often resulting in virtually all properties within an area crowding into one or two bands.

The requirement to hold a referendum for tax increases of 2 per cent or more brings into question the local control of council tax. The policy is arbitrary, undermines local democracy, wastes money, discourages local communities from taking a rounded view of local needs and priorities and penalises councils with historically low tax levels. Successive governments have adopted policies to place limits on council tax levels; the same approach has not been applied to centrally determined taxes, so the yield of other taxes rises far more quickly than council tax. Under the current referendum arrangements council tax receipts are expected to increase by 16 per cent between 2013-14 and 2019-20 while in the same period income tax receipts are expected to increase by 35.5 per cent. See Fig 4.

Fig 4 Comparison of projected tax increases in England 2013-14 to 2019-20



Source: OBR

Box 5 Referendum costs

The Chief Fire Officers Association has analysed the costs to local authorities of running a referendum, using government data and the cost guidelines issued by the Home Office for running the Police and Crime Commissioners' elections as a comparison. If all precepting fire authorities had decided to run a referendum to raise their council tax by 5 per cent for 2014-15 the costs would total an estimated £41 million, yet the income raised as a result of the increase, if accepted, would be just £38 million.

Table 1 sets out the yearly and weekly cost to residents of a 2 per cent increase. Based on the average council tax, the weekly increase for a Band A property is £0.38 per week.

Table 1: Cost of a 2 per cent increase in council tax

	Annual council tax, £s			2% increase (per year), £s			2% increase (per week), £s		
	Band			Band			Band		
	A	D	H	A	D	H	A	D	H
Lowest council tax area	452	678	1,356	9	14	27	0.17	0.26	0.52
Average council tax	979	1,468	2,936	20	29	59	0.38	0.56	1.13
Highest council tax area	1,151	1,726	3,452	23	35	69	0.44	0.66	1.33

The Commission recommends that the incoming government ends the policy of setting referendum limits on council tax and leaves the decision to local politicians.

Changes which have allowed local authorities to vary council tax discounts are a helpful reform. Since 1 April 2013, local authorities in England have been able to: apply council tax discounts of between 0 per cent and 50 per cent for second homes; to apply council tax discounts for empty dwellings at any level between 0 per cent and 100 per cent; and also to charge a premium of up to 50 per cent for dwellings that have been empty for more than two years. In 2013 there were 23.3 million properties on the Valuation Offices valuation list of which 8.8 million were subject to some form of discount or premium payment.

7.7 million properties, 33 per cent of the total, were in receipt of a single person discount, which is set nationally at 25 per cent of the council tax that applies to a property.[14] In Wiltshire, for example, the cost of the single person discount is £21 million per annum.

As Lyons has pointed out, council tax is hybrid in nature, in that it encompasses both a charge on the value of a property and a perceived service charge. The rationale for the single person discount is that fewer public services will be consumed by these households and therefore they should pay less. The discount does not take into account income and ability to pay and it also makes some significant assumptions about patterns of consumption of public services. In a period of significant funding reductions it seems right that the system of discounts should be reviewed to ensure that scarce public resources are used effectively. In the Commission's view council tax discounts should not be set nationally, but should be a local matter. Discounts are not targeted to meet the needs of the most vulnerable. If councils have the freedom to determine who receives discounts, it would enable them to be applied in a way that ensured that the impact was fair. Local authorities should be able to make these decisions with their local communities so that scarce resources can be used appropriately.

In addition, the recent partial localisation of council tax support — with local authorities being asked to run the replacement of the council tax benefit system — gives councils responsibility for the service without the power to make it work effectively. The government cut the scheme's funding by 10 per cent in the first year and imposed a framework prescribing the classes of people it had to cover and the reductions to which they were entitled. Councils should have the power to determine who receives council tax support.

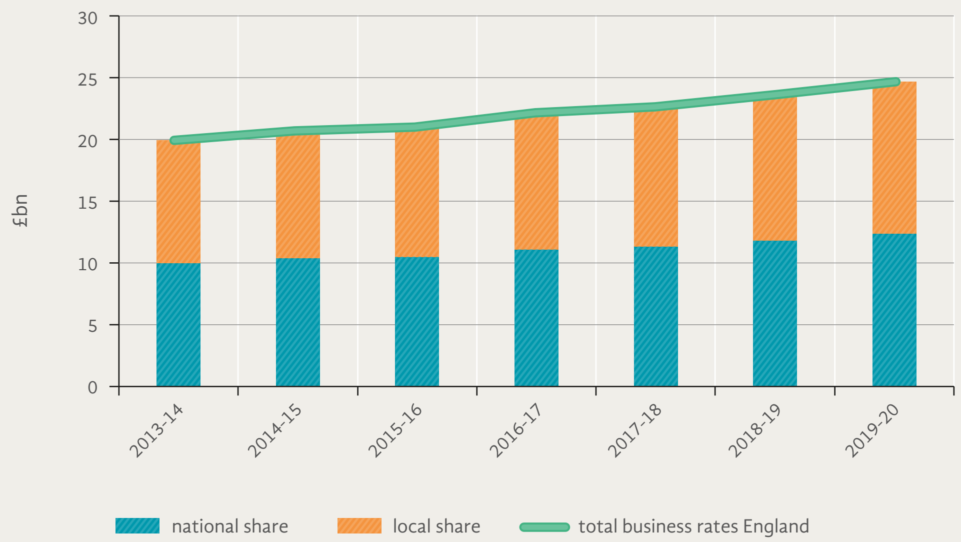
The Commission recommends that the incoming government should devolve council tax discount setting and the power to determine who receives council tax support to local authorities..

Reform of business rates

The Commission's vision is to see the business rate system localised in its entirety over the next 10 years. £20.5 billion in business rates were collected in England for the year 2013-14. Under the current financing arrangements 50 per cent of business rates are retained by local authorities. The remaining 50 per cent is taken by central government, but must be spent on local services.

14 Local Authority Council Taxbase England 2013 (revised), DCLG, February 2014.

Fig 5 Growth in business rates



Source: OBR/LGA

The decision to allow business rates retention was a good one, but the evidence from councils is that the reform did not go far enough. There is a growing consensus that local government has a vital role to play in creating the conditions for growth, and this view was behind the initial decision to localise business rates. We welcome comments from the government that they would like to see the local share increased as a way to further incentivise local authorities. In the view of the Commission the retention of 100 per cent of business rates would lead to higher overall economic growth in England.

The Commission recommends that 100 per cent of business rates and business rate growth should be retained by local government.

A second concern with the current system of business rate retention is the level of uncertainty around the 'reset' which is currently expected to take place in 2020. The Commission has received opposing views on this issue. Not all authorities have been able to benefit from the incentive to grow, reflecting underlying economic conditions which will take many years to transform.

For these authorities, a system built on a needs based formula which is rarely reset may lead to greater levels of disparity as the underlying funding baseline will not take account of demographic changes. However, for authorities that have benefited from business rates retention, the reset marks the point when these benefits, or some of these benefits, are redistributed across the local government sector. There is not a simple answer to this issue. Regular resets under the current business rates system undermines the Commission's view of "self-sufficiency" and, if carried out by central government, is incompatible with our longer term vision in that it makes central government the arbiter of distribution at each reset.

One longer term solution would be the development of a different form of business rates where revaluations don't automatically require business rate income redistributions. This also chimes with business concerns that the tax doesn't reflect economic circumstances. That can only be solved by making the tax base vary more rapidly to reflect changes in the property market and by removing the influence of changes in the property market in one part of the country on tax demands in another, although this would require dropping the presumption that revaluation is always to a constant yield. That adds more risks to it as a tax but reflects how it operates in other countries. More work is required to assess how a revised tax might work in a way that balances incentives and fairness. In the short term, a partial reset could allow local authorities to retain the growth in business rates, while making adjustments for population change and other underlying elements. This issue will need to be resolved early in the next Parliament.

The Commission recommends that the incoming government consults on the detail of the business rates retention reset as a matter of urgency, exploring options for a partial reset. The Commission also recommends that the independent funding body should advise government on the reset and report on the reasonableness of the government's decisions.

Financial risk arising from appeals is one of the biggest concerns that councils have about the retained business rates reform. There are about 131,500 outstanding appeals over business rates, with 125,500 relating to 2010 valuations and another 6,000 to 2005. Fifty per cent of the costs of appeals from before April 2013 are met by local government. Councils have argued that setting the cost of these appeals against the old national non-domestic rates pool would have been a better way to address these risks.

The review of business rate administration that has been announced by this government must look at the appeals process and propose ways to reduce the time it takes to resolve an appeal, as well as proposing options for reducing the time from valuation in which an appeal can be launched. This needs to be done in advance of the 2017 valuations.

The current business rates system is not local. The business rate multiplier, which determines how much business pays based on the valuation of their premises, is set nationally, the central and local share is determined nationally and there is a range of mandatory reliefs which are also set nationally. In 2013-14, £3.1 billion was granted in business rate reliefs. Nearly 50 per cent of the reliefs were for charities. An additional £160 million was granted by local authorities in discretionary reliefs. Business rate reliefs amount to 15 per cent of the total receipts of business rates.[15] It is not clear that a system of mandatory reliefs can target the needs of local businesses and local areas effectively.

The Commission recommends that as part of the review of business rates, the government should consult on options for the localisation of business rate relief.

Multi-year settlements

The local government sector has been calling for multi-year settlements for local government for some time. In recent years provisional settlements have been determined just three months before the start of a financial year. The government has stated its intent to work towards multi-year settlements for councils, clinical commissioning groups, schools and adult education providers, which will give local councils and their partners more certainty to better plan their service delivery. It is helpful that the government recognises the interrelationships between health and social care in this area. However, we want the government to go further.

The Commission recommends that the incoming government commits to full and clear multi-year settlements to enable effective long-term planning for local authorities and other public sector services.

Securing social care

We have set out the financial challenges facing adult social care. The funding gap amounts to over £700 million per year.[16] Practitioners recognise that health and social care are intrinsically linked, but over the last Parliament the two have been treated very differently, with health being protected as a

15 National non-domestic rates collected by local authorities in England 2013-14, DCLG, November 2014

16 Adult social care funding: 2014 state of the nation report, Local Government Association and the Association of Directors of Adult Social Services, October 2014

ring-fenced budget while social care has seen year on year reductions in funding as demand for the service continues to increase. Short, medium and long-term solutions are needed to this problem. In the Commission's discussions with NHS England, the King's Fund and others, there were calls for a single health and social care settlement, greater coordination and potentially greater integration at the sub-national level. Options for reform of social care funding must meet the needs of current and future service.

Ring-fencing social care funding is an option and might have support from professionals if it protects budgets. However, the approach does not sit well with the Commission's view that fiscal and administrative devolution should be the driving forces of reform to public services because ring-fencing reserves decisions on local spending to central government, hinders innovation and assumes that central government knows the precise boundary of need between one service and all others in every place in the country.

A second solution is to transfer the responsibility for adult social care to the NHS. This might have some superficial attractions in that it would take the problem away from local government. However in the Commission's view this would be a retrograde step. Social care provision requires locally developed and delivered support, increasingly in partnership with service users. In the Commission's discussions with senior health managers there has been no demand for the NHS to take on health and social care.

A third option is to find a way to make health and social care integration work. The Commission is aware that this is challenging. There are lots of examples from across the country where closer working between health bodies and local authorities appears to be leading to the delivery of better outcomes and savings.

However, there are fundamental differences in the provision of health services and social care services that make integration difficult. The funding of health provision is free at the point of use but social care provision is means tested. There are also cultural differences which can have a significant impact on the pace and ambition for change. The Commission's view is that the entire health and care system must work together effectively; health and care are closely connected and if one fails, it is a risk to the other. Integration won't work if forced from the top down. The best opportunity to reform services and make them more affordable is through integrating local practices across the whole of health and social care. This is a long-term aim and is as much about securing the future of the NHS as it is about securing social care.

Integration is the longer term solution and we discuss this further when outlining reforms for Pioneer areas below. However, this will not solve the short term funding issues faced by the sector.

One of the key roles for the proposed independent review of the sustainability of local government will be to assess the required level of social care funding and to advise government on the amount of money that will be required to fund social care appropriately in the next spending round.

Raising additional revenue

According to the Audit Commission, councils raise around £10 billion a year through fees and charges — approaching half the revenue raised through council tax[17]. As local government funding continues to decrease, charging for certain services is an important local power both to raise revenue and manage demand. However, there needs to be more open debate around the use of charges. Fees and charges are subject to a range of statutory restrictions and in general local authorities are limited to charging only what they need to recover in costs. There are a large number of service areas where fees and charges apply. These include: highways and transportation, including parking; planning and development; environmental and regulatory services; social care; education services; housing and cultural services. As the Communities and Local Government Select Committee has pointed out, "if the principle of fiscal devolution to local authorities is accepted, the justification for detailed financial constraints on local authorities falls down".[18]

The rationale for the power to raise additional revenues is that communities are best placed to decide if additional levies would benefit the local area by enabling investment in, for example, transport links or high street infrastructure. Business Improvement Districts (BIDs), where a ballot of local businesses approves a levy on the local business rates, show how this can work.

The Commission supports councils having the freedom to determine fees and charges locally.

17 Income from charging: Using data from the Value for Money Profiles, Audit Commission, September 2013,

18 Devolution in England: the case for local government; Communities and Local Government Select Committee, June 2014

Reforms for Pioneers

The commission's vision is devolution of powers, funding and ultimately taxes to sub-national entities which can reap the benefits of local and collaborative working and manage inequalities in capacity and resources between their constituent parts. Some sub-national areas have already achieved a substantial amount in governance, decision-making and service coordination aimed at improving the conditions for growth and achieving greater efficiencies. It is in areas like these that the Commission initially proposes more fundamental reforms of the local government finance system, although it is reasonable to expect that these reforms could apply to all within the next 10 years.

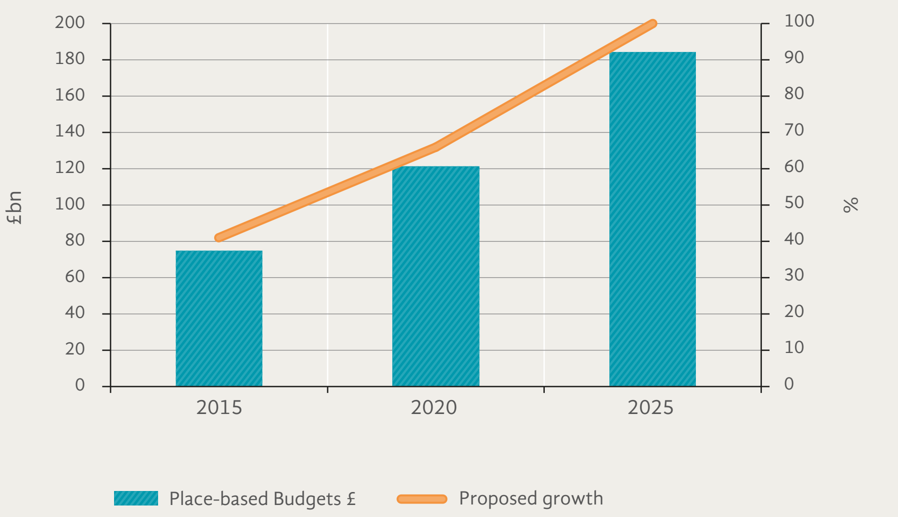
A place-based budget

For Pioneer areas the Commission proposes a single budget settlement, determined by central government. The service areas that go into a single budget will need further discussion and might differ from area to area. However, the presumption is that with some obvious exceptions, such as defence and the justice system, over time all public sector services and budgets could be devolved. The independent funding body will have a role in advising on this devolution.

The total annual revenue expenditure on local services, including health services commissioned through Clinical Commissioning Groups (CCGs), education and the police service is around £200 billion. There is great scope to bring at least some of these revenue budgets together so that decisions can be taken based on local priorities. However, the scale of ambition at the local level still needs to be assessed. It is perhaps not surprising that the most important area to get right — health and social care — will also be the most challenging. Therefore the Commission envisages that this reform will happen in stages.

The first stage might encompass existing local government functions (education, social care, housing, planning, waste management, waste collection, and libraries), police, fire, adult and youth skills and employment. The second stage might also include dedicated schools grant and the third stage might add health, although there is a prospect that some elements of the health that could be included in place-based budgets at an earlier stage. This staged approach would see place-based budgets grow from around 40 per cent of local public services to 100 per cent over a 10 year period. See Fig 6.

Fig 6 Proposed growth of place-based budgets



Source: DCLG/Independent Commission on Local Government Finance

The Commission recommends that the incoming government commits to the introduction of place-based budgets for sub-national areas that are willing and able to take on this reform.

Self-sufficiency and equalisation

We set out what we mean by self-sufficiency in the section outlining our approach to reforms. The Commission recognises that self-sufficiency cannot be achieved by all councils or sub-national areas within the foreseeable future. Even with a 100 per cent retention of business rates, without additional government grant a significant number of local authorities, over 100, would be unable to fund their services. Analysis by the LGA at a regional level shows that 85 per cent of the required redistribution between authorities is intra-regional with the remaining 15 per cent requiring transfers between regions. In London, for example, the overall surplus is estimated in the model to be around 330 million with 10 authorities in surplus and 23 in deficit.[19]

For Pioneer areas, the Commission proposes that equalisation should operate at two levels. First, there would be equalisation between areas (such as city regions). There would then be equalisation within a sub-national area

19 LGA analysis using standard English regions.

such as London or West Yorkshire, managed by the sub-national area. The Independent Funding Body would provide advice to central government and sub-national areas on these matters. The reason for the two stage approach is that adjustments between sub-national areas will need to be less dramatic and less frequent than within sub-national areas and this approach promotes self-sufficiency (in terms of areas being able to look after themselves).

Equalisation within a sub-national area could have a number of advantages over the current system. It would strengthen the degree of independence; be more transparent to councils and local communities; it could encourage strategic working between authorities; and it could lead to a more transparent discussion between local and central government on how to address ongoing economic and social challenges.

Equalisation need not be on the basis of the aggregate of the property tax base, especially where different bands are used in different areas; an issue the Commission discusses below. Instead some other indicator of taxable capacity could be used such as aggregate taxable income in the sub-national area. This approach is important because it enables local choice about the basis of the property tax.

Further reforms to council tax for Pioneer areas

Changes to council tax bands and decisions on revaluing property have to take place at the same level as equalisation. If equalisation takes place at a national level only then the re-banding and revaluing would need to take place at the national level as well. However, the Commission recognises that any government will find it politically challenging to undertake these reforms. A move to equalisation at a sub-national level provides an opportunity to break the impasse.

The Commission recommends that sub-national Pioneer areas should be given the power to determine the number and value of council tax bands and when properties are revalued.

For example this would enable London, which has seen many homes increase in value beyond £1 million, to revalue its properties and set the bands accordingly. Eventually local revaluations would need to trigger changes to the equalisation mechanism between authorities to reflect changes in the tax yield, but that could be managed in such a way as to avoid the big national storm which is assumed to be inevitable if the entire country were to be revalued simultaneously.

Box 6 New York City property tax valuation

Market values to all properties in New York City, around 1,045,000, are determined each year and this forms the basis for the property tax paid by households. The market value is based on prices of similar properties that have sold in the relevant area over the last three years. An assessed value is then calculated based on a set percentage of market value. For class one properties the assessment percentage is 6 per cent and the market value is multiplied by 6 per cent to arrive at the assessed value. State law limits how much the assessed value of a class 1 property in New York City can go up each year. It can only increase by 6 per cent in one year or 20 per cent over five years. Because of these caps, if for example the market value of a property doubles, it would take 18 years for the assessed value to reach 6 per cent of the market value.

By comparison Greater Manchester has 1,191,550 properties on the council tax valuation list and West Yorkshire has 979,680 properties on the council tax valuation list.

The role of property taxes in influencing the management of house prices is also important. As Lyons pointed out, the purpose of taxes is both to raise revenue and to affect behaviour. There is great concern that persistent price inflation is making housing unaffordable to many. If local authorities were allowed to determine the position of the bands and the levels of the taxes, they could help take some local heat out of the housing market. Conversely, a nationally set system exacerbates housing problems by distorting the housing market — forcing local authorities to levy taxes which are disproportionately low in some areas and disproportionately high in others.

Assignment of taxes to sub-national areas

The full benefits of a devolved model can only be achieved if there is a greater degree of alignment between taxation and spending decisions within a sub-national area. It must also allow the freedom for businesses and communities to work with elected representatives in shaping the tax system to suit local circumstances. The funding of locally-delivered and accessed services needs to resemble the Scottish model and be a combination of: council tax; business rates; newly assigned taxes, for example, stamp duty, tourism taxes or airport taxes; an apportionment of other taxes such as VAT or income tax; and government grant. Our view is that this would also achieve a significant cultural shift away from central government and towards greater local accountability.

The Commission recommends that the incoming government should work with local government to agree a timetable for fiscal devolution, adopting the Smith Commission principles as a basis for reform.

Local Public Accounts Committees

The shift in financial responsibilities outlined in this report would amount to a significant rebalancing of power between central and local government. To accompany that shift in responsibilities and to recognise the changing geography of public sector decision-making it will be necessary to strengthen the scrutiny arrangements at the sub-national level.

The Commission supports the introduction of local 'public accounts committees' to carry out this function, an idea discussed by the Centre for Public Scrutiny. These should be independent of decision-makers and service deliverers and should draw on the wealth of knowledge that can be found in the local business and resident population. There is now a range of experience of scrutiny to help shape how these bodies could operate. Local public accounts committees should be established in Pioneer sub-national areas to scrutinise value for money for all public services.

Box 7 Local Public Accounts Committee

The local public accounts committee (LPAC) needs to be independent of decision-makers and those delivering services. The Commission does not have a prescriptive view of the membership of an LPAC, but it is evident that a good case could be made for participants to be drawn from local members of parliament, business interests, and local community representatives with the experience and skills to serve on it. The purpose of these bodies would be to provide open, public scrutiny. They would need powers to access information and to call elected representatives and other decision-makers to hearings.

Governance

The Commission's proposals for the local government finance system in pioneer areas quite naturally have implications for other local services, including how health and social care can work together to produce better outcomes. Getting the governance right is important. The Commission fully favours a bottom-up approach to establishing tighter partnership arrangements and new statutory bodies, but greater powers and responsibilities at a sub-national level must also be matched by greater accountability.

The governance arrangements must allow for a fluid set of relationships between local stakeholders as decisions are taken on a range of policy areas. The arrangements will inevitably be complex, but this is already the case. There is scope in the new arrangements around sub-national Pioneer areas to improve the transparency of decision-making and accountability.

Box 8 Responding to the big national policy questions

The ambition for Pioneer areas should be even greater than the policies we have outlined. Submissions to the Commission highlighted a number of ways in which further reform could enhance local government's ability to respond to the big national policy questions; these could be introduced in Pioneer areas.

The ideas include:

Health and Social care

The report by the Independent Commission on the Future of Health and Social Care in England (the Barker Commission) has made a significant contribution to the debate around securing a sustainable funding system for health and social care. The increased demand faced by A&E departments during the winter of 2014-15 has been the result of a number of factors and more work is required to understand if the reductions in social care funding have had an impact on the demand for urgent and emergency NHS services.[20]

The Commission has recognised that integration is challenging as a result of different funding systems, eligibilities, resources and charging systems in the NHS and local government. However, it is essential that Pioneer areas are encouraged to develop innovative approaches to integration, which go beyond the current ambitions of the Better Care Fund.

Ultimately, local areas need to find their own solutions. The Five Year Forward View published by NHS England in 2014 highlights a greater willingness to, for example, negotiate local changes to the way money flows round the health and care system to allow greater integration. Discussions are already taking place in parts of the country along these lines. We strongly endorse the approach of local areas being given far greater freedom to shape their local health and care economies.

20 Fact or Fiction? Social care cuts are to blame for the 'crisis' in hospital emergency departments, Ruth Thorlby, Nuffield Trust 29 January 2015

Growing the economy
Infrastructure investment — building on the current tax increment financing approaches (known as TIF, a way of funding investment through future tax gains), combined authorities could have the power to finance investment in infrastructure, employment and skills based upon the potential savings from increasing employment as well as the proceeds of growth.

Transport — learning from the achievements under the powers given to the Mayor of London to control much of the capital's transport infrastructure, councils and passenger transport executives could have freedom to match local transport services to their needs. Reforms to local transport management could include:

- Freeing councils to decide whether to introduce workplace parking levies and other traffic management schemes, and make explicit their right to introduce congestion charges
- Removing the ring-fence that divides transport spending into discrete pots, separates capital and revenue transport investment and hampers the use of other budgets for transport projects
- Transferring the Bus Service Operators Grant (BSOG) and other bus subsidies entirely to councils or groups of councils.

Increasing the housing supply

In 2012 the Future Homes Commission, sponsored by the Royal Institute of British Architects, argued that there was a need for an extra 300,000 homes each year. Just 100,000 are being built. In addition, across England there are 1.7 million households on waiting lists for affordable homes.

The housing crisis will never be solved unless local government again plays a leading role in the supply of social housing. The collapse in the supply of new homes since the 1970s mirrors the virtual elimination of council house-building. The scale of the task is now huge. A new home typically costs £140,000 including land, so building an additional 100,000 to 200,000 homes per year would require between £14 billion and £28 billion — or minimum of £140 billion over a decade. Part of the long term solution has to be to translate growing housing needs into effective market demand so that the market is stimulated to increase supply. That requires incomes to rise relative to housing costs, and a transfer of housing subsidies from the state to employers. In the short to medium term a range of additional freedoms for local government would help:

- Councils should be allowed to borrow for investment in housing and this borrowing should sit outside the Public Sector Borrowing Requirement.
- Lifting the borrowing cap on the Housing Revenue Account will release an additional £4 billion.
- Local authorities should also be able to trade their borrowing limits among themselves — enabling councils with spare borrowing headroom to make this available to other authorities, and thereby helping grow the supply of housing in areas that are willing and able to build.
- It is clear from NAO data and the government's recently published review of the New Homes Bonus that it has only had a partial effect in stimulating housing supply and that it has significant distributional effects. An incoming government will need to consider if and how this scheme can be reformed to provide a genuine incentive to increase the housing supply.
- Converting some of the £21 billion spent in England on housing benefit into capital spending by forcing down rents may not work in the public and registered social landlord sectors because rent reductions would need to be made up in subsidies to rent accounts from other sources. Cutting private sector rents might help, but it would also reduce the number of properties being offered.

Promoting employment while protecting the vulnerable

Education, training and skills — local authorities, collaborating through Local Enterprise Partnerships and sub-national Pioneer areas could be entirely responsible for further and adult education, skills and apprenticeships, regeneration and employment support, including the Work Programme. This involves replacing the current system of more than 100 funding streams so that investment decisions can be based on local factors such as what local businesses need to create jobs.

Supporting families and children through early intervention

The costs of failing to support young people are high — £5,500 to lock up a young offender for a month, £46,000 to take a child into care and £4,500 to maintain an 18-24 year old NEET for a year. Coordination of different services to provide a joined up intervention when families hit problems has been improving, with the Troubled Families programme building on good practice in local government. However, practitioners have told us that still more could be done by central government to ensure that departments work together efficiently and coherently. The government could work with Pioneers to embed the Troubled Families approach to funding and collaboration across the full range of services for families and young people.

6 The benefits of devolution for central government

There has been a drive over the lifetime of this Parliament to reduce the costs of central government. Central administration costs have been reduced by around 40 per cent in real terms between 2010-11 and 2015-16[21] across the whole of the civil service, supported by a programme of centralising functions such as property, IT and procurement.

The administrative costs of central government departments are expected to be £11 billion in 2015-16; this is a cash reduction of 18.5 per cent from 2011-12.[22] The proposals outlined above, if steadily rolled out across the country, would allow central government to reduce in size with a rationalisation of the number of departments and the need for offices, ministers and senior officials. The costs of central government could be reduced further.

21 Autumn Statement 2014

22 Public Expenditure Statistical Analyses 2014, HM Treasury

Appendix 1

Round 1 of Consultation Responses

- Association of County Chief Executives
- Association of Directors of Public Health
- Association of North East Councils
- Birmingham City Council
- Bradford District Council
- Brighton and Hove City Council (Unitary)
- British Property Federation
- Cambridgeshire County Council
- Cannock Chase Council
- Chartered Institute of Housing
- Cleveland Fire Brigade
- Core Cities Group
- Cornwall Council (Unitary)
- County Councils Network
- Cumbria County Council
- Dartford Borough Council
- Derbyshire County Council
- Devon County Council
- District Councils Network
- Dorset Fire Authority
- Early Intervention Foundation
- East Northamptonshire District Council
- Essex County Council
- Greater Manchester Combined Authority
- Hampshire County Council
- Hampshire County Police and Crime Commissioner
- Hampshire Fire and Rescue
- Hartlepool Borough Council
- Hinckley and Bosworth Borough Council
- Joint submission by the LGA Fire Service Management Committee,
- The Chief Fire Officers Association and the Fire Finance Network
- Kent County Council
- Kettering Borough Council
- Knowsley Borough Council
- Leicester, Leicestershire and Rutland Combined Fire Authority
- Leicestershire County Council
- Liverpool City Council
- Local Government Shared Services
- London Borough of Camden
- London Borough of Havering

- London Borough of Lambeth
- London Councils
- Melton Borough Council
- Milton Keynes Borough Council (Unitary)
- National Audit Office
- National Housing Federation
- National Union of Students
- Newcastle City Council
- Norfolk County Council
- Northamptonshire County Council
- Peterborough City Council
- Police and Crime Commissioner — Hampshire
- Police and Crime Commissioner — Lancashire
- Police and Fire Commissioners Treasurers Society
- Preston City Council
- Rev Cooper (rural parish Preston)
- Royal Town Planning Institute
- Rural Service Network
- Slough Borough Council (Unitary)
- Society of County Treasurers
- Solihull Metropolitan Borough Council
- South East England Councils
- Sparse Rural
- Stafford Borough Council
- Stockton-on-Tees Borough Council
- Stoke on Trent City Council (Unitary)
- Suffolk County Council
- Tandridge District Council
- The LEP Network
- The Special Interest Group of Municipal Authorities (outside London) within the LGA
- Training Standards Institute
- Tyne and Wear Fire and Rescue
- Visit England
- Warwickshire County Council
- West Oxfordshire District Council and Cotswold District Council
- Worcestershire County Council

Responses to the Interim Report

- Barry Quirk
- District Councils Network
- Essex County Council
- Greater London Authority
- Hampshire County Council
- Hampshire Fire and Rescue Authority
- Knowsley Metropolitan Borough Council
- Lancashire County Council
- LGSS
- Liverpool City Council
- Liverpool City Region Directors of Finance
- London Borough of Ealing
- London Borough of Camden
- Luton Borough Council
- Manchester City Council
- Newcastle City Council
- North Hertfordshire District Council
- Northamptonshire County Council
- Police and Crime Commissioners Treasurers Society
- Society of County Treasurers
- SOLACE
- Solihull Metropolitan Borough Council
- South East England Councils and
- South East Strategic Leaders (SESL)
- South Norfolk Council
- Special Interest Group of Municipal Authorities
- Stockton-on-Tees Borough Council
- Suffolk County Council
- Telford and Wrekin Council
- Tom Lawrence
- Tunbridge Wells Borough Council
- West Sussex County Council
- Wyre Forest District Council

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The Commission on Local Government finance was established by the Local Government Association (LGA), the national voice of local government, and the Chartered Institute for Public Finance and Accountancy (CIPFA), the professional body for public finance professionals.