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Communities and Local Government Committee

Devolution in England: the case for local government

First Report of Session 2014–15

Report, together with formal minutes relating to the report

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Contacts

All correspondence should be addressed to the Clerk of the Communities and Local Government Committee, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 1234; the Committee's email address is clgcom@parliament.uk

Contents

Summary

The devolution of significant powers to raise and spend money locally, initially to a limited number of areas, would build on much that has happened in England over the past decade. Localism, City Deals, Community Budgets and the partial localisation of business rates in England all point to growing, greater local control over how money is spent and, ultimately, over how such money is raised in order to be spent. By comparison Scotland and Wales are gaining much greater control over taxation and borrowing, including responsibility for business rates, stamp duty and partial control over income tax. And all political parties recognise that the existing proposals will go even further in Scotland under so-called "devo max". A similar case can be made for devolving many of these powers to areas in England—some of whose GVA [Gross Value Added] is greater than that generated in Scotland or Wales.

We support the principle of fiscal devolution in England and call on the Government to work with local government to devise a fiscal devolution framework for local authorities. No-one who submitted evidence to this inquiry opposed fiscal devolution, though some wanted to go no further than decentralisation of spending. We see fiscal devolution and decentralisation of spending as going hand in hand. In this report we identify key features of the design of the new system. The first is that any system of devolution should recognise need while balancing incentives for local areas to build up their economies. Second, fiscal powers should be devolved to groups of local authorities, covering a recognisable large-scale area, that can demonstrate how they share, and work together as, a functioning economy. Given central Government's interest in wider economic policy, which for the foreseeable future will focus on deficit reduction, these authorities will also need to demonstrate a strategic and prudent approach to planning and investment. But continuing fiscal devolution should be something for the medium and long term. Third, a strong, locally agreed governance model will also be required. We do not prescribe a particular governance model, but any arrangements must be detailed and transparent, with a clear means of scrutinising decisions and holding those with power to account. If more significant and meaningful decisions are made locally about how money is raised and invested, local people should have a better opportunity to identify and hold those making such decisions to account.

Fiscal devolution will not happen overnight, but with an agreement in principle local and central government should then get on with implementation. Central Government should establish the general framework within which fiscal devolution can take place, so that those local authorities that are not ready, or do not wish, to take on significant fiscal devolution now are not permanently excluded. To that end authorities should have access to enhanced powers over how money is spent locally, and authorities that collaborate should have access to greater strategic powers. In addition, we suggest there should be greater freedom over council tax for all authorities. Local and central Government should agree on a specific means of negotiating fiscal devolution. We suggest this might be done through a wide-ranging Growth Deal—a fiscal agreement.

The transfer of enhanced tax and borrowing powers from central to local Government may take time and require complex negotiations and, although our report addresses the technical issues, it is fundamentally about the transfer of power to local authorities and local communities. Fiscal devolution is the logical next step on the path to genuine localism. We think a start should be made.

1 Introduction

1. The argument that local authorities should have greater powers to raise, retain and spend money locally—fiscal devolution—has gathered momentum over the past 12 months.[1] Indeed, the Prime Minister said on 9 June there was "political consensus" across the main parties that "devolving power and money from Whitehall to the cities [...] is the future. The debate now is about how far and fast it can go".[2] Fiscal devolution builds on the transfer of powers to the devolved nations of the UK over the past 15 years and on measures introduced by the Coalition Government to decentralise powers over spending and public services in England. Community Budgets, piloted from 2011, which superseded Total Place, allow local providers of public services to share their financial resources.[3] City Deals, established in 2012, have given England's large urban authorities new opportunities to stimulate economic growth and decide how public money is spent locally.[4] More recently, Growth Deals, first announced in March 2013, allow Local Enterprise Partnerships to bid for money from the Government's Single Local Growth Fund.[5]

2. This report examines how fiscal devolution to local authorities—building on the current arrangements—could go a stage further, allowing them to control more of their own taxes and enhancing their ability to borrow.

3. Over the past century the trend has been in the direction of increased centralisation with more of local authorities' resources raised and distributed by central Government. Since the 1930s locally raised income has been in decline, irrespective of the party in central Government.[6] In his 2012 report to Government, *No Stone Unturned in Pursuit of Growth*, Lord Heseltine, reflecting on the Victorian age when people looked to their city, as well to Whitehall, for solutions, considered:

> Those days are gone. Industrialisation demanded migration and urbanisation. [...] It fell to local government to respond to the needs and demands of the ever growing electorate. The cost of providing the necessary infrastructure and basic social support could not, however, be borne by many

1 See, for example, Core Cities, *Competitive Cities, Prosperous People* (November 2013); The London Finance Commission, *Raising the Capital: the report of the London Finance Commission* (May 2013); "*London and England's largest cities join to call for greater devolution to drive economic growth*", Greater London Authority press release, 30 September 2013; "*The City Growth Commission*", City Growth Commission press release, 28 October 2013.

2 "*Cameron sees devolution to England's cities as 'the future'*", *Financial Times*, 9 June 2014

3 Gov.UK, "Giving local authorities more control over how they spend public money in their area", accessed 1 May 2014. Sixteen first-phase Community Budgets for families with multiple problems were launched in April 2011. A further four 'Whole Place' Community Budgets, centred on Greater Manchester, Cheshire West and Chester, Essex County Council and the West London Tri-borough area, were launched in December that year; see the Communities and Local Government Committee, Third Report of Session 2013-14, *Community Budgets*, HC 163, paras 3-4.

4 Gov.UK, "Giving more power back to cities through city deals", accessed 1 May 2014. Deals were concluded with England's eight largest cities in 2012. A second wave of deals has been entered into with 20 cities. Fifteen have been agreed with the Government; see Local Government Information Unit, *Cities economic growth and devolution update* (April 2014).

5 Gov.UK, "Government publishes response to Heseltine report", accessed 1 May 2014

6 Tony Travers and Lorena Esposito, *The Decline and Fall of Local Democracy*, Policy Exchange / NEF, (2003), p 10

> of the cities themselves. Wealth had to be redistributed by central government. And with that redistribution came central controls […] With central government reserving for itself the power to make the vast majority of economic decisions—creating itself as a functional monopoly—local authorities have been relegated to service providers.[7]

Impetus for change

4. During our inquiry we identified two factors driving change. First, central Government has put localism back on the political agenda and has devolved some spending powers to local government. Second, devolution to Scotland and Wales has brought into question how England is governed and also accentuated how out of step England is with other nations. The referendum on Scottish independence will take place in September 2014. If Scottish voters decide to stay part of the United Kingdom, Scotland is due to acquire further tax and borrowing powers.[8] The UK Government's response to proposals in the Commission on Devolution in Wales—the Silk Commission—also means the Welsh Assembly Government's fiscal powers will be enhanced.[9] This then raises the "English question": should England also have fiscal devolution and, given that neither an English Parliament nor regional government is a likely prospect, how might it be achieved?

Foreign comparisons

5. By international standards the UK has a highly centralised system of taxation and expenditure. As of 2011 the proportion of tax set at a sub-national—local or regional—level was at most 2.5% of GDP.[10] This compared with 15.9% in Sweden; 15.3% in Canada; 10.9% in Germany; and 5.8% in France—often seen as a highly centralised state.[11] France presents an instructive case. Since the 1980s it has been steadily decentralising. As part of this inquiry we visited Lyon, which has been at the forefront of these changes. By contrast English local authorities have, in reality, power over only one, out-of-date, declining and centrally controlled tax, the council tax: its only and most recent valuation was in 1991; in recent years central Government has offered a grant to local authorities prepared to freeze the level, so less tax has been raised locally; local authorities needing more than the Government has offered, and wishing to increase the tax above a centrally specified level, are required to hold a referendum; this is the only UK tax where an increase can require a referendum; and the referendum threshold is set by the Secretary of State at a low level, which he notifies to local authorities only shortly before the start of the financial year.[12]

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7 Rt Hon The Lord Heseltine of Thenford CH, *No Stone Unturned in Pursuit of Growth*, (October 2012), paras 2.1-2.4

8 IPPR North (FDC0020) p 2

9 IPPR North (FDC0020) p 2

10 See para 16 for more detail.

11 Newcastle University Centre for Urban and Regional Development Studies (CURDS) (FDC0009) para 2.1; see Q67 [Professor Pike] and Q247 for views on France's centralisation.

12 For 2014-15 the threshold is 2%.

Definitions

Fiscal devolution

6. We define fiscal devolution as encompassing the following elements: handing to local authorities the power to raise money through a range of existing and new taxes and charges; some responsibility for setting those taxes; and the facility to borrow. It would follow that the consequence of fiscal devolution must be greater local decision-making on how the money raised locally is spent.

Spending decentralisation

7. While relaxation of central Government's control over spending programmes can be a component of fiscal devolution, on its own it is not fiscal devolution. The Government cited a number of initiatives as examples of a "very significant shift in fiscal and functional responsibilities"[13] and the Department for Communities and Local Government pointed out that it had devolved significant functions and funding to the Greater London Authority; established and supported Local Enterprise Partnerships (LEPs); worked with major conurbations to negotiate bespoke City Deals; given greater control over resources by removing ring-fences on local authority funding; and rewarded places that deliver growth through the New Homes Bonus and local business rate retention. These were seen as part of a "clear and broad commitment to decentralisation".[14] We welcome the general direction of these developments but, with the limited exception of certain City Deals, which we examine in this chapter,[15] we would not categorise greater control over local spending on its own as constituting fiscal devolution.[16] In our view, fiscal devolution and spending decentralisation are not synonymous. Fiscal devolution has to include significant tax-raising and retaining powers.

Wider decentralisation

8. The Core Cities, the Greater Manchester Combined Authority and the Key Cities Group told us that greater control over the spending of resources and more "place-based budgeting" than is currently provided by Government was necessary to decentralise and reform services such as skills and health and social care.[17] This wider decentralisation would not only empower local authorities to decide how money is spent locally, but give them responsibility for shaping local infrastructure and public services. We consider this issue in more detail at paragraph 90.

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13 Department for Communities and Local Government (FDC0014) para 4

14 Department for Communities and Local Government (FDC0014) para 2

15 See para 10.

16 See Department for Communities and Local Government (FDC0014) para 12, and Q320 [Cllr Nick Forbes].

17 Core Cities (FDC0008) para 3.4; Greater Manchester Combined Authority (FDC0006) paras 5.1, 6.1; Key Cities (FDC0015) paras 15-17

A fiscal devolution package

9. As a starting point for our deliberations we examine the proposals set out in the 2013 report of the London Finance Commission (LFC), which recommended a package of fiscal devolution for London.[18] The LFC concluded that most of its recommendations could and should operate well in England's other big cities.[19] England's eight largest cities (after London)—the self-defined Core Cities—endorsed the LFC recommendations and suggested that property taxes such as business rates, stamp duty and council tax, might be devolved to them.[20]

Models currently operating in England

10. Under our definition there are only a very few limited examples of fiscal devolution in England. The model that best marries spending decentralisation with, in some cases, a degree of fiscal devolution is the City Deal. It decentralises spending powers through economic investment funds, localised skills funding and youth contracts and local transport funding. Its fiscal measures include the Earn Back arrangement in Greater Manchester and Gain Share in Cambridge. In both cases, some of the receipts generated through local investment are kept by the local authorities instead of going back to the Treasury.[21] In Manchester's case the initial investment was generated in part by borrowing.

11. More broadly, covering all local government in England there are programmes and arrangements with some limited fiscal devolution. The Business Rates Retention Scheme (BRRS) splits locally collected business rates between central and local government on an equal basis. Subject to a system of national redistribution, it allows local areas to retain the local share of the income generated by the growth in companies locating to or expanding in their area.[22] Conversely, albeit with the protection of a safety net, local areas bear the consequence of a decline in local business rates. The New Homes Bonus is aimed at encouraging local authorities to stimulate the building of new houses in return for additional revenue.[23] Enterprise Zones allow particular business areas to retain 100% of their business rates, which can be reinvested in the local economy.[24]

18 *Raising the Capital: the report of the London Finance Commission* (May 2013). The Mayor of London established the London Finance Commission in July 2012. It was chaired by Professor Tony Travers of the London School of Economics, who in a personal capacity gave evidence to the inquiry twice.

19 *Raising the Capital: the report of the London Finance Commission*, (May 2013), p 9

20 "London and England's largest cities join to call for greater devolution to drive economic growth", Greater London Authority press release, 30 September 2013; Core Cities (FDC0008) para 3.10; the Core Cities are Birmingham, Manchester, Nottingham, Bristol, Sheffield, Newcastle, Leeds and Liverpool.

21 See Department for Communities and Local Government (FDC0014) para 12. The Greater Manchester Combined Authority said its Earn Back model "allows us to capture a proportion of the growth generated as a result of our local investment in transport infrastructure for reinvestment. This is based on a formula linked to changes in rateable values over time at the Greater Manchester level, which provides a revenue stream over 30 years, provided that additional GVA is created relative to the agreed baseline. This therefore provides an additional incentive for Greater Manchester to prioritise local government spending to maximise economic growth." See (FDC0006) para 3.2.

22 DCLG (FDC0014) para 16

23 *The New Homes Bonus Scheme,* Standard Note SN/SP/5724, House of Commons Library, January 2014

24 See Department for Communities and Local Government (FDC0014) para 20

Capital projects

12. By far the most significant use of enhanced tax and borrowing powers has been by the Greater London Authority (GLA). The GLA became the first UK local authority for 17 years to issue bonds when, in 2011, it raised £600 million to help fund Crossrail, the east-west railway line due to start running under the capital in 2018. The GLA has also borrowed £3.5 billion against a Crossrail business rate supplement.[25] London's Northern Line Underground extension was also financed in part through the Treasury providing a guarantee to enable the GLA to borrow £1 billion from the Public Works Loan Board.[26] These few examples show how little genuine fiscal devolution to local authorities is currently in place.

Our inquiry

13. We received 38 submissions from organisations, groups and individuals. Significantly, no one was against fiscal devolution in principle, though, as we have noted, some defined it as little more than the enhanced decentralisation of spending powers. We held seven oral evidence sessions, including one in Manchester as part of our visit to the Greater Manchester Combined Authority. We also visited Lyon in France. We are grateful to all those who gave evidence and to those who hosted our visits. We appointed Professor Alan Harding of the Heseltine Institute, University of Liverpool, and Sean Nolan, a consultant on local government finance, as specialist advisers to this inquiry. We are grateful to them for their advice and guidance during our deliberations.[27]

14. When we launched our inquiry in November 2013, our focus was on cities and city-regions, where up to then most interest had been focused.[28] But from the written evidence we received it became clear that other areas of England beyond London and its largest cities were anxious to share in the benefits of similar devolution.[29] Indeed, during the period of our inquiry, think tanks, commissions, groups of local authorities and political parties produced their own reflections on the issue.[30] This report therefore looks not only at fiscal devolution to large cities and city-regions, but beyond them to counties and smaller cities. Its conclusions and recommendations address local and central Government and we hope

25 Newcastle University Centre for Urban and Regional Development Studies (CURDS) (FDC0009) para 10.2

26 Newcastle University Centre for Urban and Regional Development Studies (CURDS) (FDC0009) para 9.5

27 Professor Harding made the following declaration of interest: Centrally involved in raising funding for pure and applied social scientific research and consultancy studies and supporting human and physical capacity. Led three major projects for UK Economic and Social Research Council. Other clients include European Commission, UK Government Departments, charitable trusts, regional agencies, local authorities, other local government organisations, private sector bodies, individual businesses. Sean Nolan made the following declaration of interest: Director of consultancy company SJ Nolan Ltd, permanent employee of the Kent Police Commissioners Office. Spouse is a school bursar. On Finance Committee of Crowborough Beacon Golf Club.

28 See footnote 1.

29 See, for example, County Councils Network (FDC0013); Key Cities Group (FDC0015); Oxfordshire County Council (FDC0017); and City of York Council (FDC0010).

30 See, for example, Centre for Cities, *Breaking boundaries: empowering city growth through cross-border collaboration*, March 2014; City Growth Commission, *Metro Growth: the UK's economic opportunity*, February 2014; "LGA commission launched for counties' growth", Local Government Chronicle, 7 April 2014; Policy Network, *Competing in a race to the top: Results from the employer survey for the Adonis Growth review*, April 2014.

that they may assist political parties drafting their manifestos for the 2015 general election. Implementation will be for the next Parliament. The report examines:

- the case for fiscal devolution in England (chapter 2);
- the principles and key criteria that should be part of any system of fiscal devolution (chapter 3);
- the process by which fiscal devolution could be agreed (chapter 4); and
- some of the taxes, charges and borrowing powers that might be devolved as part of fiscal devolution (chapter 5).

15. **The power to raise, retain and spend money locally—fiscal devolution—is back on the political agenda. Local government wants more of it. The UK Government, in promoting devolution, localism and spending decentralisation, has shown that we may have passed the high water mark of Whitehall control. But increased and increasing fiscal devolution to Scotland, Wales and Northern Ireland—and foreign comparisons—highlight how much England is still firmly in the fiscal grip of central Government. There is unlikely to be an English Parliament or regional assemblies, so devolution based on existing structures or groups of authorities is the only way forward. With a UK general election less than 10 months away, policy makers must listen to calls for fiscal devolution to local authorities in England and consider their response.**

2 The case for fiscal devolution

Fiscal devolution internationally

16. The starting point for several witnesses favouring greater fiscal devolution was a comparison of the level of tax set locally in the UK with other countries.[31] Professor Tony Travers of the London School of Economics, who chaired the London Finance Commission (LFC), drawing on OECD figures, noted that the UK's total of 1.7% of taxes set locally consisted entirely of council tax, adding that even if the 50% of business rates that local authorities have retained since April 2013 were included, "the figure would only rise to perhaps 2.5 per cent". He concluded that the UK was a "substantial outlier by international standards".[32] The Government itself appears to have recognised a disparity and that change is required. In October 2012 the Department for Communities and Local Government announced details of a policy, entitled "Giving local authorities more control over how they spend public money in their area". The policy's webpage, updated in October 2013, states:

> England's local government finance system is one of the most centralised in the world. This means that local authorities don't have the autonomy and flexibility they need to make sure public money is spent on the things that matter in their area.[33]

17. The London Chamber of Commerce and Industry (LCCI) described London compared with other capital cities as an "extreme outlier". It noted that Madrid looked to the state for 37% of its funding, New York 30.9%, Berlin 25.5% and Tokyo 7.7%. London, in contrast, required central government funding totalling 73.9%.[34] The Mayor of London provided further context to these figures pointing out that London, including its boroughs and the Greater London Authority "currently spend about 7% of all the taxes that are raised in London, compared to 50% in New York, [and] 77% in Tokyo".[35] (It should be noted, however, that while such cities may collect more in taxes than London, they may not retain it all, as some yield will be redistributed to other areas of the country with higher needs and lower tax bases.)[36] Crossrail is being funded in part through bonds and a

31 To recap, as of 2011 the proportion of tax set in the UK at a sub-national—local or regional—level was 1.7% of GDP. This compared with 15.9% in Sweden; 15.3% in Canada; 10.9% in Germany; and 5.8% in France. See Newcastle University Centre for Urban and Regional Development Studies (FDC0009) para 2.1. See Q67 [Professor Pike] and Q247 for views on France's centralisation.

32 Professor Tony Travers (FDC0033) pp 1, 2; see also Sheffield City Council (FDC0034) appendix 1, for OECD figures on European countries' local government tax revenue as a percentage of total tax revenue. See also Q243 [The Mayor of London, Boris Johnson, also described Britain as an outlier].

33 Gov.UK, "Giving local authorities more control over how they spend public money in their area", accessed 2 May 2014

34 London Chamber of Commerce and Industry (FDC0019) paras 18, 17

35 Q242

36 The need for redistributive and equalisation arrangements is considered in chapter 3.

business rate supplement,[37] but this is an exception. Darren Johnson AM, chair of the London Assembly, told us:

> When I greet international delegations from other cities at City Hall, they are absolutely amazed and astounded that the Mayor of London has to lobby central Government to get money to build a new bridge, a Tube line extension or something like that. They just find that concept absolutely amazing: that at that micro-level of decision making, the Mayor of London has to lobby and has so little power to raise revenue.[38]

The Mayor summed up the position: "We are comparatively fiscally infantilised in this country, and [the LFC's proposals are] a chance to do something about it".[39] Under the LFC's fiscal devolution proposals, the proportion of locally controlled tax would rise to 12%,[40] still low by international comparisons.

18. **English local authorities, when compared with their counterparts in other developed nations, have limited control over local taxation and, as a consequence, rely, by comparison, disproportionately on central Government funding. Given the level of UK central Government control over local spending and over local taxation in England compared to other developed countries, it is entirely reasonable for local areas in England to aspire to greater local control over the money raised from their areas and spent locally. The key question is what to do about this aspiration: specifically, whether England should put in place a programme of fiscal devolution to local authorities and, if so, how it should go about the task.**

Devolution to Scotland and Wales

19. Closer to home, the fiscally centralised UK state is evolving dramatically and, in the process, England's position is becoming increasingly anomalous. The Scotland Act 2012 has given the Scottish Parliament the power to set a Scottish rate of income tax. Subject to the outcome of the forthcoming referendum on independence, this power is expected to apply from April 2016. Indeed, in a joint statement, the three pro-Union parties in Scotland have backed a further extension of powers, including money-raising powers, in the event of a no vote.[41] The Scottish Conservative Party has itself proposed the full devolution of income tax to Scotland.[42] And the other main political parties have made similar if less far-reaching proposals.[43] The 2012 Act also fully devolves the power to raise taxes on land transactions—stamp duty land tax—and on waste disposal to landfill. It is expected that this will take effect in April 2015. In addition, the Act has provided powers

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37 Newcastle University Centre for Urban and Regional Development Studies (CURDS) (FDC0009) para 10.2

38 Q316

39 Q242

40 Q240; Q283 [Darren Johnson]; Q354 [Cllr Nick Forbes]; Q415 [Professor Travers]

41 "Powers pledged by pro-UK parties after poll", *The Herald,* 16 June 2014

42 Scottish Conservatives, *Commission on the Future Governance of Scotland*, p 2

43 "Scottish independence: What are the 'No' parties offering instead of independence?" BBC News, accessed 16 June 2014

for new taxes to be created in Scotland and for additional taxes to be devolved.[44] In relation to Wales, the Government announced in the Queen's Speech a new Bill, which:

- devolves stamp duty land tax and landfill tax to Wales, enabling the Assembly to replace them with new taxes specific to Wales;
- allows further taxes to be devolved, if agreed by Parliament and the Assembly;
- provides for a referendum on devolving an element of income tax; and
- grants powers for Welsh ministers to borrow to fund capital expenditure.[45]

20. The Local Government Association (LGA) pointed out that there was now a "stark contrast" between the powers being devolved to the Scottish Parliament and to the Welsh Assembly and the position of England:

> The devolved nations are increasingly being given powers to raise revenue locally, with the Prime Minister and Deputy Prime Minister making the case that for "too long, decisions about Wales's future have been directed by bureaucrats hundreds of miles away in Westminster—and it has suffered as a result. Wales could benefit hugely if the government at Cardiff Bay was responsible for raising more of the money it spends".[46]

In oral evidence, Sir Merrick Cockell, Chairman of the LGA, told us:

> The real ability to do things is controlled by your ability to tax or borrow […] if it is good enough for Scotland and good enough for Wales, why is it not good enough for London, Manchester, Sheffield or any other part that you may represent?[47]

Witnesses also noted the difference between different areas' contributions to the UK economy and the extent of their devolved powers. Professor Tony Travers noted:

> Greater Manchester has total 'gross value added' of £50 billion, more than that of Wales (£47 billion). The West Midlands (former metropolitan county area) also has a larger GVA[48] than Wales […] London's GVA (£310 billion) is 60 per cent bigger than that of Scotland, Wales and Northern Ireland added together.[49]

44 HM Revenue and Customs, "Devolved taxation in Scotland", accessed 2 May 2014. The income tax rate paid by Scottish taxpayers will be calculated by reducing the basic, higher and additional rates of Income tax by 10 pence in the pound and adding a new Scottish rate set by the Scottish Parliament.

45 Cabinet Office, "Queen's Speech 2014: what it means for you", accessed 10 June 2014

46 Local Government Association (FDC0005) para 19

47 Q380

48 Gross value added is the value of output less the value of intermediate consumption; it is a measure of the contribution to GDP (Gross Domestic Product) made by an individual producer, industry or sector (OECD Glossary of Statistical Terms, accessed on 1 July 2014).

49 Professor Tony Travers (FDC0033) p 3

21. **The UK Government is in the process of granting substantial fiscal devolution to Scotland and Wales. Ministers have therefore accepted the principle of fiscal devolution from Whitehall. This prompts the question, if such powers are considered justified and workable in Scotland and Wales, why not in England? Greater Manchester and Greater Birmingham each have a larger GVA [Gross Value Added] than Wales. London has a larger GVA than Scotland, Wales and Northern Ireland combined. When the changes for Scotland and Wales take place, England's local authorities will be left in an increasingly anomalous position, with a little more responsibility for spending than they have now but much less control over taxation than the Scottish Parliament and the Welsh Assembly.**

Spending decentralisation and fiscal devolution

22. As we noted in chapter 1, some limited examples of fiscal devolution already exist in England.[50] The Minister of State for Cities and Constitution, Greg Clark MP, referred to the Manchester City Deal, which includes Earn Back, as "ground-breaking".[51] The Parliamentary Under-Secretary of State for Communities and Local Government, Brandon Lewis MP, said the new homes bonus and business rates retention scheme showed that on fiscal devolution "it is fair to say we have done a lot".[52] As we have noted, we detected in the Government a focus on the decentralisation of spending powers and public services. While Mr Lewis acknowledged that taxation powers had a role, he also said: "We get very caught up in fiscal devolution, and I understand why, but it is also about having the power to do things locally." He drew attention to the Localism Act 2011, which had transferred powers to local government and other local bodies,[53] and as a consequence increased what could be done locally through agency collaboration, local government collaboration and central-local government collaboration. This he said was happening through Community Budgets, the Transformation Network, the Local Growth Fund and Local Enterprise Partnerships.[54] Mr Clark agreed on the need to increase local authority responsibility for expenditure: "There is a lot of spending that takes place within cities in this context that is controlled from central Government and should be controlled locally."[55]

23. Mr Clark's perception was shared by some local authorities. When we asked how the case might be made to the Government for more fiscal devolution, some witnesses emphasised the need for greater local control over Government funding. We heard, for example, how Newcastle had shown it could save 15% from the health and social care budget through community budgets and how Essex had put forward a case for community budgets to create 25,500 houses and 60,000 jobs.[56] Key Cities wanted to see localisation of

50 See para 10.

51 Q446

52 Q444

53 Q443

54 Q452

55 Q447

56 Q76 [Tom Riordan]; Q81 [Cllr David Hodge]; see also Q227 [Sir Richard Leese].

the Work Programme and skills funding, both as powers and with revenue streams handed over from central Government to local control.[57]

24. We received evidence that there was a direct link between the decentralisation of powers over spending and public services and the devolution of taxation powers. Tom Riordan, on behalf of Core Cities, said the two would have to go hand in hand.[58] The Greater Manchester Combined Authority said that fiscal devolution had to

> play a significant role in any realignment of the relationship between local authorities and central government […] incentivising and rewarding growth must be accompanied by more control over the other public sector resources which are spent in local areas.[59]

Wolverhampton City Council said that the devolution of business rates had the "potential to be beneficial, if such devolution is complemented by Single Pot funding".[60]

25. **The process of devolution, if it is to be meaningful and effective, must include more than decentralised funding streams spent in local authority areas. Fiscal devolution provides enhanced local autonomy. Without it, local authorities will be agencies of central Government, focused in large measure on the requirements set by the funder, central Government, and acting within spending constraints set by Whitehall. That said, fiscal devolution and decentralisation, through place-based funding, are mutually reinforcing policies. Taken together they would give local areas greater control over spending and allow policies on growth and public service reform to complement each other.**

Fiscal devolution and economic growth

26. We considered whether fiscal devolution would encourage economic growth across England. We were told that England was unusual among developed nations in having few cities whose GVA was above the national average.[61] London outperformed the national average throughout the recession and now accounts for 19% of the UK's jobs, 21% of its businesses and 25% of its economic output. The UK's recent recovery has been led by the capital.[62] Besides London and the South East, Scotland, which has had a form of fiscal devolution since 1999, was the only region that grew relative to the UK national average between 2001 and 2011.[63] Witnesses suggested that decisions taken at a distance from the people and places they affect have the effect of limiting the activities that can lead to growth. Centre for Cities summarised the position:

57 Key Cities Group (FDC0015) paras 15, 16 and 19; see also London Councils (FDC0007) paras 13 to 19.

58 Q96

59 GMCA (FDC0006) paras 4.1, 5.1

60 Wolverhampton City Council (FDC0024) para 8

61 See IPPR North (FDC0020) p 2. In 2012 only Bristol and London outperformed it; see also Core Cities, *Keys to the City*, 2012, p 12.

62 See Office for National Statistics, Statistical Release, March 2013; Centre for Cities, *Cities Outlook*, 2014, p14.

63 "Scottish independence", *The Economist*, 31 May 2014

> Devolution will not *inevitably* lead to increased economic growth but we do know that the current centralised system restricts growth opportunities […] By providing freedoms, tools and incentives to local authorities, devolution would enable cities to unlock their full potential.[64]

27. Fiscal devolution was also considered to be an opportunity to increase the number of economic growth areas in England. Several witnesses, including Greg Clark, said local growth was not a zero sum game: growth in one area would not preclude growth elsewhere.[65] IPPR North pointed out:

> Unlike other European nations with their devolved governance and more distributed expenditure on infrastructure and economic affairs, central government in the UK has invested in London and not afforded its other cities the same opportunities […] In short, UK cities outside London have huge potential to grow, to transform public service provision and to drive a fairer Britain, but over-centralised economic policy-making is holding them back.[66]

Stephen Hughes, former chief executive of Birmingham City Council, said that the devolution of fiscal powers to areas outside London would enable them to develop projects that otherwise would not happen, going some way to closing the differential in growth rates between London and the rest of the country.[67] Newcastle University noted that if policymakers were serious about a balanced recovery, "fiscal decentralisation should itself incorporate a significant element of geographical redistribution, directing greater resources towards areas of greatest need".[68] Professor Travers told us DCLG's own research had suggested business rates retention would increase GVA by "a substantial number of billions of pounds […] the logic being […] that if councils kept at least part of the growth in the tax base, they would make decisions that would generate economic activity more quickly". While he acknowledged that wider academic research on devolution and growth "shows results both ways", he said there was no evidence that devolving public finance to lower levels of government produced lower economic output.[69]

28. **We conclude that there is evidence of at least an indirect connection between fiscal devolution and growth. There is also evidence that fiscal devolution—as part of a package of wider decentralisation—would encourage greater economic growth across England. The Government has, through its own business rates retention scheme, accepted the logic behind this. Putting a wider range of tax and borrowing powers into the hands of local politicians simply extends this logic. London, already in the vanguard of UK growth, would not be pressing for devolution if it was not to its advantage.**

64 Centre for Cities (FDC0028) para 1.3. See also Newcastle University (FDC0009) executive summary; Q114 [Professor Andy Pike]; and Q436 [Professor Travers]

65 Q450 [Greg Clark]; Q12 [Alexandra Jones]; Q67 [Cllr David Hodge]; Q218 [Sir Richard Leese]

66 IPPR North (FDC0020) p 3

67 Q357; see also Cllr Nick Forbes, Q359.

68 Newcastle University (FDC0009) executive summary; equalisation and redistribution is dealt with in chapter 4.

69 Q2

Placing power in the hands of other areas, too, would provide an opportunity to contribute to a more balanced economy. Cities and their wider regions have the most potential to drive growth.

Fiscal devolution and local democracy

29. We heard that a corollary of more economic and fiscal decisions being taken outside Whitehall, including on local taxation, would generate more interest in the political process locally.[70] Centre for Cities said that "creating a more direct link between funding raised and spent would […] strengthen local accountability and governance".[71] Professor Travers, referring to Manchester's tram system, said:

> The more decisions are made by people who feel how that system operates, the better they will use the money, simply because however frail we humans are, the ones nearer to you are the ones you can eyeball and get to make the decisions that you want.[72]

By contrast, one criticism of the City Deals process was that it was bureaucratic and a challenge to understand and deconstruct.[73] Sir Merrick Cockell also cited surveys that the LGA, the BBC and Ipsos MORI had conducted, showing that "people trust 79% of decisions taken closest to them; 11% (of) decisions taken in Whitehall".[74] Sir Merrick's approach chimes with our report, *Councillors on the Frontline*, in which we said that for the health of democracy at all levels councillors needed to be empowered to effect change within their local areas.[75] It also fits with the Government's policy of building localism. As Cllr Philip Atkins, Leader of Staffordshire County Council, pointed out, the principle of fiscal devolution was "the heart of localism".[76]

30. **Fiscal devolution presents an opportunity to improve accountability, to hold local politicians to account for their successes and failures and, therefore, to improve democracy. By giving politicians outside Westminster the responsibility for raising, as well as spending, money locally, fiscal devolution would bring decisions on how that money is generated and spent much closer to local people—and make those who make such decisions much more visible. This would enhance the standing of local democracy and, by extension, democracy throughout the country. Enhanced local democracy offers the best possibility of a step towards addressing the challenges of the wider democratic deficit caused by the over centralisation of England.**

70 Chapter 3 deals in more detail with governance and accountability locally.

71 Centre for Cities (FDC0028) paras 1.3, 4.1; see also Newcastle University (FDC0009) executive summary; Q114 [Professor Andy Pike]; and Q436 [Professor Travers].

72 Q425

73 See Q91 [Tom Riordan]; Q137 [Ed Cox] and Newcastle University (FDC0009) para 3.5.

74 Q398

75 Communities and Local Government Committee, Sixth Report of Session 2012-13, *Councillors on the Frontline*, HC 432, para 105

76 Q202

Commitment to the principle of greater fiscal devolution

31. The evidence shows in England that to date more progress has been made on spending decentralisation than on fiscal devolution. The Department for Communities and Local Government said:

> any further decentralisation should not be rushed and should always be the subject of careful consideration. The key tests, in addition to legality, against which any proposals for future fiscal decentralisation should be measured are: does it support deficit reduction; does it have cross-party support; is it supported by evidence; and; will it have a detrimental effect on the rest of the UK.[77]

Professor Tony Travers said devolution had occurred without mishap in Scotland and Wales, and "contemporary city leaderships are self-evidently moderate, pragmatic and effective". He added:

> The single biggest obstacle to reform is the fear within the Treasury and service departments that they will lose control of spending levels and provision which can only be run effectively by them […] Devolved and decentralised models in virtually all other countries work effectively. Chicago, Frankfurt and Lyon are no more 'out of control' than British cities, but they have greater freedom to innovate.[78]

Jules Pipe, Chair of London Councils and Mayor of Hackney, told us that Government agreement on the principle of fiscal devolution needed to be established before spending time and money on working out the detail,[79] and Colin Stanbridge, Chair of the London Chamber of Commerce and Industry, added:

> What we want from the (2015 election) manifestos is a statement to the effect that, in principle, if elected as a government, they (the political parties) would look at the devolution to the major cities of more fiscal powers. Then you would have huge pressure for us to come up with all those details.[80]

32. ***The point has been reached for the Government (and policy makers in other political parties) to make it clear whether they are committed in principle to larger-scale and more comprehensive fiscal devolution in England. We are, and we believe they should be too.***

33. **With a clear national commitment to the principle of fiscal devolution local authorities working with central government would be able to produce more detail on how such devolution might work in their areas. The Government is rightly concerned about deficit reduction and whether fiscal devolution will have a detrimental effect on the rest of the UK. However, the Government must plan beyond the next few years and**

77 DCLG (FDC0014) para 4

78 Professor Tony Travers (FDC0033) p 4

79 Q304

80 Q305

the present financial constraints. A common agreement to the principle, combined with a measured approach arranged between local and central Government, including initial devolution to a small number of areas, should allay those concerns. We set out this approach in the following chapters.

3 Conditions for fiscal devolution

Introduction

34. We support the principle of fiscal devolution. We recognise, however, that winning support for it in practice will require a number of matters to be settled:

- the place of equalisation and redistribution within fiscal devolution;
- the definition of the area to which fiscal powers are devolved;
- the extent to which a *devolved* authority will have to demonstrate a capacity for planning and delivery; and
- the governance and accountability arrangements that should apply.

Equalisation and redistribution

The assessment of needs and resources

35. Prior to April 2013 the general grant funding received by each local authority was determined, in part, by both its relative need and its relative ability to raise income locally from council tax. It was allocated annually as Formula Grant, a combination of business rates and Revenue Support Grant (RSG), through the Local Government Finance Settlement. The formula used was built on a complex four block model.[81]

Introduction of the Business Rates Retention Scheme

36. The 2013-14 Local Government Finance Settlement used the same formula, albeit with some technical changes, to calculate the total funding required by all local authorities in England. The national total in 2013-14 was £26.1 billion and, as before, was paid over via business rates and RSG.[82] The calculation of the amount due to each authority in 2013-14 was called its start-up funding assessment (SFA)[83] and reflected both its needs and resources in 2013-14.

37. In April 2013, however, the distribution of funding changed. The Business Rates Retention Scheme began, enabling local authorities to keep half their business rates yield (the local share). The other half (the central share) was returned to Government for redistribution as part of RSG. After adjustments the Government determined the local share of business rates for 2013-14 to be £10.1 billion and the RSG—including the £10.1 billion of central share—needed to cover the rest of local authorities' required funding to

81 See *Local Government Finance Settlement 2014/15,* Standard Note SN/SG/6816, House of Commons Library, February 2014, p 12; *The Local Government Finance Settlement 2011-13* Research Paper RP11/16, House of Commons Library, February 2011, pp 2, 6.

82 *The Local Government Finance Settlement 2013-14 and 2014-15*, Research Paper RP13/10, House of Commons Library, February 2013, p 24

83 From 2014-15 onwards this is known as its settlement funding assessment.

be £15.2 billion. The Government used the ratio of 10.1 to 15.2 to determine how much notional SFAs for each local authority would be funded by the local share of business rates and how much by RSG.[84] The Government then estimated every local authority's actual local share of business rates yield. According to whether its local share was higher or lower than its local SFA, the authority then paid a tariff or received a top-up payment.[85]

38. Other key features of the Business Rates Retention Scheme (BRRS) are:

- authorities that experience disproportionate growth in business rates income pay a levy, which is used primarily to fund safety net payments to authorities whose business rates income fall significantly—determined by a proportion set by the Government;
- the system will be reset—with a new assessment of relative needs and relative resources—in future, with Government currently proposing a reset in 2020;
- the top-up and tariff payments remain part of the system over the life of the scheme but are uprated for inflation each year; and
- no changes are made to the way that businesses rates bills are calculated or collected.[86]

A key difference from the earlier system is that, since April 2013 and the introduction of the BRRS, a local authority's funding has been linked to need only through its funding assessment calculated for 2013-14. No re-assessment has been made for the 2014-15 finance settlement.[87]

39. Professor Tony Travers from the London School of Economics explained the consequence of the changes:

> If you have full equalisation—and we did for many years—you cannot build up your tax base at all, because any extra tax base you generate will be equalised away. That was the logic of the previous system, which is why the previous Government, and now this one, have taken steps, or at least made an effort, to get away from that arrangement. At the other end of the spectrum, there is a "winner takes all" system, where those who grow build

84 For example Birmingham's 2013-14 SFA was £783 million, with £313 million funded by the local share of business rates and £430 million by RSG; Birmingham was assessed as needing to fund £313 million of that amount locally. See *The Local Government Finance Settlement 2013-14 and 2014-15*, Research Paper RP13/10, House of Commons Library, February 2013, p 25.

85 Birmingham's estimated local share would bring in £191 million, so it received a top-up payment of £122 million to reach its assessed need for £313 million of funding to be paid for locally. See Department for Communities and Local Government, Business rates baseline calculations model, accessed 10 June 2014.

86 *The Local Government Finance Settlement 2013-14 and 2014-15*, Research Paper RP13/10, House of Commons Library, February 2013, p 27. The Local Government Finance Act 1988 provided for national non-domestic rates to be held in a separate account, audited by the National Audit Office; the Local Government Finance Act 2012 amended this provision.

87 *The Local Government Finance Settlement 2013-14 and 2014-15*, Research Paper RP13/10, House of Commons Library, February 2013, pp 23, 36

> up their tax base, and those who do not lose everything; as their tax base declines, everything within that declines.[88]

The LGA has voiced its concerns about the operation of the BRRS but does not wish to go back to the old system of central Government redistribution of all yield. Indeed, in its evidence it called for 100% local retention of business rates.[89]

40. **The new system of local government finance introduced in 2013-14 appears to have broad, but not universal, acceptance among local authorities. It was an improvement on previous arrangements but its operation still causes some concern. Significantly, it recognises the equalisation of needs and resources at the outset but thereafter incentivises local growth and provides some autonomy, albeit with limits on "excessive" gain and untoward loss in any one area. We refer later in this Report to these limits, the precise nature of which should be agreed between central and local government.**

London Finance Commission proposals

41. In its report the London Finance Commission (LFC) set out its proposals for addressing equalisation and distribution in the event of London assuming responsibility for its local property taxes and greater borrowing powers:

> In order to ensure that the Exchequer, and thus other parts of the UK, did not lose out as the result of any transfer of taxes to London there would need to be an equivalent off setting reduction in the grants received by London [...] This off-set could be achieved either by reductions in the residual Revenue support grant or by changes to transport funding.[90]

We note that the LFC did *not* recommend at the outset of fiscal devolution in the capital an assessment of London's relative need and resources—its ability to raise income locally. Nor, in contrast to the BRRS, did it have any proposals for:

- consequent opening tariffs or top-ups London might pay or receive;
- a levy on disproportionate growth London might experience;
- what would happen in the event of a serious reduction in tax revenue; or
- a reset point, when a fresh assessment would be made of London's need and income.

42. The absence of these arrangements and the omission of a proposal for a reset would take the system of local government finance further along Professor Travers's spectrum from equalisation. During our inquiry, we heard that some areas might struggle to develop or maintain their tax base. They might not therefore be able to take advantage of the potential benefits of fiscal devolution and would require some form of redistributive

88 Q415

89 See Local Government Association, *Rewiring Public Services* (December 2013); and LGA (FDC0005) para 29.2.

90 *Raising the Capital: the report of the London Finance Commission*, p 76, paras 2 and 3

support.[91] At the other end of the spectrum, if, for example, London took over responsibility and receipts for stamp duty, without a levy on excessive growth in a strong housing market, it would receive a windfall tax unrelated to incentives to promote economic growth.

Setting a starting point for fiscal devolution

43. The equalisation model involving the BRRS could provide a starting point for negotiations between central Government and local authorities seeking fiscal devolution. The LFC said it "would be easy enough" for the DCLG to adopt a similar approach to the retention of business rates.[92] The Core Cities pointed out that the top-up and tariff scheme could "evolve" to deal with changes in needs and resources, "and although focused currently on business rates, has essentially created a framework through which any fiscal reform might operate".[93] There was in fact broad support for an equalisation mechanism operating within fiscal devolution. Jules Pipe, Chair of London Councils and Mayor of Hackney, said that "we do not have a specific model at the moment". But when we asked him whether such a model would be a good idea, he replied, "Yes is the short answer."[94] Cllr Nick Forbes, from Core Cities, said fiscal devolution would not give London substantially more revenue if there was "a proper rebalancing and a proper rebasing, according to a new formula or funding settlement".[95]

	2012-13 Formula grant	2012-13 combined stamp duty and business rate yield[96]
Greater London	£6.27 billion	£9.31 billion
Greater Manchester	£1.30 billion	£1.12 billion
West Midlands	£1.49 billion	£1.03 billion
West Yorkshire	£961 million	£846 million
Lancashire	£429 million	£384 million
South Yorkshire	£652 million	£454 million
Tyne and Wear	£609 million	£439 million
Oxfordshire	£149 million	£393 million

44. The table shows that needs, funded by formula grant, and resources, as provided by stamp duty and business rates, are not evenly matched. Some adjustment would need to take place. It would not be possible, however, to replicate the full arrangements of the BRRS scheme for full business rates retention and devolution of stamp duty because—as we explain in more detail in the next chapter—we envisage fiscal devolution being a

91 Q111 [Tom Riordan], [Cllr Hodge]; Q157 [Cllr Box]

92 *Raising the Capital: the report of the London Finance Commission*, p 76, para 3

93 Core Cities (FDC0008) para 3.9

94 Qq288-89

95 Q363

96 See Department for Communities and Local Government, Changes in Grant Allocations: 2012-13 compared to Adjusted 2011-12 (amounts, except for Greater London, exclude police funding); Stamp duty figures, see HM Revenue and Customs, *UK Stamp Tax Statistics 2012-13* (September 2013), table 4.2. For business rate figures, see Department for Communities and Local Government, "Collection rates for Council Tax and non-domestic rates in England, 2012 to 2013", table 4, accessed 17 May 2014. Figures for West Midlands, Greater Manchester, South Yorkshire, West Yorkshire and Tyne and Wear are for met county areas.

piecemeal process as groups of local authorities seek packages of devolution. But certain features of the BRRS should be retained. Given that a local authority area's funding assessment is resourced only by business rates, RSG and certain smaller grants, this would allow every devolved area to offset roughly these same grants against their devolved tax yields.[97] If an area's devolved tax yield were higher than its funding assessment, however, it might offset the difference against other grants.[98]

45. **Through the Business Rates Retention Scheme, England has a system which balances equalisation and incentives for local growth. It provides a useful signpost for further fiscal devolution. First, it was set up on the basis of an assessment of need and resources. Second, there is a period of stability without further equalisation and redistribution, to provide an incentive to local authorities to increase and retain revenue, and, third, it is predicated on periodic re-assessments of needs and resources—the first will be in 2020. For further fiscal devolution local and central Government will need to take the model and develop it to establish an agreed approach. We therefore consider that similar arrangements, incorporating equalisation, should feature in any process of significant fiscal devolution, which we expect a limited number of local authorities to pursue initially. This will ensure a degree of fairness to begin with, balancing needs and resources with incentives to improve the local economy. If fiscal devolution does not include these principles, it could become a system in which the winner takes all.**

Treatment of disproportionate growth

46. We envisage that for fiscal devolution to work authorities should be able to keep a portion of the growth in the yield of a devolved tax. Without that the incentive to grow the local economy could be blunted. We considered whether in cases the growth of tax yield could be so great as to justify a limit on the amount the devolved authorities could retain. The Mayor of London told us that he was not keen on a "complicated claw-back mechanism".[99] He said that London should retain any uplift in devolved property tax revenues and instead central Government "would collect and redistribute" an amount related to the uplift through "other tax revenues (such as income tax and corporation tax),

97 The specific grants used to cover the funding assessment are: 2011-12 Council Tax Freeze Grant, excluding the amount that will be paid to Local Policing bodies; Council Tax Support Grant, excluding the amount that will be paid to Local Policing bodies; Early Intervention Grant, excluding funding for free education for two-year olds; Greater London Authority General Grant; a proportion of Greater London Authority Transport Grant; Bus Services Operators Grant in London; Homelessness Prevention Grant; a proportion of Lead Local Flood Authorities Grant; and Learning Disability and Health Reform Grant. Department for Communities and Local Government, A guide to the local government finance settlement in England, para 38.

98 Local authorities receive a number of ring-fenced and non-ring-fenced grants—outside their settlement funding assessment—from different Government Departments. London, for example, receives a Transport for London grant from the Department for Transport. A list of such grants can be found at Department for Communities and Local Government, Business rates retention and the local government finance settlement: a practitioners guide, February 2013, annex C.

99 Qq 253, 255

which make up by far the majority of overall tax revenues (around 88 per cent, according to our estimates).[100]

47. **We do not consider that a putative general uplift in taxes such as income tax and corporation tax would provide a satisfactory redistributive arrangement under fiscal devolution to areas outside London. First, it is likely to be difficult to identify and quantify. Second, the use of the yield from these taxes will be subject to the Government's competing priorities, including deficit reduction. Third, under current Treasury rules, it would count against the Total Managed Expenditure limit, the control on gross UK spending, and so either the Government would have to raise the limit or offset it with a reduction elsewhere. We conclude that such an approach, on which we received no detailed costings or calculations, is unlikely to command support**. (We examine Total Managed Expenditure further in chapter 5.)

48. Stamp duty, which we examine further in chapter 5 as a candidate for inclusion in fiscal devolution, provides a case study of a tax that is not only volatile but unevenly spread across England as the table below illustrates.

Stamp duty yield[101]	2009–10	2012–13	% increase	2012–13 yield per head[102]
Greater London	£1.55 billion	£2.86 billion	85%	£348
Greater Manchester	£90 million	£120 million	33%	£44
Oxfordshire	£94 million	£116 million	23%	£177
West Midlands	£80 million	£109 million	36%	£107
West Yorkshire	£70 million	£87 million	24%	£39
Lancashire	£41 million	£49 million	20%	£41
South Yorkshire	£40 million	£46 million	15%	£34
Tyne and Wear	£42 million	£42 million	0%	£38

The table shows that London's stamp duty yield was £1.55 billion in 2009-10 and £2.86 billion in 2012-13, an increase of 85%.[103] Greater Manchester's yield was £90 million in 2009-10 and £120 million in 2012-13, an increase of 33%. South Yorkshire's take rose by 15%. Tyne and Wear saw no change.[104] Professor Travers pointed out that outside London stamp duty operated in "a reasonably ordinary way". But in London he said that there was a "curious" property market, so for London's local authorities "it is a bit of a gamble" as "it works both ways. Is this the top of the boom, or is four years or four months out (from) the

100 Mayor of London (FDC0029) para 40

101 See HM Revenue and Customs, *UK Stamp Tax Statistics 2012-13* (September 2013), table 4.2. Figures for West Midlands, Greater Manchester, South Yorkshire, West Yorkshire and Tyne and Wear are for met county areas.

102 Population statistics used to calculate 2012-13 per head yield based on 2011 census; see "2011 census results: how many people live in your local authority?", The Guardian, accessed 9 June 2014.

103 2009-10 to 2011-12, see HM Revenue and Customs, "Stamp Duty Land Tax, by Local Authority, County and Government office region", accessed 18 May 2014; 2012-13, see HM Revenue and Customs, *UK Stamp Tax Statistics 2012-13*, (September 2013), table 4.2.

104 2009-10; see HM Revenue and Customs, "Stamp Duty Land Tax, by Local Authority, County and Government office region", accessed 18 May 2014; 2012-13, see HM Revenue and Customs, *UK Stamp Tax Statistics 2012-13* (September 2013), table 4.2.

top of the boom?"[105] Cllr Forbes envisaged that there would be a swapping of property taxes for revenue-formula grants but he said:

> We cannot get away from this point about resource equalisation. If we simply ring-fence existing property taxes within an area, that does not take account of historic circumstances, of what has gone before or of how we got to where we are now. What we need is an independent review of the allocation process, which would kick-start this whole thing off and re-establish that principle of resource equalisation.[106]

The BRRS includes a levy which might be adapted for fiscal devolution, where the devolved authorities' tax yield exceeded their needs assessment or grants offset. Under the BRRS a large difference between yield and need means a large levy. The levy is capped at 50p in the pound and calculated annually to take account of any increase in yield.[107]

49. **London's stamp duty yield increased by 85% between 2009-10 and 2012-13—dramatically more than any other area, including the Core Cities. By any objective measure, London's relative spending requirements could not have increased by 85% over the same period. Its yield per head of population was also considerably more than elsewhere. If a similar increase in stamp duty yield, or indeed in business rate yield, occurred in future, the question whether a local area was solely responsible for it, or the beneficiary of a windfall due to national economic circumstances, would need to be addressed. In our view there has to be a levy on disproportionate tax yield growth.**

Reassessment and rebasing

50. The BRRS will be reset in 2020 to take account of changes of relative need and resources.[108] At the reset point, new equalisation adjustments will be employed to take account of the intervening period and its impact on relative need and ability to raise income locally. Reflecting the LFC position Mayor Johnson said he "could look" at a reset, but "would prefer just a clean devolution".[109] In other words once, tax yield was swapped for grant there would be no further changes.

105 Q420

106 Q333

107 Under the BRRS any growth in such an authority's yield is considered disproportionate, because a 1% increase in its business rates yield is worth more than a 1% increase in its needs assessment. But the levy is capped and tapers according to the difference in yield and need. For example, Westminster's estimated 2013-14 local share of business rates yield was £523 million, while its needs assessment was £78 million. Its levy was calculated at 85p in the pound but capped at 50p. In contrast Hammersmith and Fulham's yield was £56 million, while its needs assessment was £54 million, so its levy was only 0.05p in the pound. See 'The Local Government Finance Settlement 2013-14 and 2014-15', House of Commons Library Research Paper 13/10, p 33.

108 *The Local Government Finance Settlement 2013-14 and 2014-15*, Research Paper RP13/10, House of Commons Library, p 35

109 Q258

51. Even with the relatively more stable and predictable business rates we heard that over time changes could be significant. The variation in yields across city and county regions is set out below.

Business rates yield[110]	2009–10	2012–13	% increase	2012–13 yield per head
Greater London	£5.10 billion	£6.45 billion	26%	£786
Greater Manchester	£942 million	£1.01 billion	6%	£373
West Midlands	£897 million	£934 million	4%	£345
West Yorkshire	£696 million	£759 million	9%	£343
South Yorkshire	£379 million	£408 million	8%	£304
Tyne and Wear	£360 million	£397 million	10%	£360
Lancashire	£295 million	£335 million	14%	£286
Oxfordshire	£267 million	£277 million	4%	£424

52. The table shows that between 2009-10 and 2012-13 London's business rate revenue increased from £5.1 billion to £6.45 billion, a rise of 26%; Greater Manchester's by 6%.[111] Sir Merrick Cockell said he envisaged a new equalisation settlement having to be able to cope with local conditions and needs changing, such as a major employer leaving an area or new investment creating a disproportionate benefit.[112] He told us:

> as happens now, money would go from parts of the country that have vast surpluses on business rates. That is something that when I was the leader of Kensington and Chelsea I was committed to, and leaders of Westminster and others, particularly in central London, are absolutely committed to. [Business rates] have to be shared appropriately with the rest of the country but that would be part of that new formula.[113]

Jules Pipe, Mayor of Hackney, agreed there ought to be "some sort of tax, take for the rest of the country, on disproportionate benefit" in London.[114] Sir Merrick, speaking for the LGA, added that if London was removed from equalisation, "and you let London do things for itself, there could be risks to the rest of the economy".[115] The LGA's view was that "overall there is a balance, and if you look four years hence, overall in local government we could be self-sufficient, but that would require equalisation".[116] Lord Smith of Leigh, chair of the Greater Manchester Combined Authority, shared this approach:

110 See Department for Communities and Local Government, "Collection rates for Council Tax and non-domestic rates in England, 2012 to 2013", table 4, accessed 17 May 2014. Figures for West Midlands, Greater Manchester, South Yorkshire, West Yorkshire and Tyne and Wear are for met county areas. Population statistics used to calculate 2012-13 per head yield based on 2011 census. See "2011 census results: how many people live in your local authority?", *The Guardian,* accessed 9 June 2014.

111 Department for Communities and Local Government, "Collection rates for Council Tax and national non-domestic rates in England 2009 to 2010", table 5, and "Collection rates for Council Tax and non-domestic rates in England, 2012 to 2013", table 4, accessed 17 May 2014. Westminster City Council's business rates revenue rose from £1.1bn to £1.65 billion in the same period, while Kensington and Chelsea's went from £213 million to £268 million.

112 Q378

113 Q395

114 Q290

115 Qq395,397

116 Q405

> we do not want to be people who are always on the receiving end. We want to create a successful economic and social background so we can get away from that, but there may then be economic change that means other parts of the country need support. We will willingly give that.[117]

53. Cllr Nick Forbes also argued the case for a periodic reset:

> The position of the Core Cities is that it would be sensible to build in a review process over a longer period of time. The rationale for that would be that if we were having this debate 40 years ago, I would be snapping at your heels to have the settlement for my area, because we had a huge manufacturing industry […] Yet that has changed, because the economy has changed over the last 40 years. We need something that takes account of the bigger forces at play above and beyond local determination.[118]

54. It was also recognised that outside any system of equalisation central Government would continue to step in to help poor-performing areas. Professor Travers told us even if the system were much more about "winner takes all" government would inevitably intervene.[119] We also raised with Professor Travers the issue of devolved tax yield being used for revenue purposes, such as to fund social care, while other non-devolved areas were subject to central Government cuts affecting their ability to fund such services. Such discrepancies could be addressed through a periodic reassessment of needs and resources.

55. Ed Cox, from IPPR North suggested that rebasing of devolved fiscal measures and funding formulas should be carried out independently as:

> There needs to be a reset process every 10 years to allow the system to run for a decent length of time and build up certain incentives; and I would suggest that we consider some kind of independent body, rather than expect it is in any political party's interest to actually revalue or reset equalisation measures at any given point in time.[120]

Conclusions on a system of equalisation and redistribution

56. **We conclude that for a system of fiscal devolution to balance equalisation and incentives it has to: start with an assessment of need and resources; have a mechanism for reallocating disproportionate tax yield growth; and include periodic reassessments. The operation of the arrangements will be for agreement between local and central government but we recommend that before fiscal devolution take place in an area:**

a) **the negotiations for the package are carried out on the basis of a current assessment of need—either the 2013-14 assessment or a subsequent reassessment;**

117 Q239

118 Q335; see also Q215 [Sir Richard Leese].

119 Q438

120 Qq 155, 157

b) **negotiations take place on the basis of an up-to-date assessment of projected income from the taxes to be devolved up to the next reassessment;**

c) **the arrangement would operate by offsetting grants and support paid by central Government for local authority control of taxes;**

d) **the parties agree an excessive rate of increase in the yield of the devolved taxes above which a levy will apply; and**

e) **the parties acknowledge and agree that a reassessment of need and resources will take place after specified periods.**

The levy

57. **We make no detailed recommendation on the levy beyond that, although it should be part of the arrangements for fiscal devolution, it should only come into operation in exceptional circumstances. It should not be set so low as to stifle dynamic local authorities' attempts to stimulate economic development but should aim to capture windfall taxes.**

The safety net and use of specific grants

58. The system needs to be able to cope with the point Sir Merrick Cockell made about local conditions changing radically for the worse—such as when a major employer closes down. ***The levy will be derived from taxes devolved to local government. We recommend the levy from disproportionate growth in yield be held in an account by the Government. This should be ring-fenced and, by law, protected for use as a fund to provide a safety net for an area facing a significant and uncontrolled revenue shortfall, but explicitly exclude under-performing authorities. It should also be available to be redistributed to all local authorities. As is the case now, we would expect provision from other funds met from general taxation and disbursed to local authorities also to be available. In addition, specific grants should be targeted at low-growth areas, and local authorities should control how that money is spent.***

59. **If more powers were devolved, associated funds would have to be transferred from central Government. In the case, for example of the Work programme, which will inevitably operate in areas of high need, such transfers will enable further redistribution and achieve a strong match of resources to need.**

The reassessment

60. ***On the reassessment, we recommend that the Government legislate for such an assessment to take place every 10 years. This would ensure the process actually takes place, and local authorities should be clear from the outset that it is an integral part of the process of fiscal devolution. On the reassessment process, we recommend that it be informed by the advice of an independent body, with responsibility for the assessment of needs and resources and the determination of apportionment between local authorities,***

but with the Government determining the national totals of resources for England, and with precepts for major capital projects in devolved areas excluded. This would ensure the process was not only fair but seen to be fair. We recommend that the Chair of the independent body be subject to a confirmation hearing with this Committee. We discuss Total Managed Expenditure at paragraph 143.

61. ***The reassessment should allow local authorities to keep a substantial proportion of the improvement since the previous assessment. It should not reward those areas that have made no effort to grow.*** **We consider that a system incorporating the arrangements we have outlined would be fair and make it sustainable in the medium and long-term. It would prevent any area being automatically advantaged—or disadvantaged—at the outset and instil confidence in those areas that might not be in the first wave of fiscal devolution.**

Definition of areas for fiscal devolution

62. There are several layers of local government in England and a variety of "areas" to which fiscal powers could be devolved. Supporters of fiscal devolution cited economic reasons to justify the devolution to their areas of greater powers to raise money locally.[121] It would follow that an area seeking devolved powers should be able to demonstrate a potential economic benefit. There was general agreement on the *type* of area with the greatest potential to assume fiscal devolution: the functional economic area. London Councils said the capital could be described as "an economic whole", although its economy functioned through complex overlapping markets, which required strategic oversight and local knowledge.[122] The County Councils Network (CCN) said that "in many cases the functional regional economic area is coterminous with County boundaries and […] fiscal devolution should reflect this reality". But CCN also said counties recognised they were not "complete" functional economic areas and any new arrangements would need to acknowledge strategic links often in different regions.[123]

63. We considered whether the characteristics of the "functional economic area" provided a definition of an area for fiscal devolution. The Centre for Cities noted that successful city economies needed "efficient transport, skilled workers, quality housing, good public space and amenities" but that city economies did not "stop at local authority boundaries […] So

121 See Mayor of London (FDC0029) paras 4, 12; Core Cities (FDC0008) paras 1.2, 1.3, which said that its member cities, together with their surrounding urban areas, were home to 16 million people and were set to grow by at least 1 million by 2030, generated 27% of England's wealth (more than London), were home to half of the country's leading research universities and contained 28% of highly skilled workers. The County Councils Network (FDC0013) para 2.9, said its member council areas generate over half of all GVA (Gross Value Added) generated outside of London (ONS, 2012), County areas contribute more GVA per head of population than many of the Core Cities (ONS, 2012) […] and that Counties account for more than half the jobs in key sectors such as manufacturing, construction and motor trades (ONS, 2012). Oxfordshire County Council said devolution measures should be considered across England, rather than an assumption of "core city first" devolution. It added that its functional economic geography was coterminous with its county boundary. See (FDC0017) paras 12, 15 and Key Cities (FDC0015) para 3.

122 London Councils (FDC0007) paras 26, 27

123 County Councils Network (FDC0013) paras 4.2, 4.10; Oxfordshire County Council, however, suggested its functional economic geography was coterminous with its county boundary; see (FDC0017) paras 12, 15.

budgets and strategies to organise and deliver planning, transport, housing and skills should cross local authority boundaries".[124] Alexandra Jones, chief executive of Centre for Cities, told us:

> if you did, say, devolve to the travel-to-work area, which is what people experience as a city, rather than the administrative boundaries, and you looked at public services as well [...] you could get a more efficient and effective system where you make better use of the limited money that you have got.[125]

The Key Cities added that cities which were large second-tier authorities within counties, such as Preston, Norwich and Worcester, should have a distinct menu of new devolved powers. It said this would not only promote localism and stimulate economic growth and innovation, but by working with smaller neighbouring districts, mitigate risks of increased inequality between areas and encourage cooperation between different tiers and types of local authority area.[126]

64. "Functional economic area" can be defined in a range of ways. The Core Cities of Manchester, Sheffield, Leeds and Liverpool have sought to reflect the economic reality of their areas by establishing combined authorities with neighbouring local councils. Newcastle is doing the same with its neighbours. These groups have powers over transport, regeneration and economic development.[127] Beyond the Core Cities, counties such as Staffordshire, Warwickshire and Lancashire have collaborated with cities within their geographical boundaries on City Deals.[128] Another approach is the Joint Committee system, through which local authorities such as Wolverhampton City Council collaborate with other councils.[129]

65. While collaboration between local authorities within demonstrable economic areas was important, a certain scale was considered significant too. Newcastle University told us that if money-raising powers were devolved to too small an area:

> there are risks of inequalities in resource and policy outcomes—post code lottery issues—and displacement to neighbouring cities or local areas [...] Cities and city regions need to consider carefully the geography of areas seeking greater fiscal autonomy—and if necessary improve and build effective collaboration.[130]

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124 Centre for Cities, *Breaking boundaries: empowering city growth through cross-border collaboration*, March 2014, p 1

125 Q26

126 Key Cities Group (FDC0015) para 25

127 Some cities in the Key Cities group are members of combined authorities. Wakefield and Kirklees councils are part of the West Yorkshire Combined Authority; Doncaster is part of the South Yorkshire combined authority; Sunderland is part of a proposed North-East Combined Authority.

128 See CCN (FDC0013) appendix 1.

129 See RTPI (FDC0011) p 2; Wolverhampton City Council (FDC0024) para 3.

130 Newcastle University (FDC0009) executive summary. See also Royal Town Planning Institute (FDC0011) para 1

Sir Richard Leese, vice-chair of Greater Manchester Combined Authority said most of the work his authority wanted to undertake with significant fiscal powers was not possible for an individual local authority. He also said he could envisage Lancashire County Council working with the unitary and district authorities in the county in the equivalent of a combined authority.[131] Professor Tony Travers commented that "we are in the middle of the evolution of what looks to me like in the medium to long term a city and county regional model of devolution."[132] This is the model we saw in Lyon. Its communauté urbaine, or combined authority, incorporating 58—soon to be 59—individual authorities (though in France some of these are very small), has various strategic responsibilities and control over France's version of business rates. Individual authorities retain control over domestic property taxes.

66. There were, nevertheless, other ideas on how and where an initial introduction of meaningful fiscal devolution might take place. Stephen Hughes, former chief executive of Birmingham City Council, said, there was some benefit in introducing it to a variety of areas "to see whether or not it makes a difference in different places". Cllr Roger Lawrence, leader of Wolverhampton City Council, agreed and cited Cambridge—a new member of the Key Cities Group—as "one of the great success stories outside London".[133]

67. **The first test for areas seeking to assume more control over local property taxes and enhanced borrowing powers is that they are able to demonstrate how their particular unit functions as an economic entity. They may cut across administrative boundaries and are likely to be geographically large in scale. We see merit in starting with an existing model. Combined authorities provide one potential example. But such areas could include and, in some cases already do include, large cities, smaller cities and counties. In that sense fiscal devolution would not be restricted to any one type of area, capital city, Core City, Key City or county or combination. It is potentially appropriate for a range of areas that contributed evidence to this inquiry.**

Impact of urban economic growth on nearby areas

68. The size and economic predominance of London raises questions about smaller cities within its orbit. Core Cities cited research suggesting that "a synergistic relationship", such as that between London and Reading, "allows the smaller city direct access to the markets, skills and specialisations of its larger neighbour, in turn giving it the opportunity to develop its own specialised growth momentum".[134] Recent research has found that unlike most countries the performance of UK cities depended on location more than size. Smaller places such as Milton Keynes and Reading, close to the capital, were found to have done better than Manchester, Leeds and Birmingham.[135]

131 Q233

132 Q30

133 Q331

134 Core Cities (FDC0008) para 3.5

135 "UK cities need devolution of powers and links to London to succeed", *Financial Times*, 6 May 2014

69. **In any consideration of functional economic area, and of those that might "go first" in any process of fiscal devolution, local and central Government should bear in mind the influence of London on the economic performance of those closest to it. Balanced economic growth may not require devolution to multiple areas. Smaller areas with good links to larger devolved areas, for example, might benefit from fiscal devolution without needing similar powers themselves but this should not stop smaller areas acquiring fiscal devolution if it is appropriate and they can satisfy the necessary conditions.**

Capacity for planning and delivery

70. IPPR North said that every area wanting additional fiscal powers would need a clear account of "its approach to strategic planning and decision making" and of "delivery arrangements on a range of different matters".[136] Core Cities said an area would need to demonstrate how it would operate fiscal reforms across a "functioning labour market geography".[137] Cllr James Lewis, from Leeds City Council, gave one example: "We have a very clear prospectus and purpose for devolution around improving infrastructure, investment, jobs and skills […] That might not be the right approach in another area."[138] Cllr Forbes, from Core Cities, said the answer to the question who should receive fiscal devolution "depends very much on what it is you want to achieve". He said the Government should ask areas:

> 'What would make the biggest difference to your area? Who are you prepared to work with in order to make it happen? How do you want to show you are proving successful?' If you offered areas that, people would come up with all sorts of different things, but that is the beauty of local government: we do come up with tailored solutions for our local communities.[139]

Stephen Hughes, former chief executive of Birmingham City Council, considered that fiscal devolution, if it were to happen, would be to a small number of areas and probably the larger cities and added that it was "about those who have the appetite to do it and can put forward a good plan to demonstrate that it will add value".[140] Indeed the Department stressed any further decentralisation would be measured against the test of whether it supported deficit reduction.[141]

71. **We conclude that an authority or group of local authorities seeking fiscal devolution must be able to demonstrate: fiscal competence, which would include the prudent management of borrowing; a capacity for strategic planning and decision-making leading to economic growth; clear plans as to what they would do with their**

136 IPPR North (FDC0020) p 4

137 Core Cities (FDC0008) para 3.1

138 Q160

139 Q330

140 Q331

141 DCLG (FDC0014) para 4

enhanced powers, including how they would cope with an unplanned and significant change in forecast revenue; and, importantly, an appetite to make them work. Given the Government would test whether any further transfer of powers supported deficit reduction, local authorities will need firm, costed proposals.

72. We consider deficit reduction again in chapters 4 and 5.

Governance and accountability

73. Newcastle University underscored the importance of good governance:

> Places are more likely to be successful if they possess effective, sound and high quality institutions and leadership driving forward effective visions and evidence-based strategies […] Different governance models may exist in different cities and city regions. However, the principles of openness, public accountability and scrutiny should underpin all decentralised governance arrangements.[142]

As joint working has developed in England different governance arrangements have evolved. For example, the Greater Manchester combined authority's chair, vice-chair and cabinet are the leaders of its 10 constituent authorities. They are elected to their local authority and, by virtue of being leader, become a member of the combined authority. Lord Smith of Leigh, Leader of Wigan Council, was appointed leader of the combined authority and the other leaders have formed the cabinet of the authority. A group of 30 local councillors is appointed, according to political proportionality, to scrutinise the cabinet's decisions. By contrast, in London the Mayor is directly elected by Londoners and there is an elected Assembly to scrutinise him. The Mayor's cabinet consists of his appointees. Under the London Finance Commission proposals some of the governance of London would be carried out separately by, or in different combinations of, the Mayor and the GLA, groups of boroughs and individual boroughs according to agreed principles.[143]

74. In the context of fiscal devolution the Centre for Cities said creating a directly elected mayor would be an effective way of holding one person to account for decisions made, but Alexandra Jones from Centre for Cities acknowledged:

> If it is a system that is bottom-up—so if the decision is that places come forward with the arrangement that works best for them—then, based on the sentiment in cities around the country, many of them would not want to opt for [a directly elected mayor].[144]

142 Newcastle University (FDC0009) p 1

143 *Raising the Capital: the report of the London Finance Commission* (May 2013) p 15; see Q285 [Jules Pipe] for the principles behind London's proposed system of governance under fiscal devolution.

144 Q44

Ms Jones added that "even with a combined authority you can hold individual local authority leaders to account".[145] Tom Riordan, chief executive of Leeds City Council, noted that Lille, Barcelona and Berlin all had indirectly elected mayors, and that in his city region there had been three votes in which the idea of directly elected mayors had been "emphatically rejected".[146] From the perspective of business, Liz Peace, chief executive of the British Property Federation, said:

> The whole discussion around elected mayors is a distraction […] The Greater Manchester group comprises representatives of councils that have indeed been elected. For the purposes of delivering the best services to their members, they have come together with others and, between them, they have acknowledged a leader.[147]

75. The Minister, Greg Clark, took a relaxed approach:

> My own view is that it helps to have a directly-elected mayor because you have got someone who is both visible and has the clear mandate of the entire population, but would I say that you should only be able to have powers devolved to you if you have an elected mayor? That would have prevented us doing a deal with Manchester. That would have been bad for Greater Manchester and bad for the nation, so I do not want to have a red line about it.

But he did not "think we should establish an ideal, because one of the features of the country is that every place is different, and you would not want to prescribe something that has to take place in every area". Referring back to Greater Manchester he said: "It works. We know that they have got a track record of very close working together; they can organise in such a way that they can take collective decisions".[148] Lord Heseltine, in *No Stone Unturned,* recommended the introduction of legislation enabling the election of conurbation mayors. He added "where broad local support exists, (Government should) act to facilitate such developments without a referendum".[149]

76. Professor Travers summed up the position saying that the Government would want to be convinced that any arrangements put in place locally "were powerful enough and fair enough and democratic enough".[150] He pointed out, however, that "we are working with

145 Q54

146 Q114

147 Qq 141, 143; when the Committee visited the Greater Manchester Combined Authority it heard differing views on the need for an elected mayor; they were sceptical about introducing a directly elected assembly; see Qq 228-230.

148 Q490

149 Rt Hon The Lord Heseltine of Thenford CH, *No Stone Unturned in Pursuit of Growth*, (October 2012) paras 2.1-2.94; in response the Government said it intended "to seek legislation for such mayors where the authorities want this". See HM Treasury, Department for Business, Innovation and Skills, *Government response to the Heseltine review,* Cm 8587, March 2013, pp 5, 47.

150 Q53

the institutions we have got. We are trying to do something that does not require the full-scale reorganisation of local government."[151] He added that in Greater Manchester

> there are 10 powerful districts, each one with its own history as a town or several towns, and trying to overwhelm all of that by something else [a directly elected mayor] would cause such a fight-back [...] that that would take years, and then you would have to come back to the financing issue after that.[152]

77. **We wish to ensure fiscal devolution does not stall due to ongoing discussions about governance. But we are clear that there must be a requirement on local authorities seeking fiscal devolution to demonstrate a commitment and an ability to deliver on the principles of openness, public accountability and scrutiny, which should underpin all decentralised governance arrangements. No single model of governance had a monopoly on these attributes, however. In the combined authority model, members are drawn from the same tier of governance and have an equal stake in it. Any decision on governance should ideally be made locally. If the Government legislates to enable combined authorities to introduce directly elected mayors, local authorities must consult local people on such a change in a referendum.**

Redistribution within devolved areas

78. One practical example of where effective and transparent governance will be required is in the disbursement of revenue to different local authorities that make up a devolved area. Witnesses referred to the need for detailed proposals in the event of fiscal devolution in order to redistribute tax yields and the proceeds of growth within their areas.[153]

79. **We consider that local authorities putting forward proposals for fiscal devolution should be able to show equitable and fair arrangements for the disbursement of tax yields within the devolved area and, similarly, for the sharing of the proceeds of growth generated by fiscal devolution. In addition, any area seeking devolution will have to have in place transparent governance procedures for redistributing revenues within its boundaries.**

The need for a referendum

80. Voters in Scotland, Wales and London had the opportunity in referendums to decide whether they wanted devolution. We asked witnesses whether such a referendum might be necessary for fiscal devolution in England. IPPR North said,

> the public are very wary of any sub-national institutional change and the social identification around England's core cities—however strong—is quite unlike that of the devolved nations [...] there could be provision made for a

151 Q54

152 Q62

153 Q250 [Boris Johnson]; Q287 [Jules Pipe]; Q345 [Cllr Nick Forbes]

> post-hoc referendum after say—3 or 5 years—once a city region has had the chance to consider the advantages and disadvantages of the new system.[154]

Sir Merrick Cockell noted that central Government had willingly agreed to introduce further, fiscal devolution to Scotland and Wales without a referendum.[155]

81. **We see no compelling reason for a referendum on fiscal devolution.**

154 IPPR North (FDC0020) para 3

155 Q372

4 Practicalities of introducing devolution

The speed and spread of fiscal devolution

82. An incremental approach will stand the best chance of success with the Government. We referred at paragraph 70 to the Government's test of whether further decentralisation supported deficit reduction. The Minister of State for Cabinet Office (Cities and Constitution), Greg Clark MP, said that the Treasury would not agree to general fiscal devolution but might be persuaded to move incrementally and to adopt proposals in particular areas. He said progress on devolution had been held back in the past by concerns that, "'It is fine for some places, but is everyone ready to take on these powers?'"[156] Others were more explicit, telling us that any attempt at blanket fiscal devolution risked derailing the whole process. Professor Travers warned that a proposal that the whole country adopt such reforms in one go would "generate strong opposition within central government".[157] He added that, "if we ask for the same localisation or decentralisation for all of England at once, we are less likely to get it than if we ask for one or two places".[158] The idea of devolution at different speeds, with Government incentive leading to local initiatives, has been a feature of recent Government policymaking. The Parliamentary Under-Secretary of State for Communities and Local Government, Brandon Lewis MP, said that:

> if any Government were to wait until it felt every part of the country could go ahead with a particular area (of policy), what you would end up doing is slowing down the areas that can go forward further, faster.[159]

He also pointed to the advantages of local authorities moving at a different pace. He told us that areas moving forward with local growth funds and City Deals drove people in other areas to ask their elected representatives,

> "What about us? Why have we not got this yet?" […] we use the fact that areas can drive forward faster and quicker to encourage those others (saying), "Look what can be done" […] The more successful some areas are, I would hope we can drive other areas to want to be part of that as well.[160]

Sir Merrick Cockell, Chairman of the Local Government Association, explained: "we are used to an imperfectly designed and imperfectly operating set of local government structures and we can cope well with that".[161]

156 Q448

157 Professor Tony Travers (FDC0033) p 3

158 Q7; see also Q9 [Alexandra Jones]. Ms Jones suggested incremental reform was more likely as there was no mass movement for devolution.

159 Q448

160 Q479

161 Q366

83. A system that develops in line with the features we have set out in the previous chapter is likely to mean that most local authorities will take some time to devise and bring forward proposals for fiscal devolution.

84. **We conclude that in the short-term at least fiscal devolution encompassing a range of taxes and enhanced borrowing powers is likely to be implemented successfully by a small group of local authorities, particularly those that have already secured decentralisation packages or shown a strong interest in fiscal devolution, such as London and some Core Cities. This would be nothing new: local government in England has for a long time been structured asymmetrically and developed at different speeds. An incremental approach has more chance of gaining acceptance from the Treasury, which has a tendency to be cautious on fiscal matters. It would also allow those who want to make progress to move forward faster.**

Government incentive

85. The Core Cities, the County Councils Network (CCN) and Key Cities were content to see fiscal devolution start in other areas as long as there was a guarantee of their being able to join the process within an agreed timescale. Tom Riordan, chief executive of Leeds City Council, who also appeared on behalf of Core Cities, told us that if fiscal devolution was offered first to London, he would expect Core Cities' political leaders to be pressing strongly for it themselves, too.[162] Cllr David Hodge, chair of CCN, said "So long as we were given that assurance that we were going to get those powers then I think I would be quite happy with that."[163] Cllr Peter Box from the Key Cities Group agreed but said that it was "not acceptable to say that it would happen in certain areas and not the rest". Instead, he envisaged the devolution of different powers to individual cities, to county areas and to combined authorities, depending on what suited local areas.[164]

86. Witnesses told us that central Government needed to put in place a programme of devolution which would allow those ahead of the pack to move on while giving assurance to those areas wishing to follow in their path. To that end several witnesses suggested a framework—or roadmap—for devolution. Core Cities said:

> We should […] have a clear and shared timetable for devolution […] Some changes, for example the devolution of property taxes, should be possible to begin without large scale institutional change […] Government should recognise that there is no "one size fits all" approach to local devolution. Some areas may wish to move further and faster than others, taking on more responsibility within compressed timescales.[165]

IPPR North said in its submission:

162 Q75

163 Q70

164 Q124

165 Core Cities (FDC0008) para 3.6

> History tells us that without a clear implementation plan, what is promised before the general election is unlikely to be fulfilled afterwards. To this end it is worth considering the kind of 'routemap' that might need to be followed if fiscal devolution is likely to come to fruition.[166]

This model has been used in other countries. France and Japan looked at the powers that could be devolved to different levels of government at different times over a 10-year period. Expanding on this, Ed Cox, the director of IPPR North, said:

> You come up with a programme […] that enables you to say, "Yes, at the beginning there will perhaps be a big-bang approach for the Core Cities, counties and those who have the capacity and the democratic accountability to get on with it." Over a period of time though, we can see what is coming down the line for smaller places […] and then those things that are standard things that need to be decentralised everywhere to local authority level, particularly around public services.[167]

87. Ministers were uneasy about the idea of a "roadmap". Brandon Lewis had reservations about prescribing a timeline, but he added that:

> That is why it is important that we have got a menu of options out there at the moment […] There is a range of different things there that any local area can look at and pick and choose what is right for them and at what speed they can move. That reflects the fact that different parts of our country are different. We will get differences in delivery speed.[168]

This approach was not out of step with others. Sir Merrick Cockell told us:

> we would like government to let local government go at its own speed but to make it clear that the freedoms and the opportunities are there, moving away from that 'earned autonomy' idea to, 'This is what is available and you go at your own speed'.[169]

88. **While we are clear that the decision whether or not to seek fiscal devolution must rest with local authorities, the Government has a crucial role in facilitating the development of the arrangements, not least in respect of the redistribution considerations discussed earlier.** ***Ministers should, through negotiation with local authorities, expand the range of powers available to all levels of local government as part of a framework that ultimately includes fiscal devolution. As part of a commitment to create balanced opportunities for growth, the Government should in this framework spell out the range of powers that would be available to different levels of local government. For large and small cities and counties a framework would provide an incentive to make plans for enhanced collaboration and, if they wished, to pursue more meaningful, fiscal***

166 IPPR North (FDC0020) pp 4, 5

167 Q133

168 Q454

169 Q366

devolution in the future. The framework should set out what powers could be available to local authorities over the next 10 years.

89. **We envisage that the framework as well as setting out a range of devolutionary powers would contain terms and conditions that the local authorities seeking substantial fiscal powers would have to meet. These include an agreed approach to equalisation and redistribution, and being able to demonstrate that the devolved area functions as an economic entity, has a strategic approach to planning and delivery and includes good governance.**

Enhanced powers for individual authorities

90. We were told that some authorities might want more control over local spending and public services, but not large-scale fiscal devolution. Alexandra Jones from Centre for Cities told us that devolution with a menu of options "would reflect better the different needs of different places".[170] The Key Cities Group recommended that "government act in a corporate and strategic manner by developing a cross government menu of significant funding streams and powers that local areas could adopt should they meet local needs".[171] The Group referred to some of the specific powers it would like, including:

- place-based budgets;
- devolving the Work programme to cities;
- single housing plans;
- reforms to the New Homes Bonus; and
- tax increment financing.[172]

Cllr Peter Box, from Key Cities, added that "in the first 12 months" of any such devolution programme, they were also calling for devolution of sustainable communities programmes and the localisation of probation services.[173]

91. ***For all local authorities, the framework should make provision for local control over spending on a wider range of services and for them to expand or change the range of services decentralised over time. This arrangement would reassure those areas not wishing to proceed with substantial fiscal devolution that tailored powers—in particular, over how money was spent locally—would be available. Decentralised powers, such as the Work programme, should be accompanied by an appropriate amount of decentralised spending to fund such initiatives.***

92. Newcastle University said that

170 Q9

171 Key Cities (FDC0015) para 31

172 Key Cities (FDC0015) para 18

173 Q136

> if fiscal decentralisation and public service reform are to succeed there should be genuine decentralisation by Government and then all Departments and Agencies need to subscribe to the process rather than working, as has been the case in the past, with different levels of enthusiasm, commitment and even definitions of decentralisation.[174]

The LGA urged "reform [of] the Victorian departmental structures, developing a structure that promotes a focus on public service outcomes and joint working between public services”.[175] Brandon Lewis responded that over the past four years “there has been a phenomenal speed of movement there (in Government), which is a credit to all of the Departments that have been involved”.[176] Greg Clark added that: “We would not have concluded any of these City Deals without colleagues in other Departments—officials and Ministers—agreeing to give up the powers and to back a good deal.”[177]

93. ***Any process of decentralisation that links to budgets allocated to places rather than policies will require further changes in the attitude and organisation of central Government. Its structures need to mirror more readily those being developed in local government, so that budgets can be developed based on the spending priorities of local people, not national Departments. The framework needs to be able to assist individual local authorities which are primarily seeking decentralisation of spending programmes such as the Work programme with, if necessary, an option for limited fiscal devolution allowing the authority to raise low-yield local taxes, such as on landfill or tourism.***

Enhancing the role of collaborating authorities

94. Combined authorities were established in 2011 in Greater Manchester and in April 2014 in West Yorkshire, South Yorkshire and the Liverpool city region. Each process had its origins in the local authorities in those areas taking the initiative and deciding to ask Government to approve their collaborative working in specific policy areas.[178] The legislation governing the establishment of combined authorities allows counties to combine with such unitary councils.[179] The CCN noted that

> There is interaction and movement across county boundaries and therefore a need for any new arrangements to acknowledge strategic links across county areas.[180]

The Centre for Cities has recently put forward the idea of a “strategic county”. In self-contained functional economic areas, with two tiers of local authority, the county would,

174 Newcastle University (FDC0009) para 2.7

175 Local Government Association (FDC0005) para 40; see also Sunderland City Council (FDC0022) para 1.

176 Q461

177 *As above*

178 *Combined Authorities*, Standard Note SN/PC/06649, House of Commons Library, April 2014; combined authorities may be set up, by the Secretary of State, at the request of local authorities in a specified area in order to undertake joint functions; they were introduced in the Local Democracy, Economic Development and Construction Act 2009.

179 See *Combined Authorities* Standard Note SN/PC/06649, House of Commons Library, April 2014, p 3.

180 County Councils Network (FDC0013) para 4.10

subject to local agreement, coordinate housing, transport, regeneration and skills budgets and strategies.[181] Sir Merrick Cockell suggested that enhanced powers for more categories of authorities to combine and collaborate would be an incentive:

> If there is a clear understanding that, "These powers are coming your way; sort yourself out," then my belief is that local government will move itself into the right configurations to receive those powers.[182]

Enhanced powers

95. Sheffield City Council urged the Government to address the inability of combined authorities to borrow to fund non-transport related investments. It said that despite robust governance arrangements it had few resources to invest in growth and, therefore, could not achieve its ambitions.[183] Leeds City Council said successful combined authorities should be given council tax precepting powers.[184] As an overarching enhancement, the Centre for Cities has suggested combined authorities should have similar powers to the Greater London Authority, including powers to: levy and raise additional funds for economic growth projects, such as a business rate supplement and community infrastructure levy; intervene in strategic planning issues; and control Homes and Communities Agency assets.[185] IPPR suggested place-based budgets and skills funding should be available to combined authorities after 2015. As we noted at paragraph 90, Key Cities suggested such budgets should be available to individual authorities, demonstrating how the level to which powers are devolved will have to be locally agreed. IPPR added that building on the principle of the Earn Back scheme in Manchester, combined authorities should also be able to finance investment in infrastructure, employment and skills based upon the savings from increasing employment and the proceeds of GVA growth.[186] Professor Andy Pike, from Newcastle University, told us:

> The crucial thing is trying to find some ways of creating incentives and frameworks to get the local authorities to co-operate and pool resources so that they can actually accrue lots of the benefits.[187]

96. Within existing legislation, the Localism Act 2011 allows the transfer of any public function from other bodies, or from Ministers, to 'permitted bodies', a designation which includes combined authorities. It would therefore be possible for further powers to be

181 Centre for Cities, *Breaking boundaries: empowering city growth through cross-border collaboration*, March 2014, p 13

182 Q388

183 Sheffield City Council (FDC0034) paras 19, 48

184 Leeds City Council (FDC0025) p 4

185 Centre for Cities, *Breaking boundaries: empowering city growth through cross-border collaboration*, March 2014, para 1

186 IPPR North (FDC0020) p 5; any calls for enhanced borrowing run up against Treasury Total Managed Expenditure Limits, which is discussed in chapter 4.

187 Q97

devolved to combined authorities by statutory instrument without recourse to primary legislation.[188]

97. ***We recommend that, as part of any framework for devolution of further powers to all local authorities, including fiscal devolution initially to a limited number, the Government enhance the powers available to combined authorities. This would align their powers more closely with those available to the Greater London Authority, give them a greater strategic role and enable them to prepare, if they wish, for more significant fiscal devolution in the future. These enhancements would include: control over place-based budgets; powers to borrow for non-transport purposes, to become precepting authorities and to finance investment based upon the proceeds of GVA growth; and strategic housing and planning responsibilities, including the power to oversee local authorities' duty to co-operate.*** (We would expect to address local authorities' duty to co-operate in planning in our current inquiry into the operation of the National Planning Policy Framework.)

Changes to membership regulations

98. On the regulations governing the creation of combined authorities, City of York Council said that:

> the legislative process required to establish such a grouping is complex, and depends on the grouping having contiguous boundaries, even though the travel-to-work area may include non-contiguous local authorities. It would be useful to remove bureaucratic restrictions to enable combined authorities to evolve on the basis of economic market relationships, as the Government committed to do in its response to Lord Heseltine's report "No Stone Unturned".[189]

During our visit to Lyon, we heard how its combined authority, la communauté urbaine de Grand Lyon, included municipal authorities with which it did not share a geographical border. Brandon Lewis told the House recently that a legislative reform order was expected to be introduced in the summer to allow authorities that do not have contiguous boundaries to join combined authorities.[190] We also heard that while district councils can join combined authorities they do not have full voting rights. Combined authorities are responsible for transport, but in two-tier areas district councils are not transport authorities, county councils are, so the district cannot exercise the range of powers available to other combined authority members.[191] Sir Merrick Cockell said it was in the Government's power to make the situation easier for combined authorities.[192] Brandon Lewis told us there were no plans to change that policy, but if areas had a workable

188 See *Combined Authorities* Standard Note SN/PC/06649, House of Commons Library, April 2014, p 4.

189 City of York Council (FDC0010) para 5; see also Sheffield City Council (FDC0034) para 19.

190 See *Combined Authorities* Standard Note SN/PC/06649, House of Commons Library, April 2014, p 7.

191 See Q322 [Stephen Hughes].

192 Q390

proposal he would, in the interests of looking at what was right for the locality, consider it on its merits.[193]

99. ***We recommend that the Government bring forward as soon as possible its planned legislative reform order, to allow authorities that do not have contiguous boundaries to join combined authorities. Similarly, Government should bring forward legislation, to allow a district or groups of districts that form part of a locally agreed functional economic area to have full voting rights. The full powers of the combined authority should then extend to cover such districts.***

Fiscal agreements

100. In the 2013 Autumn Statement the Government encouraged the submission of public service reform proposals made by local enterprise partnerships as part of the Growth Deals process.[194] On 31 March Greg Clark told us:

> There is a danger that if you just keep it (fiscal devolution) at a theological and constitutional level, then it stays there and you do not get to talking about it. Where I think that the London Finance Commission could usefully go a bit further is to turn their high-level analysis of which taxes they think London should have under its control to think about which particular investments and which areas of policy they could, like Greater Manchester—and Greater Manchester was for infrastructure investment—make a proposal to the Government saying, "If you do this, we will do that".[195]

On the same day London's Local Enterprise Panel did just that. It published its Growth Deal proposals, in which it asked for certain funds from the Government's Single Local Growth Fund and reiterated the London Finance Commission's request for fiscal devolution: full control of property taxes and a relaxation of borrowing restrictions. In return for this, it said it would invest in the capital's infrastructure and introduce employment, skills and housing programmes. It also said this would offer central Government

- an ability to focus on national priorities rather than be distracted by local and regional issues;
- higher overall growth with continued receipt of the majority of the tax base;
- fewer spending negotiations with regional and local government; and
- a more mature dialogue between central and local government regarding the latter's strategic priorities, rather than negotiations over minutiae.[196]

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193 Q489

194 Newcastle University (FDC0009) para 2.6

195 Q447

196 London Enterprise Panel, *A Growth Deal for London*, 31 March 2014, pp 5,6

A comprehensive agreement based on London's proposed growth deal might be one way forward for authorities.

101. The London approach is not without international precedent, either. European governments, according to Core Cities, have been moving towards more long-term contractual relationships between national and local government to deliver improved urban economic performance.[197] And Newcastle University said,

> we support the creation of meaningful 'Centre-Local Contracts' to manage decentralisation. OECD analysis of international practice, such as the 'Contrats de Ville' that operate in France, suggests that it is possible to allow for innovation, tailored local approaches and decentralisation but within a more transparent, fair and accountable system.[198]

102. **Local and central Government should devise a means of enabling those authorities covering functional economic areas that wish to assume significant fiscal devolution to enter into negotiations with the Government. The London Enterprise Panel has made such a proposal within the existing mechanism of the Government's Growth Deals. If the Growth Deal route is feasible, those local authorities that wish to should take the initiative and, subject to an agreed equalisation and redistribution mechanism, make their own proposals within the framework arrangement we urge the Government to develop and adopt.**

Legislation and timetable for devising the framework

103. IPPR suggested legislation might be required in England for what it called "big bang city deals".[199] As we noted in the previous section, the Localism Act 2011 might provide a vehicle for transferring powers to a small group of areas in England.[200] The matter was raised with us and should be clarified on the basis of maximum powers that are likely to be devolved.

104. ***In responding to our report we ask the Government to confirm whether the Growth Deal route with, if necessary, the exercise of provisions in the Localism Act 2011 to transfer powers is a vehicle for comprehensive fiscal devolution. If this is the case, we would expect that by this route similar powers should be made available to further authorities in due course. If it is not, we recommend that the Government bring forward primary legislation to enable fiscal agreements to be negotiated. In addition, we recommend that within six months after the next general election the Government and local authorities agree and set out the arrangements by which certain areas might secure a long-term fiscal agreement.***

197 Core Cities (FDC0008) para 3.4

198 Newcastle University (FDC0009) para 4.1

199 IPPR North (FDC0020) pp 4-5

200 See *Combined Authorities* Standard Note SN/PC/06649, House of Commons Library, April 2014, p 4.

Agreeing the terms of fiscal agreements

105. As we have noted, witnesses told us that the City Deal process did not feel like decentralisation, given the amount of bureaucracy involved. They said it required teams to prove each proposition and haggle with an "oligarchic patron".[201] Ed Cox from IPPR North, referring to the criteria for fiscal devolution, said that this should not involve

> conditions that central Government is imposing on local government; this is not earned autonomy […] This is about an arrangement between two adult partners trying to sort out what the power relations need to be between the two of them.[202]

According to research cited by Newcastle University, Contrats de Ville were used in France to "replace traditional hierarchical relationships with contracts based on negotiation".[203] Some in local authorities have argued they should not have to have "proved their worth" to central Government but, instead, should be given further powers and judged by their electorate.[204] The Minister Greg Clark told us, however, that Government could not just accept local proposals at face value. Rather it had to conduct due diligence, negotiate and "get the best possible value".[205]

106. Given the evidence we received about the city deals process being one-sided and bureaucratic, we considered how any impasse in reaching a fiscal agreement might be dealt with. In oral evidence the idea of a local government finance "Office for Budget Responsibility" was put to us. The office, it was suggested by Ed Cox from IPPR North, could offer information and advice in relation to resetting any system of equalisation and redistribution introduced under fiscal devolution.[206] Its remit might extend to include consideration of fiscal agreements themselves.

107. **Central Government rightly has to ensure any introduction of fiscal devolution is done effectively and efficiently. Where an authority or group of authorities demonstrate that they meet the principles we outlined in the previous chapter and come within the framework we set out above, there should be a presumption in favour of fiscal devolution. In our view it is essential that the process develops on from City Deals which, despite their considerable benefits, have been characterised as bureaucratic, placing local government in the unequal position of supplicant.**

108. **To assist the development of the process we make two recommendations.** ***First, where agreement between central Government and local authorities cannot be reached,***

201 See Q91 [Tom Riordan]; and Newcastle University (FDC0009) para 3.5.

202 Q140

203 See Kamal-Chaoui, L. and Sanchez-Reaza, J. (eds.) "Urban Trends and Policies in OECD Countries", OECD Regional Development Working Papers 012/01, p 161.

204 See, for example, "Nothing to Prove", *MJ*, 24 April 2014. See also Localis, "Can Localism Deliver? 10 Lessons from Manchester", it says "Presumed autonomy is the most localist approach […] There should be no centralised measure of 'performance' as national departmental perspectives do not always align with local priorities and needs."

205 Q470

206 Q155

there should be a process of impartial evaluation. We see a role for the independent body, described earlier in our report, to advise. **Second, we recommend that local government examine whether a small group of strategic authorities, selected by their peers and with an agreed approach based on the principles we have outlined, present to the Government joined-up proposals for fiscal devolution to several areas in one go. In our view this would provide a collaborative approach, develop the framework and act as a way forward for authorities in future.**

Wider issues: local government reorganisation and constitutional changes

109. Comprehensive fiscal devolution raises broader issues relating to the reorganisation of local government finance and the codification of the relationship between local and central Government. We have, however, not examined these in this report for two reasons. First, neither is a precondition for fiscal devolution. The Minister, Greg Clark, observed:

> if you can identify a place and an area of policy in which the counterparty to the deal is ready, willing and able and you can have confidence in their ability to discharge their responsibilities, then get on with it; do not wait for a great constitutional settlement that devolves these powers on every place in the country at the same time. That is my practical observation, and I think it was shared in the evidence that Tony Travers gave to you, which I was interested to see.[207]

Core Cities pointed out devolution of the Work Programme, business rates and more significant devolution "could happen under the current structures".[208] Second, fiscal devolution will create opportunities to develop a new relationship between central and local government which could inform both reorganisation and codification.

110. Professor Andy Pike of Newcastle University pointed out that devolution had taken place "asymmetrically" in the UK already, with Scotland, Wales and Northern Ireland, London and the English regions forming a hierarchy of decentralisation: further decentralisation could unfold in a similarly uneven way.[209]

111. Wider questions about the role and place of local government in our constitutional settlement should not delay fiscal devolution. But implementation of this significant change will require appraisal. ***We therefore recommend that towards the end of the next Parliament a comprehensive assessment of the operation of any fiscal devolution and decentralisation take place. This assessment might be a starting point for a revised constitutional settlement.*** **On this issue we welcome the Political and Constitutional Reform Committee's existing work, which we expect will inform any such revision.**[210]

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207 Q448

208 Q89

209 Q68

210 See for example Political and Constitutional Reform Committee, Third Report of Session 2012-13, *Prospects for codifying the relationship between central and local government*, HC 656-I.

5 Devolved taxes and powers

Introduction

112. Fiscal devolution means greater control over taxation as well as spending locally. We have already made recommendations on broad principles of fiscal devolution. Here we look at more detailed implications. The London Finance Commission (LFC)[211] and the Core Cities[212] proposed that a suite of property taxes could be devolved and we examine three: full business rates retention, council tax and stamp duty. We also examine the LFC suggestion that London—and by implication "devolved" local authorities—should have responsibility for setting the rates of those taxes and authority over revaluation, banding and discounts[213] and that they should also be able to introduce new smaller yield taxes, such as betting, landfill and hotel duties, and to set fees and charges for all discretionary services.[214] We expect fiscal devolution to provide local authorities with enhanced borrowing powers which we also examine in this chapter.

Control over business rates

113. The LFC proposed the full devolution of business rates to London, which would mean:

- 100 per cent retention of business rates; (We considered the issue of 100 per cent retention at paragraphs 44, 51 and 52.)
- freedom to set and vary the business rate multiplier; and
- responsibility for the timing of revaluations.[215]

In this chapter we examine rate setting and revaluation.

Rate setting

114. The open market rental value—the rateable value—of a business property is calculated by the Valuation Office Agency. The multiplier—the percentage of rateable value that will be payable in business rates—is set by the Government. The business rate payable to the local authority is calculated by multiplying the rateable value by the multiplier. The

211 *Raising the Capital: the report of the London Finance Commission* (May 2013); the Mayor of London established the London Finance Commission in July 2012; it was chaired by Professor Tony Travers of the London School of Economics, who in a personal capacity gave evidence to this inquiry twice.

212 'London and England's largest cities join to call for greater devolution to drive economic growth' Greater London Authority press release, 30 September 2013; and Core Cities (FDC0008) para 3.10; the Core Cities are Birmingham, Manchester, Nottingham, Bristol, Sheffield, Newcastle, Leeds and Liverpool.

213 *Raising the Capital: the report of the London Finance Commission*, p 9

214 *Raising the Capital: the report of the London Finance Commission*, pp 9, 71

215 *Raising the Capital: the report of the London Finance Commission*, pp 11, 64, 65

Government is responsible for the timing of any revaluation, which historically has always been carried out nationally.[216]

115. Some witnesses suggested that local authorities should be responsible for setting the business rate multiplier. Leeds City Council said that cities should

> set their own business rates, as was the case prior to 1990. Even within city regions there are diverse and complex economies which would be better managed by combined or local authorities controlling the business rates. This would eliminate the problems arising in relation to a nationally set multiplier and encourage cities to come up with innovative approaches to attract and support businesses.[217]

Cllr James Lewis from Leeds City Council pointed out: "Cities are responsible organisations. We set a council tax every year […] I do not think the power to set a rate is uncommon to us."[218] Cllr Peter Box, from the Key Cities Group, told us:

> if you are serious about devolution and localism, sometimes local government will take decisions that parliamentarians do not like. That is the nature of it […] we are accountable. I cannot see how any sensible local government […] is going to take a decision that is going to mean that we have outrage and business and every individual constituent complaining. It does not work like that. […] We do not do things and succeed by ourselves; we do it in partnership.[219]

116. Cllr Roger Lawrence, leader of Wolverhampton City Council, had concerns, however. He drew our attention to tax competition with Wales when Regional Development Agencies still existed: "It was a dreadful waste of everyone's time and effort, chasing that around. Clearly, we need to have measures in place to prevent that."[220] Stephen Hughes, formerly of Birmingham City Council, said "the buoyancy should come […] from building the tax base, not necessarily by changing the tax rate". He added that "we are too small a country, really, to have lots of different variable tax rates. It does not do any good".[221] Cllr Paul Watson, leader of Sunderland City Council, agreed there was a lack of detail on the impact of rate setting locally on rebasing business rates or revaluing rents nationally, and said the mechanics of any scheme would have to be sorted out.[222]

117. Among business, the London Chamber of Commerce and Industry said "with the right safeguards and consultation with the business community, there is no reason for LCCI to oppose the GLA or London [local authorities] being given the power to determine

216 Valuation Office Agency, "How are my rates calculated?", accessed 19 May 2014

217 Leeds City Council (FDC0025) p 4

218 Q193

219 Q153

220 Q352

221 Qq 351, 354; see also Q192 [Cllr Watson].

222 Q195

the rate".[223] The Greater Birmingham Chambers of Commerce disagreed, saying new freedoms would bring "new opportunities for additional taxes and levies aimed at business which could stymie the growth of the private sector". It therefore could not support local rate-setting.[224] Liz Peace, chief executive of the British Property Federation, said greater relocation of business rate collection rather than setting was needed. Its members were

> trying to balance one thing against the other: a degree of nervousness in case a local authority went mad and whacked up the business rates phenomenally, if they had rate-setting powers, compared with the wish to see local authorities having a degree of freedom to borrow.[225]

Varying the rate

118. Whether or not the multiplier was set locally, witnesses saw merit in being able to vary it within their area. Cllr Nick Forbes, from Core Cities, said that the "issue about business rates [...] is not so much about the difference between local authorities; actually, it is within a local-authority area where you might want to have some marginal variation of business rates."[226] Cllr Lawrence cited the Business Improvement District model, "where a small supplement on the business rate in small areas is used very explicitly for particular activities to help those businesses and those businesses have a share in driving that forward".[227] Sir Merrick Cockell added that small variations and increases in business rates might be decided locally: "Areas might be able to save 5% either way, and that would be down to those areas to work with local businesses to agree what was right and how that money was being invested."[228]

119. **We consider that restoring the ability of local authorities to set the business rate multiplier to meet local circumstances, combined with the power to vary the rate for specific projects and categories of business, will provide authorities with a key lever in stimulating and fostering local economic growth as well as guaranteeing that they work closely with local business. It will ensure that local authorities have to consult with, and focus on the needs of, local business. We see a logic in the same multiplier being set across the devolved area. We also recognise, however, that there may be a concern about the potential for excessive increases in the multiplier. One option to constrain that would be for local authorities in a devolved area to be limited to increasing business rates by no more than the increase in the average council tax in the devolved area. The operation of the business rates levy would need to avoid penalising authorities that, after full consultation with local business, increase their multiplier.**

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223 LCCI (FDC0019) para 25

224 Greater Birmingham Chambers of Commerce (FDC0016) pp 2, 3

225 Qq126, 150

226 Q354

227 Q352

228 Q393; see also Q317 [Darren Johnson AM]; Q354 [Cllr Nick Forbes].

Revaluation

120. Although the national reassessment of rateable values must take place every five years, the Growth and Infrastructure Act 2013 changed the date of the next revaluation from 2015 to 2017.[229] While there has been some criticism of this change,[230] the transfer of responsibility for revaluation to local areas was not seen as the solution or as a prerequisite for fiscal devolution. Sir Merrick Cockell said:

> I do not think we are saying that we would want to do the valuation […] I am sure we could create a system that operated within the current national body working out the rateable value of businesses.[231]

But several witnesses wanted more frequent valuations. Among business, LCCI noted that "revaluations are frequently delayed",[232] while Liz Peace suggested that, with modern technology, revaluation could take place every two years and there would be fewer arguments.[233] Three to four years was suggested by Lord Smith, Chair of the Greater Manchester Combined Authority.[234] On the other hand, Ed Cox, from IPPR North, suggested combining the revaluation of business rateable values with a more general rebasing of devolved fiscal measures and funding formulas—a comprehensive resetting. He said this might be carried out by an independent body every 10 years.[235]

121. **We detected little clamour for transferring the revaluation of business rateable values to local areas as part of the process of fiscal devolution. The main concern has been the delay in holding national valuations. The time has come to set a timescale for an independently commissioned national business rate revaluation and, to ensure it happens, for it to be set in primary legislation without the facility to change the date through secondary legislation.** ***We recommend it takes place every five years, beginning in 2020, and within six months of a general election.*** **Revaluation could then coincide with the resetting of the Business Rates Retention scheme, to which we see a strong link. Subsequently, it could coincide once every 10 years with the resetting of any assessment of relative need among local authorities, administered by the independent body to which we have referred. In our view such a process would ensure not only regular and fair equalisation and redistribution of resources, but predictability, allowing local authorities to plan ahead.**

The independent office for local government fiscal management

122. **In sum, the independent body we recommend would introduce a substantial degree of objectivity into local government fiscal management. Specifically, it would be**

229 Growth and Infrastructure Act 2013, section 29

230 For example, "Small shops 'to pay as supermarkets save £1bn on rates'", *The Independent*, 29 October 2013

231 Q399

232 LCCI (FDC0019) para 25

233 Q155

234 Q222

235 Q157

responsible for: assessing relative needs and resources every 10 years, starting in 2020 when the BRRS is rebased; evaluating proposals when a fiscal agreement cannot be reached; and commissioning the independent revaluation of business rates and council tax every five years, starting in 2020.

Council tax

123. The LFC recommended that:

> Council tax should be retained as a local tax but London government should be given the power and be required to hold periodic revaluations (undertaken by the Valuation Office, according to national practice), to determine the number of bands, to set the ratio of tax from band to band and to set the tax rate.[236]

Council tax referendums

124. The Localism Act 2011 makes planned increases in council tax, above a certain threshold set by central Government, subject to a local binding council tax referendum. In 2014-15 the threshold is 2%. Explaining the Government's thinking behind the policy, the Minister, Brandon Lewis, told us that:

> When I was a local government councillor—not when I was in control of the council—the local authority I was in had, back in the late 1990s and early 2000s, council tax rises of 19%, 18% and 16%; they were generally quite regularly in double figures. It is quite reasonable for central Government to say, "We think the highest it should be is around 2%. We want to try to help people with their bills."[237]

Mr Lewis added:

> They (local authorities) have got the freedom to go out, have a referendum, make the case and get the agreement of their local residents to do it (raise council tax).[238]

Sir Merrick Cockell said that:

> local authorities should make their case to those who elect them. It gives a good reason for people to bother to vote [...] people who take those decisions should be held accountable through the ballot box rather than through a referendum.[239]

The Greater Manchester Combined Authority said:

236 *Raising the Capital: the report of the London Finance Commission,* p 11

237 Q504

238 Q505

239 Q373

> Whilst the principle of council tax referendums provides direct accountability, the variable nature of the referendum threshold set by central Government makes long term decision making for local authorities problematic.[240]

When we asked Mr Lewis why the principle of a referendum should not apply to other taxes, he said that was "a very good question" but offered no further explanation.[241]

125. **We found across local government in England, if not a demand for full fiscal devolution in all areas, a strong appetite for greater fiscal responsibility. The Government is going to have to learn to have confidence in local authorities in the same way it has confidence in the devolved legislatures. For a start all local authorities should be trusted with responsibility for setting the council tax rate in their areas. We consider that all local authorities should have the freedom to set their local domestic property tax rates. There is no hard and fast rule that they will automatically use this flexibility to increase their council tax rates, but if they do they should be free to do so and then test local people's appetite for it, as they do for a range of decisions, on local election polling day.**

Revaluation and rebanding

126. Domestic properties in England have not been revalued since 1991. The Government announced in 2010 that there would be no revaluation in this Parliament, as according to the Secretary of State it "could have pushed up taxes on people's homes".[242] Similar excuses were used by the last Government when in 2005 it also postponed a revaluation, which had been planned for 2007, after revaluation in Wales led to anger over council tax rises.[243] The absence of any revaluation was of concern to witnesses. Lord Smith, Chair of the GMCA, told us that "we have a council tax system based in 1991 that has never been revalued. You buy a new house where there are all these broadband facilities and so on. How do you measure that?"[244] The LFC called for London to be required to hold periodic revaluations of domestic properties, carried out by the Valuation Office Agency. Other witnesses recognised the importance of a general revaluation but focused on smaller, incremental devolutionary measures that might be taken. Wolverhampton City Council said that:

> Even if the regulation of council tax was relaxed, instead of fully devolved, the impact on Wolverhampton would be positive. Re-banding properties and the removal of the referendum threshold would give far greater freedom and enable the local authority to respond to local needs.[245]

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240 GMCA (FDC0006) para 4.2

241 Q507

242 Department for Communities and Local Government, "No Council Tax revaluation tax rises pledge ministers", accessed 20 May 2014

243 "Council tax revaluation 'would hit poorest the hardest'", *The Guardian*, accessed 16 June 2014

244 Q216. See also Leeds City Council (FDC0025) p 4

245 Wolverhampton City Council (FDC0024) para 8

127. The LFC noted that council tax did not operate on the basis of a full range of values:

> Rather, all properties are attributed to one of eight bands of value, based on capital values in 1991. The ratio of tax paid from Band A (the lowest) to Band H (the highest) is 1:3. Thus, a home in a London borough with a 2013 value of £25 million is likely to pay just three times the council tax of one with a value of £250,000.[246]

IPPR said local authorities should be allowed to introduce new additional council tax bands as they saw fit, while the structure and number of council tax bands should be reviewed.[247] Leeds City Council agreed and said "the setting and adjustment of bandings should be done by Combined Authorities". It added local setting of bands would "more accurately reflect local economic conditions".[248] And in London the Mayor agreed that the introduction of extra council tax bands, particularly for valuable properties, should be examined.[249] The Chair of the Assembly, Darren Johnson AM, said, while each borough should be able to set its own council tax, decisions on banding should take place across the whole of London.[250]

128. **Council tax rates are based on valuations made a generation ago, and those in the highest-banded properties are limited to paying no more than three times the tax of those in the lowest. The pretext for deferring revaluation—that it would increase most people's council tax—is erroneous if the revaluation is carried out properly and is fiscally neutral overall locally. Therefore a revaluation of itself must not affect a council's income. If nothing is done, there is a risk that the whole system will eventually collapse or, like domestic rates, have to be replaced. If there is a case for a revaluation of business rateable values—last carried out in 2010—the case for revaluation of domestic rates must be greater.** ***We recommend that Government introduce legislation to ensure, for the purposes of Council Tax, domestic properties are revalued every five years.***

129. **There is also scope for further flexibility. We conclude that devolved areas—which we envisage, in the first instance, would be London or combined authority areas—should be given the power to introduce new council tax bands at the top end of the scale and to split existing ones. The national revaluation will therefore need to be precise, citing a property's price not just its band, so that any devolved local authorities wishing to introduce a new band are able to include the appropriate properties in it. Doing so might go some way to increasing fairness in the distribution of the tax burden locally.**

246 *Raising the Capital: the report of the London Finance Commission*, p 67

247 IPPR North (FDC0020) p 5

248 Leeds City Council (FDC0025) p 4

249 Q278

250 Q307

Stamp duty

130. Stamp duty is levied only on a limited number of properties, concentrated in areas such as London and the South East.[251] London's stamp duty yield in 2012-13 accounted for 33% of all stamp duty collected, about £2.8 billion out of a UK total of £7.7 billion. Professor Travers noted that outside London and South East, however, the tax

> produces tens of millions, rather than billions, of pounds in most places […] of course it would generate less money in the Sheffield city region, the Liverpool city region or even the Manchester city region, by a long way than it would in London. However, even there, it would leave those authorities with a bigger tax base than they have today.[252]

The Greater Manchester Combined Authority said there was a strong case for devolving stamp duty to its area:

> Local authorities would be incentivised to encourage economic activity such as house-buying in their area if they retained some or all of the stamp duty due on a property sale, and the funds could then be used to provide local services.[253]

Responsibility for stamp duty in Scotland is due to be transferred in 2015.[254]

131. **The yield from stamp duty in London and the South East is a fiscal anomaly in England. Full fiscal devolution of the tax in London could deprive the Exchequer of a significant amount of revenue that could be used elsewhere and for different purposes. As we have set out, to meet the principle of equalisation, it could be devolved in London subject to a levy requiring transfer of duty above an agreed threshold to the Exchequer. On the basis of this requirement, which could apply also to other devolved authorities, we recommend that stamp duty be included in the fiscal devolution framework. In addition, we would expect the Department for Communities and Local Government to monitor and review lessons that can be drawn from devolution of stamp duty in Scotland to inform its introduction in England.**

Other taxes and charges

132. We noted in the first chapter how under new devolution arrangements Scotland and Wales will be given the power to introduce some taxes.[255] The LFC suggested the creation of tourism, environmental, alcohol or betting taxes might be permitted under devolution to the capital.[256] The LGA said such powers could reduce the dependence on council tax

251 See paragraph 48.

252 Q420

253 GMCA (FDC0006) para 4.3

254 HM Revenue and Customs, "Devolved taxation in Scotland", accessed 2 May 2014

255 At para 19

256 *Raising the Capital: the report of the London Finance Commission*, p 71

and business rates and allow areas to reduce the tax burden on local taxpayers.[257] When in France we heard that Lyon had a tourism tax of around €1 per night, dependant on the type of accommodation used. Tom Riordan noted how Leeds, the venue for the start of this year's Tour de France, might have benefited from levying such a tax.[258] Professor Andy Pike, of Newcastle University, however, warned that other taxes, such as environmental or betting levies, were volatile and often unpopular and were a route to increase taxes outside the control of a centralised system.

Local income tax and VAT

133. The Scotland Act 2012 introduced the Scottish rate of income tax (SRIT), which is expected to be implemented in April 2016. The rate paid by Scottish taxpayers will be calculated by reducing the basic, higher and additional rates of Income Tax by 10 pence in the pound and adding a new Scottish rate set by the Scottish Parliament. A SRIT of 10% would mean no change from the UK rates. However, a SRIT of 9% would mean the rates paid by Scottish taxpayers were lower and a Scottish rate of 11% would mean they were higher.[259] IPPR North recommended this arrangement in England:

> Ten per cent of the income tax take in each of the combined authorities should be assigned to those authorities with a corresponding reduction in the central government grants to their constituent local authorities.[260]

Another suggested local tax was VAT. Stephen Hughes said it was a better incentive, because "VAT is much more directly related to value added. It is not dependent on a particular type of growth".[261]

134. **Arrangements have been developed to allow the devolved nations to introduce new taxes, as well to take control of business rates, stamp duty and, in the case of Scotland, part of income tax. As we expect fiscal devolution in England would in the short term be restricted to a handful of areas the opportunity is available to replicate some of the Scottish and Welsh arrangements in areas in England with the capacity to take advantage of these resources and to implement projects with the potential to generate good returns on investment. *At the minimum fiscal devolution should empower these authorities to introduce relatively low-yield taxes. A range of suggestions includes betting taxes and landfill and hotel duties.***

135. **Recognising what is happening in Scotland and Wales we see a case in the long term for examining the apportioning in a similar manner to Scotland a percentage of income tax or VAT to groups of authorities covering significant geographical areas in England. We recognise, however, this is an extension of the fiscal devolution on which we have not taken detailed evidence. We would not want consideration of devolving**

257 LGA (FDC0005) para 37.2

258 Q120

259 See HM Revenue and Customs, "Scottish rate of income tax", accessed 14 May 2014.

260 IPPR North (FDC0020) para 4

261 Q334; see also Qq279-281 [Boris Johnson].

income tax and VAT to hold up fiscal devolution of property taxes, but Government and local authorities should evaluate the proposals. Evaluation of devolution of these taxes could and should form part of the comprehensive assessment of the operation of any fiscal devolution and decentralisation we have recommended to be carried out after the first wave of fiscal devolution has been implemented and which we describe in the previous chapter.

Fees and charges

136. If the principle of fiscal devolution to local authorities is accepted, the justification for detailed financial constraints on local authorities falls down. One example is the constraint on the level of fees and charges local authorities can levy. We recognise that there are risks—for example, where a local authority is the sole supplier of a service for which it can charge. Local authorities are currently limited to charging only what they need to recover in costs. Central Government is, however, going to have to learn to trust local government and their local electors, and as a first step it could use a devolution framework and fiscal agreements to set limits to allow local authorities to charge, for example, more than the cost of providing a service and to allow authorities greater freedom to apply these resources.

137. ***We recommend that as part of a devolution framework and in fiscal agreements the Government provide for the relaxation of the current controls on the levels of fees and charges local authorities can charge for services and the purposes to which the income generated can be disbursed.***

Borrowing

138. Those authorities to which fiscal responsibilities are devolved should be able to demonstrate fiscal competence and management, and a key objective of the process would be economic growth. The process would allow them a greater range of revenue streams. On enhanced borrowing powers, the LFC said:

- the Government should distinguish between borrowing that will be used to promote growth or reduce public expenditure and thus be repaid, and other kinds of debt;
- in light of the robust and effective prudential borrowing regime, GLA Group borrowing ceilings should be removed;
- the Mayor and London's local authorities should determine which Tax Increment Financing (TIF) projects to proceed with in London, within the prudential borrowing code.[262]

Under current prudential borrowing arrangements local authorities can borrow for capital expenditure without obtaining prior Government approval. Local government officers

262 *Raising the Capital: the report of the London Finance Commission,* p 10; further information on the prudential code, p 50.

assess the sustainability of borrowing and set limits in line with the prudential code, which requires councils to have the financial capacity to repay debt, as borrowing is unsecured by assets.[263] Newcastle University noted the precedent being set once again in Wales:

> The UK Government accepts that the Welsh Assembly Government should have new capital borrowing arrangements subject to a proposed referendum on income tax powers. The Welsh Government will also be offered early access to limited capital borrowing in order to fund immediate improvements to the M4 Motorway.[264]

Tax increment financing

139. Earn Back and Gain Share are tax increment financing (TIF) schemes now in place in Manchester and Cambridge respectively. The GMCA said its model:

> allows us to capture a proportion of the growth generated as a result of our local investment in transport infrastructure for reinvestment. This is based on a formula linked to changes in rateable values over time at the Greater Manchester level, which provides a revenue stream over 30 years, provided that additional GVA is created relative to the agreed baseline. This therefore provides an additional incentive for Greater Manchester to prioritise local government spending to maximise economic growth.[265]

The Department for Communities and Local Government said that the business rates retention scheme now gave all councils unfettered access to tax increment financing by enabling them to retain and borrow against future business rates.[266] Core Cities told us its members needed access to a wider range of devolved taxes in order to fund further TIF schemes and allocate finance over longer periods.[267] It added:

> Government should not […] be concerned about large increases in borrowing. The use of the Prudential Code is a robust process, and the numbers of viable schemes on which cities would feel able to use mechanisms like TIF is relatively small in the context of national borrowing and spending.

It also said local areas should determine which TIF projects to proceed with, again within the prudential borrowing code.[268] The GMCA also referred to "the strong financial stewardship of local government" and said that the Treasury could be reassured about the affordability of borrowing within the PBF.[269] As we have noted in previous chapters, the

263 See Newcastle University (FDC0009) para 9.6.

264 Newcastle University (FDC0009) para 9.4

265 GMCA (FDC0006) para 3.2

266 DCLG (FDC0014) para 20

267 Core Cities (FDC0008) para 3.8

268 Core Cities (FDC0008) paras 3.8, 3.10

269 GMCA (FDC0006) para 8.2; see also Q316 [Darren Johnson AM].

Department made plain that further decentralisation should support deficit reduction.[270] Professor Andy Pike from Newcastle University took issue with the deficit reduction test, however, noting that

> of course one of the easiest ways to reduce the deficit is not to borrow at all, but where does that leave the counties and the cities in terms of investing and putting in place the future conditions for growth?[271]

140. **One key aspect of fiscal devolution is its focus on stimulating economic growth. Local authorities in England wanting to grow their economies may therefore need to borrow to invest. Given the Government's focus on deficit reduction, however, we recognise that a general relaxation of the rules on borrowing is not appropriate at this stage. But those local authorities that negotiate a fiscal agreement with the Government will have had to demonstrate strategic financial management and competence.** ***Such authorities should therefore have access to greater and more flexible borrowing powers—for the purposes of capital investment in projects clearly and quantifiably designed to stimulate growth. Enhanced powers should remain within the stringent prudential borrowing code, however, ensuring authorities have the means and capacity to meet their annual borrowing costs.*** **This would allow them to pursue the innovative approach to borrowing that the Government has, commendably, negotiated with Greater Manchester, allowing it to benefit from increased tax take. Greater local revenue streams would enable local authorities to borrow to invest and so increase their tax yield and reinvest in further schemes.** ***Devolved areas should have the power to determine what TIF projects to introduce without the need for Treasury approval but within the prudential borrowing code.*** **Given the limited number of projects to which this would apply, this should be achievable in practice.**

Housing Revenue Account

141. Core Cities, among others, also wanted the Government to raise the Housing Revenue Account borrowing cap, which it described as "an unnecessary threshold which restricts growth and construction, and sets limits on local self-determination".[272] The LGA told us that reforming the classification of council borrowing for housing would bring the UK into line with Europe in the way it classifies this kind of borrowing and end the current preoccupation with where the borrowing sits for accounting purposes, rather than the value attained for investment. Sir Merrick Cockell from the LGA added that:

> Some research has been done by Capital Economics into the impact of lifting the cap, and the belief is that if we lifted the cap, we are talking about

270 DCLG (FDC0014) para 4

271 Q83

272 Core Cities (FDC0008) para 3.7; see also Wolverhampton City Council (FDC0024) para 9, London Chamber of Commerce and Industry (FDC0019) para 2, and LGA (FDC0005) para 29.3.

> (councils having an additional) £7 billion (to invest) over five years. They believe that that is not going to have any impact on the market.[273]

In our report, *Financing of New Housing Supply*, we recommended that:

> that the Government lift the cap on local authorities' borrowing for housing, and allow councils to borrow in accordance with the Prudential Code […] The cap is already unnecessary, and further borrowing restrictions would have a detrimental impact upon the contribution councils can make to new housing supply.[274]

The Government responded saying:

> Our reforms must not jeopardise the Government's first economic priority, which is to reduce the national deficit. Borrowing made possible by any income stream, including housing rents, must be affordable not just locally but within the national fiscal framework.[275]

142. ***We reiterate our recommendation in a previous report that the Government lift the cap on local authorities' borrowing for housing. We believe this should be universally applied.***

National fiscal implications and management

143. Throughout our inquiry witnesses emphasised that any increased tax yields or borrowing would be spent on—invested in—infrastructure projects or, indeed, public services. This has implications for the UK's gross national spending limits, particularly, Total Managed Expenditure (TME). TME covers all current and capital spending carried out by the central Government, local authorities and public enterprises. It comprises Departmental-Expenditure Limits, spending that Government departments control, and Annually Managed Expenditure (AME). AME includes locally financed public expenditure, funded by council tax and other local sources.[276]

144. When we put the impact of fiscal devolution on national spending to Professor Travers, Chair of the LFC, he said:

> so long as we have a public spending control system of the kind we do […] and we now have one set all the way out to 2018/19 […] if a part of the country were given some fiscal independence or autonomy and were able to

273 Q407

274 Communities and Local Government Committee, Eleventh Report of Session 2010-12, *Financing of New Housing Supply*, HC 1652, para 93

275 Department for Communities and Local Government, *Government Response to the Communities and Local Government Committee's Report on Financing of New Housing Supply*, Cm 8401, July 2012, para 16

276 House of Commons Scrutiny Unit, *Finance Glossary*, pp 1, 5, 13; see also Politics.co.uk "Public spending", accessed 20 May 2014.

> grow its economy faster and then spend more, that extra spending will always count against the preordained total. There is no way out.[277]

He explained:

> That is why in the Finance Commission we effectively put in a thinly disguised argument for some derogation—some exemption from these rules—at least for investment. If this money were generated by city regions as a result of these reforms going through, and they were then able to invest in their infrastructure—in tramways or, frankly, any physical capital—the money markets and the eight ratings agencies would tell the difference between that and borrowing to fund day-to-day spending.[278]

Professor Travers added that "the way the Office for National Statistics measures public expenditure is entirely ordained by classifications issues, which I am sure they would say were fitting with international accounting standards".[279] Both Professor Travers and Rob Whiteman from CIPFA told us other countries had a more restricted definition of public debt in their control totals. Professor Travers cited Germany and the United States as examples. While acknowledging these were federal counties, he noted that in the US total public spending funded by taxation was "definitely not something that the President starts with and says, 'This will be a total we will work down from'".[280]

145. We put these points to the Minister, Greg Clark, and he too linked them to those accounting rules, which he said assumed a certain growth trajectory whereby, if Manchester or Liverpool grew faster than the average, it was at the expense of somewhere else. He urged us to reflect on how those conventions did not allow for the association of growth and revenue with particular places.[281] With the further Scottish devolution in mind, we asked him whether TME could be raised to take account of what Scotland decided to spend (rather than trigger an offsetting reduction in England). He said:

> That will be a decision that the Government has to take: whether to expand it or whether to accommodate it (increased spending).[282]

146. **Growth in one area of England does not mean reduced growth elsewhere. Fiscal devolution focused on local growth may involve increased local spending financed from local or national taxes, borrowing or voluntary contributions through business levies. Under the current rules limiting gross expenditure, this would have to be offset by a reduction in expenditure. Applying that requirement to infrastructure projects would be unjustified. While we accept that all governments have to manage the resources taken by the public sector, we think it would be regrettable if the control system were used to hobble fiscal devolution in England. It has not obstructed fiscal devolution to**

277 Q426

278 Q430

279 Q432

280 Q442

281 Q510

282 Q514

Scotland and Wales. ***We recommend that the Government clarify how the controls on UK public expenditure will apply to fiscal devolution to Scotland and Wales and whether similar arrangements could be put in place for local authorities in England.***

147. **There are perhaps three ways in which the problem could be addressed. First, local authority expenditure on capital projects designed to stimulate economic growth could be taken out of the control total. It would be distinguishable by the ratings agencies, and would be used to invest in growth projects, a potentially virtuous circle. Second, the Government could agree to raise Total Managed Expenditure to accommodate expenditure devolved to local authorities in England. A third way would be to decrease central Government spending.**

148. **No Government having accepted fiscal devolution to Scotland and Wales should allow the Treasury's fiscal control system focused on gross expenditure to require every additional pound of additional public expenditure in Scotland and Wales to be offset pound-for-pound by a reduction in spending in England. Nor should such a perverse arrangement apply to additional public expenditure determined under fiscal devolution in England. Where such expenditure is fully funded by increased local taxes and charges a gross control of public expenditure cannot be justified. Fully funded expenditure does not increase the deficit.**

6 Conclusion

Time for change

149. Fiscal devolution in England is an idea whose time has come. The long shadows cast by the fiscal turmoil of the 1980s and 2000s—failed reform of local government finance, financial irresponsibility in parts of local government, inflexible, formulaic equalisation of local authorities' needs and resources and, above all, firm control by central Government—have started to recede. A few tentative steps towards fiscal devolution have been taken in England with City Deals and the partial localisation of business rates. But the most striking changes have occurred outside England. As devolution to Scotland and Wales has gained momentum it has brought with it significant fiscal devolution, and the anomalous position of England has become starker. Many English cities and regions have economies larger than these countries. Why should they not have fiscal devolution too?

150. We found across England a demand for decentralisation, particularly of spending, and in some areas a strong appetite for fiscal devolution. In our previous report on *Localism*,[283] we endorsed the idea of shifting power from Whitehall to the town hall. We therefore support fiscal devolution in principle. It is the logical next step on a path to genuine localism.

151. A small group of local authorities, led by London and the Core Cities, are ready to move on to the detail of implementation. They want greater control over a wider range of taxes, and enhanced prudential borrowing powers, to provide resources to fund local economic strategies suited to their local needs. Their proposals are moderate and would increase local control of taxes by no more than a few percentage points, still low by international comparisons. This report aims to get things moving in the short term. In the medium term, with the introduction of limited fiscal devolution, a review of the local-central government relationship in England and an examination of further fiscal devolution, English local authorities should be able to move from earned autonomy to devolution as of right.

How fiscal devolution will look

152. The key features of the fiscal devolution we want to see adopted in the next parliament are as follows.

a) Local and central government should agree a framework of taxes, powers and responsibilities which can be devolved and decentralised to local authorities. The framework would provide a range of options for local authorities from decentralisation of spending powers to full fiscal devolution of several taxes and powers to institute new taxes and enhanced borrowing powers.

b) The initiative for seeking powers and responsibilities should lie with local authorities.

283 Communities and Local Government Committee, Third Report of Session 2010-12, *Localism*, HC 547

c) The area to which fiscal powers (as opposed to decentralisation of spending) are initially devolved should demonstrably function as an economic unit—most likely being a group of authorities such as in London or the areas covered by combined authorities.

d) The functional economic area should be able to demonstrate a record of competent, strategic financial management and have governance arrangements which ensure transparency and accountability, including democratic elections.

e) The powers and responsibilities devolved should be subject to negotiation between the authorities seeking the powers and central Government.

f) An independent office would bring objectivity to the process: evaluating devolution proposals; assessing relative needs and resources of local authority areas, including devolved areas, every 10 years; and commissioning the independent revaluation of business rates and council tax values every five years.

g) The arrangements governing fiscal devolution have to balance incentives to stimulate local growth, a key rationale behind fiscal devolution, with some equalisation and redistribution of resources from authorities with the greatest resources to those with the greatest needs. These arrangements would: require an assessment of need and resources; have a mechanism for redistributing disproportionate growth; provide a safety net for local authorities facing severe and unexpected downturn in their circumstances; and include periodic reassessments.

h) Decisions on national levels of public expenditure in England are for ministers but the current system of public expenditure control will need to be adapted to allow fully funded local expenditure no longer to count against tight national controls.

Conclusions and recommendations

Our inquiry

1. The power to raise, retain and spend money locally—fiscal devolution—is back on the political agenda. Local government wants more of it. The UK Government, in promoting devolution, localism and spending decentralisation, has shown that we may have passed the high water mark of Whitehall control. But increased and increasing fiscal devolution to Scotland, Wales and Northern Ireland—and foreign comparisons—highlight how much England is still firmly in the fiscal grip of central Government. There is unlikely to be an English Parliament or regional assemblies, so devolution based on existing structures or groups of authorities is the only way forward. With a UK general election less than 10 months away, policy makers must listen to calls for fiscal devolution to local authorities in England and consider their response. (Paragraph 15)

The case for fiscal devolution

2. English local authorities, when compared with their counterparts in other developed nations, have limited control over local taxation and, as a consequence, rely, by comparison, disproportionately on central Government funding. Given the level of UK central Government control over local spending and over local taxation in England compared to other developed countries, it is entirely reasonable for local areas in England to aspire to greater local control over the money raised from their areas and spent locally. The key question is what to do about this aspiration: specifically, whether England should put in place a programme of fiscal devolution to local authorities and, if so, how it should go about the task. (Paragraph 18)

Devolution to Scotland and Wales

3. The UK Government is in the process of granting substantial fiscal devolution to Scotland and Wales. Ministers have therefore accepted the principle of fiscal devolution from Whitehall. This prompts the question, if such powers are considered justified and workable in Scotland and Wales, why not in England? Greater Manchester and Greater Birmingham each have a larger GVA [Gross Value Added] than Wales. London has a larger GVA than Scotland, Wales and Northern Ireland combined. When the changes for Scotland and Wales take place, England's local authorities will be left in an increasingly anomalous position, with a little more responsibility for spending than they have now but much less control over taxation than the Scottish Parliament and the Welsh Assembly. (Paragraph 21)

Spending decentralisation and fiscal devolution

4. The process of devolution, if it is to be meaningful and effective, must include more than decentralised funding streams spent in local authority areas. Fiscal devolution provides enhanced local autonomy. Without it, local authorities will be agencies of central Government, focused in large measure on the requirements set by the funder, central Government, and acting within spending constraints set by Whitehall. That said, fiscal devolution and decentralisation, through place-based funding, are mutually reinforcing policies. Taken together they would give local areas greater control over spending and allow policies on growth and public service reform to complement each other. (Paragraph 25)

Fiscal devolution and economic growth

5. We conclude that there is evidence of at least an indirect connection between fiscal devolution and growth. There is also evidence that fiscal devolution—as part of a package of wider decentralisation—would encourage greater economic growth across England. The Government has, through its own business rates retention scheme, accepted the logic behind this. Putting a wider range of tax and borrowing powers into the hands of local politicians simply extends this logic. London, already in the vanguard of UK growth, would not be pressing for devolution if it was not to its advantage. Placing power in the hands of other areas, too, would provide an opportunity to contribute to a more balanced economy. Cities and their wider regions have the most potential to drive growth. (Paragraph 28)

Enhancing democracy

6. Fiscal devolution presents an opportunity to improve accountability, to hold local politicians to account for their successes and failures and, therefore, to improve democracy. By giving politicians outside Westminster the responsibility for raising, as well as spending, money locally, fiscal devolution would bring decisions on how that money is generated and spent much closer to local people—and make those who make such decisions much more visible. This would enhance the standing of local democracy and, by extension, democracy throughout the country. Enhanced local democracy offers the best possibility of a step towards addressing the challenges of the wider democratic deficit caused by the over centralisation of England. (Paragraph 30)

Committing to the principle of fiscal devolution

7. *The point has been reached for the Government (and policy makers in other political parties) to make it clear whether they are committed in principle to larger-scale and more comprehensive fiscal devolution in England. We are, and we believe they should be too.* (Paragraph 32)

8. With a clear national commitment to the principle of fiscal devolution local authorities working with central government would be able to produce more detail on how such devolution might work in their areas. The Government is rightly concerned about deficit reduction and whether fiscal devolution will have a detrimental effect on the rest of the UK. However, the Government must plan beyond the next few years and the present financial constraints. A common agreement to the principle, combined with a measured approach arranged between local and central Government, including initial devolution to a small number of areas, should allay those concerns. (Paragraph 33)

Equalisation and redistribution

9. The new system of local government finance introduced in 2013-14 appears to have broad, but not universal, acceptance among local authorities. It was an improvement on previous arrangements but its operation still causes some concern. Significantly, it recognises the equalisation of needs and resources at the outset but thereafter incentivises local growth and provides some autonomy, albeit with limits on "excessive" gain and untoward loss in any one area. We refer later in this Report to these limits, the precise nature of which should be agreed between central and local government. (Paragraph 40)

10. Through the Business Rates Retention Scheme, England has a system which balances equalisation and incentives for local growth. It provides a useful signpost for further fiscal devolution. First, it was set up on the basis of an assessment of need and resources. Second, there is a period of stability without further equalisation and redistribution, to provide an incentive to local authorities to increase and retain revenue, and, third, it is predicated on periodic re-assessments of needs and resources—the first will be in 2020. For further fiscal devolution local and central Government will need to take the model and develop it to establish an agreed approach. We therefore consider that similar arrangements, incorporating equalisation, should feature in any process of significant fiscal devolution, which we expect a limited number of local authorities to pursue initially. This will ensure a degree of fairness to begin with, balancing needs and resources with incentives to improve the local economy. If fiscal devolution does not include these principles, it could become a system in which the winner takes all. (Paragraph 45)

11. We do not consider that a putative general uplift in taxes such as income tax and corporation tax would provide a satisfactory redistributive arrangement under fiscal devolution to areas outside London. First, it is likely to be difficult to identify and quantify. Second, the use of the yield from these taxes will be subject to the Government's competing priorities, including deficit reduction. Third, under current Treasury rules, it would count against the Total Managed Expenditure limit, the control on gross UK spending, and so either the Government would have to raise the limit or offset it with a reduction elsewhere. We conclude that such an approach, on which we received no detailed costings or calculations, is unlikely to command support (Paragraph 47)

12. London's stamp duty yield increased by 85% between 2009-10 and 2012-13—dramatically more than any other area, including the Core Cities. By any objective measure, London's relative spending requirements could not have increased by 85% over the same period. Its yield per head of population was also considerably more than elsewhere. If a similar increase in stamp duty yield, or indeed in business rate yield, occurred in future, the question whether a local area was solely responsible for it, or the beneficiary of a windfall due to national economic circumstances, would need to be addressed. In our view there has to be a levy on disproportionate tax yield growth. (Paragraph 49)

13. We conclude that for a system of fiscal devolution to balance equalisation and incentives it has to: start with an assessment of need and resources; have a mechanism for reallocating disproportionate tax yield growth; and include periodic reassessments. The operation of the arrangements will be for agreement between local and central government but we recommend that before fiscal devolution take place in an area:

a) the negotiations for the package are carried out on the basis of a current assessment of need—either the 2013-14 assessment or a subsequent reassessment;

b) negotiations take place on the basis of an up-to-date assessment of projected income from the taxes to be devolved up to the next reassessment;

c) the arrangement would operate by offsetting grants and support paid by central Government for local authority control of taxes;

d) the parties agree an excessive rate of increase in the yield of the devolved taxes above which a levy will apply; and

e) the parties acknowledge and agree that a reassessment of need and resources will take place after specified periods. (Paragraph 56)

14. We make no detailed recommendation on the levy beyond that, although it should be part of the arrangements for fiscal devolution, it should only come into operation in exceptional circumstances. It should not be set so low as to stifle dynamic local authorities' attempts to stimulate economic development but should aim to capture windfall taxes. (Paragraph 57)

15. *The levy will be derived from taxes devolved to local government. We recommend the levy from disproportionate growth in yield be held in an account by the Government. This should be ring-fenced and, by law, protected for use as a fund to provide a safety net for an area facing a significant and uncontrolled revenue shortfall, but explicitly exclude under-performing authorities. It should also be available to be redistributed to all local authorities. As is the case now, we would expect provision from other funds met from general taxation and disbursed to local authorities also to be available. In addition, specific grants should be targeted at low-growth areas, and local authorities should control how that money is spent.* (Paragraph 58)

16. If more powers were devolved, associated funds would have to be transferred from central Government. In the case, for example of the Work programme, which will inevitably operate in areas of high need, such transfers will enable further redistribution and achieve a strong match of resources to need. (Paragraph 59)

17. *On the reassessment, we recommend that the Government legislate for such an assessment to take place every 10 years. This would ensure the process actually takes place, and local authorities should be clear from the outset that it is an integral part of the process of fiscal devolution. On the reassessment process, we recommend that it be informed by the advice of an independent body, with responsibility for the assessment of needs and resources and the determination of apportionment between local authorities, but with the Government determining the national totals of resources for England, and with precepts for major capital projects in devolved areas excluded. This would ensure the process was not only fair but seen to be fair. We recommend that the Chair of the independent body be subject to a confirmation hearing with this Committee.* (Paragraph 60)

18. *The reassessment should allow local authorities to keep a substantial proportion of the improvement since the previous assessment. It should not reward those areas that have made no effort to grow.* We consider that a system incorporating the arrangements we have outlined would be fair and make it sustainable in the medium and long-term. It would prevent any area being automatically advantaged—or disadvantaged—at the outset and instil confidence in those areas that might not be in the first wave of fiscal devolution. (Paragraph 61)

Definition of areas for fiscal devolution

19. The first test for areas seeking to assume more control over local property taxes and enhanced borrowing powers is that they are able to demonstrate how their particular unit functions as an economic entity. They may cut across administrative boundaries and are likely to be geographically large in scale. We see merit in starting with an existing model. Combined authorities provide one potential example. But such areas could include and, in some cases already do include, large cities, smaller cities and counties. In that sense fiscal devolution would not be restricted to any one type of area, capital city, Core City, Key City or county or combination. It is potentially appropriate for a range of areas that contributed evidence to this inquiry. (Paragraph 67)

20. In any consideration of functional economic area, and of those that might "go first" in any process of fiscal devolution, local and central Government should bear in mind the influence of London on the economic performance of those closest to it. Balanced economic growth may not require devolution to multiple areas. Smaller areas with good links to larger devolved areas, for example, might benefit from fiscal devolution without needing similar powers themselves but this should not stop smaller areas acquiring fiscal devolution if it is appropriate and they can satisfy the necessary conditions. (Paragraph 69)

Criteria for securing fiscal devolution

21. We conclude that an authority or group of local authorities seeking fiscal devolution must be able to demonstrate: fiscal competence, which would include the prudent management of borrowing; a capacity for strategic planning and decision-making leading to economic growth; clear plans as to what they would do with their enhanced powers, including how they would cope with an unplanned and significant change in forecast revenue; and, importantly, an appetite to make them work. Given the Government would test whether any further transfer of powers supported deficit reduction, local authorities will need firm, costed proposals. (Paragraph 71)

Governance and accountability

22. We wish to ensure fiscal devolution does not stall due to ongoing discussions about governance. But we are clear that there must be a requirement on local authorities seeking fiscal devolution to demonstrate a commitment and an ability to deliver on the principles of openness, public accountability and scrutiny, which should underpin all decentralised governance arrangements. No single model of governance had a monopoly on these attributes, however. In the combined authority model, members are drawn from the same tier of governance and have an equal stake in it.

Any decision on governance should ideally be made locally. If the Government legislates to enable combined authorities to introduce directly elected mayors, local authorities must consult local people on such a change in a referendum. (Paragraph 77)

Redistribution within devolved areas

23. We consider that local authorities putting forward proposals for fiscal devolution should be able to show equitable and fair arrangements for the disbursement of tax yields within the devolved area and, similarly, for the sharing of the proceeds of growth generated by fiscal devolution. In addition, any area seeking devolution will have to have in place transparent governance procedures for redistributing revenues within its boundaries. (Paragraph 79)

Local referendums

24. We see no compelling reason for a referendum on fiscal devolution. (Paragraph 81)

The speed and spread of fiscal devolution

25. We conclude that in the short-term at least fiscal devolution encompassing a range of taxes and enhanced borrowing powers is likely to be implemented successfully by a small group of local authorities, particularly those that have already secured decentralisation packages or shown a strong interest in fiscal devolution, such as London and some Core Cities. This would be nothing new: local government in England has for a long time been structured asymmetrically and developed at different speeds. An incremental approach has more chance of gaining acceptance from the Treasury, which has a tendency to be cautious on fiscal matters. It would also allow those who want to make progress to move forward faster. (Paragraph 84)

A framework for devolution

26. While we are clear that the decision whether or not to seek fiscal devolution must rest with local authorities, the Government has a crucial role in facilitating the development of the arrangements, not least in respect of the redistribution considerations discussed earlier. *Ministers should, through negotiation with local authorities, expand the range of powers available to all levels of local government as part of a framework that ultimately includes fiscal devolution. As part of a commitment to create balanced opportunities for growth, the Government should in this framework spell out the range of powers that would be available to different levels of local government. For large and small cities and counties a framework would provide an incentive to make plans for enhanced collaboration and, if they wished, to pursue more meaningful, fiscal devolution in the future. The framework should set out what powers could be available to local authorities over the next 10 years.* (Paragraph 88)

27. We envisage that the framework as well as setting out a range of devolutionary powers would contain terms and conditions that the local authorities seeking substantial fiscal powers would have to meet. These include an agreed approach to equalisation and redistribution, and being able to demonstrate that the devolved area functions as an economic entity, has a strategic approach to planning and delivery and includes good governance. (Paragraph 89)

Enhanced powers for individual authorities

28. *For all local authorities, the framework should make provision for local control over spending on a wider range of services and for them to expand or change the range of services decentralised over time. This arrangement would reassure those areas not wishing to proceed with substantial fiscal devolution that tailored powers—in particular, over how money was spent locally—would be available. Decentralised powers, such as the Work programme, should be accompanied by an appropriate amount of decentralised spending to fund such initiatives.* (Paragraph 91)

29. *Any process of decentralisation that links to budgets allocated to places rather than policies will require further changes in the attitude and organisation of central Government. Its structures need to mirror more readily those being developed in local government, so that budgets can be developed based on the spending priorities of local people, not national Departments. The framework needs to be able to assist individual local authorities which are primarily seeking decentralisation of spending programmes such as the Work programme with, if necessary, an option for limited fiscal devolution allowing the authority to raise low-yield local taxes, such as on landfill or tourism.* (Paragraph 93)

Enhancing the role of collaborating authorities

30. *We recommend that, as part of any framework for devolution of further powers to all local authorities, including fiscal devolution initially to a limited number, the Government enhance the powers available to combined authorities. This would align their powers more closely with those available to the Greater London Authority, give them a greater strategic role and enable them to prepare, if they wish, for more significant fiscal devolution in the future. These enhancements would include: control over place-based budgets; powers to borrow for non-transport purposes, to become precepting authorities and to finance investment based upon the proceeds of GVA growth; and strategic housing and planning responsibilities, including the power to oversee local authorities' duty to co-operate.* (Paragraph 97)

31. *We recommend that the Government bring forward as soon as possible its planned legislative reform order, to allow authorities that do not have contiguous boundaries to join combined authorities. Similarly, Government should bring forward legislation, to allow a district or groups of districts that form part of a locally agreed functional economic area to have full voting rights. The full powers of the combined authority should then extend to cover such districts.* (Paragraph 99)

Fiscal agreements

32. Local and central Government should devise a means of enabling those authorities covering functional economic areas that wish to assume significant fiscal devolution to enter into negotiations with the Government. The London Enterprise Panel has made such a proposal within the existing mechanism of the Government's Growth Deals. If the Growth Deal route is feasible, those local authorities that wish to should take the initiative and, subject to an agreed equalisation and redistribution mechanism, make their own proposals within the framework arrangement we urge the Government to develop and adopt. (Paragraph 102)

33. *In responding to our report we ask the Government to confirm whether the Growth Deal route with, if necessary, the exercise of provisions in the Localism Act 2011 to transfer powers is a vehicle for comprehensive fiscal devolution. If this is the case, we would expect that by this route similar powers should be made available to further authorities in due course. If it is not, we recommend that the Government bring forward primary legislation to enable fiscal agreements to be negotiated. In addition, we recommend that within six months after the next general election the Government and local authorities agree and set out the arrangements by which certain areas might secure a long-term fiscal agreement.* (Paragraph 104)

34. Central Government rightly has to ensure any introduction of fiscal devolution is done effectively and efficiently. Where an authority or group of authorities demonstrate that they meet the principles we outlined in the previous chapter and come within the framework we set out above, there should be a presumption in favour of fiscal devolution. In our view it is essential that the process develops on from City Deals which, despite their considerable benefits, have been characterised as bureaucratic, placing local government in the unequal position of supplicant. (Paragraph 107)

35. To assist the development of the process we make two recommendations. *First, where agreement between central Government and local authorities cannot be reached, there should be a process of impartial evaluation. We see a role for the independent body, described earlier in our report, to advise.* Second, we recommend that local government examine whether a small group of strategic authorities, selected by their peers and with an agreed approach based on the principles we have outlined, present to the Government joined-up proposals for fiscal devolution to several areas in one go. In our view this would provide a collaborative approach, develop the framework and act as a way forward for authorities in future. (Paragraph 108)

Constitutional issues

36. Wider questions about the role and place of local government in our constitutional settlement should not delay fiscal devolution. But implementation of this significant change will require appraisal. *We therefore recommend that towards the end of the next Parliament a comprehensive assessment of the operation of any fiscal devolution and decentralisation take place. This assessment might be a starting point for a revised constitutional settlement.* On this issue we welcome the Political and Constitutional Reform Committee's existing work, which we expect will inform any such revision. (Paragraph 111)

Control over business rates

37. We consider that restoring the ability of local authorities to set the business rate multiplier to meet local circumstances, combined with the power to vary the rate for specific projects and categories of business, will provide authorities with a key lever in stimulating and fostering local economic growth as well as guaranteeing that they work closely with local business. It will ensure that local authorities have to consult with, and focus on the needs of, local business. We see a logic in the same multiplier being set across the devolved area. We also recognise, however, that there may be a concern about the potential for excessive increases in the multiplier. One option to constrain that would be for local authorities in a devolved area to be limited to increasing business rates by no more than the increase in the average council tax in the devolved area. The operation of the business rates levy would need to avoid penalising authorities that, after full consultation with local business, increase their multiplier. (Paragraph 119)

Business rates revaluation

38. We detected little clamour for transferring the revaluation of business rateable values to local areas as part of the process of fiscal devolution. The main concern has been the delay in holding national valuations. The time has come to set a timescale for an independently commissioned national business rate revaluation and, to ensure it happens, for it to be set in primary legislation without the facility to change the date through secondary legislation. *We recommend it takes place every five years, beginning in 2020, and within six months of a general election.* Revaluation could then coincide with the resetting of the Business Rates Retention scheme, to which we see a strong link. Subsequently, it could coincide once every 10 years with the resetting of any assessment of relative need among local authorities, administered by the independent body to which we have referred. In our view such a process would ensure not only regular and fair equalisation and redistribution of resources, but predictability, allowing local authorities to plan ahead. (Paragraph 121)

39. In sum, the independent body we recommend would introduce a substantial degree of objectivity into local government fiscal management. Specifically, it would be responsible for: assessing relative needs and resources every 10 years, starting in 2020 when the BRRS is rebased; evaluating proposals when a fiscal agreement cannot be reached; and commissioning the independent revaluation of business rates and council tax every five years, starting in 2020. (Paragraph 122)

Council tax

40. We found across local government in England, if not a demand for full fiscal devolution in all areas, a strong appetite for greater fiscal responsibility. The Government is going to have to learn to have confidence in local authorities in the same way it has confidence in the devolved legislatures. For a start all local authorities should be trusted with responsibility for setting the council tax rate in their areas. We consider that all local authorities should have the freedom to set their local domestic property tax rates. There is no hard and fast rule that they will automatically use this flexibility to increase their council tax rates, but if they do they should be free to do so and then test local people's appetite for it, as they do for a range of decisions, on local election polling day. (Paragraph 125)

41. Council tax rates are based on valuations made a generation ago, and those in the highest-banded properties are limited to paying no more than three times the tax of those in the lowest. The pretext for deferring revaluation—that it would increase most people's council tax—is erroneous if the revaluation is carried out properly and is fiscally neutral overall locally. Therefore a revaluation of itself must not affect a council's income. If nothing is done, there is a risk that the whole system will eventually collapse or, like domestic rates, have to be replaced. If there is a case for a revaluation of business rateable values—last carried out in 2010—the case for revaluation of domestic rates must be greater. *We recommend that Government introduce legislation to ensure, for the purposes of Council Tax, domestic properties are revalued every five years.* (Paragraph 128)

42. There is also scope for further flexibility. We conclude that devolved areas—which we envisage, in the first instance, would be London or combined authority areas—should be given the power to introduce new council tax bands at the top end of the scale and to split existing ones. The national revaluation will therefore need to be precise, citing a property's price not just its band, so that any devolved local authorities wishing to introduce a new band are able to include the appropriate properties in it. Doing so might go some way to increasing fairness in the distribution of the tax burden locally. (Paragraph 129)

Stamp duty

43. The yield from stamp duty in London and the South East is a fiscal anomaly in England. Full fiscal devolution of the tax in London could deprive the Exchequer of a significant amount of revenue that could be used elsewhere and for different purposes. As we have set out, to meet the principle of equalisation, it could be devolved in London subject to a levy requiring transfer of duty above an agreed threshold to the Exchequer. On the basis of this requirement, which could apply also to other devolved authorities, we recommend that stamp duty be included in the fiscal devolution framework. In addition, we would expect the Department for Communities and Local Government to monitor and review lessons that can be drawn from devolution of stamp duty in Scotland to inform its introduction in England. (Paragraph 131)

Other taxes and fees and charges

44. Arrangements have been developed to allow the devolved nations to introduce new taxes, as well to take control of business rates, stamp duty and, in the case of Scotland, part of income tax. As we expect fiscal devolution in England would in the short term be restricted to a handful of areas the opportunity is available to replicate some of the Scottish and Welsh arrangements in areas in England with the capacity to take advantage of these resources and to implement projects with the potential to generate good returns on investment. *At the minimum fiscal devolution should empower these authorities to introduce relatively low-yield taxes. A range of suggestions includes betting taxes and landfill and hotel duties.* (Paragraph 134)

45. Recognising what is happening in Scotland and Wales we see a case in the long term for examining the apportioning in a similar manner to Scotland a percentage of income tax or VAT to groups of authorities covering significant geographical areas in England. We recognise, however, this is an extension of the fiscal devolution on which we have not taken detailed evidence. We would not want consideration of devolving income tax and VAT to hold up fiscal devolution of property taxes, but

Government and local authorities should evaluate the proposals. Evaluation of devolution of these taxes could and should form part of the comprehensive assessment of the operation of any fiscal devolution and decentralisation we have recommended to be carried out after the first wave of fiscal devolution has been implemented and which we describe in the previous chapter. (Paragraph 135)

46. *We recommend that as part of a devolution framework and in fiscal agreements the Government provide for the relaxation of the current controls on the levels of fees and charges local authorities can charge for services and the purposes to which the income generated can be disbursed.* (Paragraph 137)

Borrowing

47. One key aspect of fiscal devolution is its focus on stimulating economic growth. Local authorities in England wanting to grow their economies may therefore need to borrow to invest. Given the Government's focus on deficit reduction, however, we recognise that a general relaxation of the rules on borrowing is not appropriate at this stage. But those local authorities that negotiate a fiscal agreement with the Government will have had to demonstrate strategic financial management and competence. *Such authorities should therefore have access to greater and more flexible borrowing powers—for the purposes of capital investment in projects clearly and quantifiably designed to stimulate growth. Enhanced powers should remain within the stringent prudential borrowing code, however, ensuring authorities have the means and capacity to meet their annual borrowing costs.* This would allow them to pursue the innovative approach to borrowing that the Government has, commendably, negotiated with Greater Manchester, allowing it to benefit from increased tax take. Greater local revenue streams would enable local authorities to borrow to invest and so increase their tax yield and reinvest in further schemes. *Devolved areas should have the power to determine what TIF projects to introduce without the need for Treasury approval but within the prudential borrowing code.* Given the limited number of projects to which this would apply, this should be achievable in practice. (Paragraph 140)

48. *We reiterate our recommendation in a previous report that the Government lift the cap on local authorities' borrowing for housing. We believe this should be universally applied.* (Paragraph 142)

National fiscal implications and management

49. Growth in one area of England does not mean reduced growth elsewhere. Fiscal devolution focused on local growth may involve increased local spending financed from local or national taxes, borrowing or voluntary contributions through business levies. Under the current rules limiting gross expenditure, this would have to be offset by a reduction in expenditure. Applying that requirement to infrastructure projects would be unjustified. While we accept that all governments have to manage the resources taken by the public sector, we think it would be regrettable if the control system were used to hobble fiscal devolution in England. It has not obstructed fiscal devolution to Scotland and Wales. *We recommend that the Government clarify how the controls on UK public expenditure will apply to fiscal* *devolution to Scotland and Wales and whether similar arrangements could be put in place for local authorities in England.* (Paragraph 146)

50. There are perhaps three ways in which the problem could be addressed. First, local authority expenditure on capital projects designed to stimulate economic growth could be taken out of the control total. It would be distinguishable by the ratings agencies, and would be used to invest in growth projects, a potentially virtuous circle. Second, the Government could agree to raise Total Managed Expenditure to accommodate expenditure devolved to local authorities in England. A third way would be to decrease central Government spending. (Paragraph 147)

51. No Government having accepted fiscal devolution to Scotland and Wales should allow the Treasury's fiscal control system focused on gross expenditure to require every additional pound of additional public expenditure in Scotland and Wales to be offset pound-for-pound by a reduction in spending in England. Nor should such a perverse arrangement apply to additional public expenditure determined under fiscal devolution in England. Where such expenditure is fully funded by increased local taxes and charges a gross control of public expenditure cannot be justified. Fully funded expenditure does not increase the deficit. (Paragraph 148)

Formal Minutes

Monday 30 June 2014

Members present:

Mr Clive Betts, in the Chair

Bob Blackman	Alec Shelbrooke
Simon Danczuk	John Stevenson
Mrs Mary Glindon	Heather Wheeler
Mark Pawsey	Chris Williamson
John Pugh	

Draft Report (*Devolution in England: the case for local government)* proposed by the Chair, brought up and read.

Ordered, That the Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 152 read and agreed to.

Summary agreed to.

Resolved, That the Report be the First Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Written evidence was ordered to be reported to the House for printing with the Report (ordered to be reported for publishing on 20, 27 January, 10 February, 3, 17, 31 March, and 28 April 2014).

[Adjourned until 4.00pm on Monday 7 July

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the Committee's inquiry page

Monday 27 January 2014

Question number

Alexandra Jones, Chief Executive, Centre for Cities**, Jim O'Neill,** Chair, RSA City Growth Commission**, Professor Tony Travers** Q1-65

Monday 3 February 2014

Cllr David Hodge, Chair, County Councils Network**, Professor Andy Pike,** Director, Centre for Urban and Regional Development Studies**,** Newcastle University, **Tom Riordan,** on behalf of Core Cities Q66-121

Ed Cox, Director, IPPR North, **Liz Peace,** Chief Executive, British Property Federation, **Cllr Peter Box,** on behalf of Key Cities Q122–158

Monday 10 February 2014

Cllr Philip Atkins, Leader, Staffordshire City Council, **Cllr James Lewis,** on behalf of Leeds City Council, **Cllr Paul Watson,** Leader, Sunderland City Council Q159-203

Cllr Sue Derbyshire, Vice-Chair, **Cllr Sir Richard Leese,** Vice-Chair, **Cllr Lord Peter Smith of Leigh,** Chair, Greater Manchester Combined Authority Q204-239

Monday 3 March 2014

Boris Johnson, Mayor of London Q240-282

Darren Johnson AM, Chair, London Assembly, **Mayor Jules Pipe,** Chair, London Councils**, Colin Stanbridge,** Chief Executive, London Chamber of Commerce and Industry Q283-319

Monday 10 March 2014

Cllr Nick Forbes, on behalf of Core Cities**, Stephen Hughes,** former Chief Executive, Birmingham City Council, **Cllr Roger Lawrence,** leader, Wolverhampton City Council Q320-363

Monday 24 March 2014

Cllr Sir Merrick Cockell, Chair, Local Government Association Q364-413

Professor Tony Travers, Rob Whiteman, Chief Executive, Chartered Institute of Public Finance and Accountancy Q414-442

Monday 31 March 2014

Rt Hon. Greg Clark MP, Minister of State (Cities and Constitution), Cabinet Office, **Brandon Lewis MP,** Parliamentary Under-Secretary of State, Department for Communities and Local Government Q443-514

Published written evidence

The following written evidence was received and can be viewed on the Committee's inquiry web page at www.parliament.uk/clg. INQ numbers are generated by the evidence processing system and so may not be complete.

1 Action With Communities In Rural England (FDC0021)
2 Birmingham City Council (FDC0030)
3 British Property Federation (FDC0032)
4 Centre for Cities (FDC0028)
5 Centre for Urban and Regional Development Studies (Curds), Newcastle University (FDC0009)
6 Chief Economic Development Officers Society & Association of Directors of Environment, Economy, Planning & Transport (FDC0036)
7 City of York Council (FDC0010)
8 Core Cities (FDC0008)
9 Cornwall Council (FDC0026)
10 County Councils Network (FDC0013)
11 Department for Communities and Local Government (FDC0014)
12 GLA (FDC0040)
13 Greater Birmingham Chambers of Commerce (FDC0016)
14 Greater London Authority (FDC0029)
15 Greater Manchester Combined Authority (FDC0006)
16 Greater Manchester Combined Authority (FDC0038)
17 Hirst, John (FDC0001)
18 Intu Properties Plc (FDC0003)
19 IPPR North (FDC0020)
20 Key Cities Group through Wakefield Council (FDC0015)
21 Learndirect (FDC0018)
22 Leeds City Council (FDC0025)
23 Local Government Association (FDC0005)
24 London Assembly (FDC0012)
25 London Chamber of Commerce and Industry (FDC0019)
26 London Councils (FDC0007)
27 London First (FDC0004)
28 Oxfordshire County Council (FDC0017)
29 Royal Town Planning Institute (FDC0011)
30 RSA Cities Growth Commission (FDC0002)
31 Sheffield City Council (FDC0034)
32 South East Strategic Leaders (FDC0039)
33 Staffordshire County Council (FDC0027)
34 Sunderland City Council (FDC0022)
35 Travers, Professor Tony (FDC0033)
36 Unlock Democracy—Merseyside And West Cheshire Group (FDC0035)
37 West End Partnership (FDC0037)

38 Wolverhampton City Council (FDC0024)

List of Reports from the Committee during the current Parliament

All publications from the Committee are available on the Committee's website at www.parliament.uk/clg.
The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2014–15

First Special Report	Further review of the work of the Local Government Ombudsman: Responses to the Committee's Fifth Report of Session 2014–14	HC 192
Second Special Report	Local Government Procurement: Response of the Local Government Association to the Committee's Sixth Report of Session 2013–14	HC 193

Session 2013–14

First Report	The Private Rented Sector	HC 50 (CM 8730)
First Special Report	Committee's response to the Government's consultation on permitted development rights for homeowners: Government response to the Committee's Seventh Report of Session 2012–13	HC 173
Second Report	The work of the Regulation Committee of the Homes and Communities Agency	HC 310 (HC 836)
Third Report	Community Budgets	HC 163 (CM 8794)
Fourth Report	Post-legislative scrutiny of the Greater London Authority Act 2007 and the London Assembly	HC 213 (CM 8761)
Fifth Report	Further review of the work of the Local Government Ombudsman	HC 866
Sixth Report	Local Government Procurement	HC712 (CM 8888)
Seventh Report	Building Regulations certification of domestic electrical work	HC 906 (CM 8853)

HC Session 2012–13

First Report	Park Homes	HC 177-I (CM 8424)
Second Report	European Regional Development Fund	HC 81 (CM 8389)
Third Report	The work of the Local Government Ombudsman	HC 431 (HC 615 & HC 650)
Fourth Report	Pre-appointment hearing for the Chair of the Audit Commission	HC 553
Fifth Report	Mutual and co-operative approaches to delivering local services	HC 112 (CM 8547 & HC 1091)
Sixth Report	Councillors on the frontline	HC 432 (CM 8582)
Seventh Report	The Committee's response to the Government's consultation on permitted development rights for	HC 830 (HC 173, 2013–14)

	homeowners	
Eighth Report	The role of local authorities in health issues	HC 694 (CM 8638)
Ninth Report	Implementation of welfare reform by local authorities	HC 833 (CM 8635)

Session 2010–12

First Special Report	Beyond Decent Homes: Government response to the Committee's Fourth Report of Session 2009–10	HC 746
First Report	Local Authority Publications	HC 666 (HC 834)
Second Special Report	Local Authority Publications: Government response to the Committee's Sixth Report of Session 2010-11	HC 834
Second Report	Abolition of Regional Spatial Strategies: a planning vacuum?	HC 517 (CM 8103)
Third Special Report	FiReControl: Government response to the Committee's Fifth Report of Session 2009–10	HC 835
Third Report	Localism	HC 547 (CM 8183)
Fourth Report	Audit and inspection of local authorities	HC 763 (CM 8209)
Fifth Report	Localisation issues in welfare reform	HC 1406 (CM 8272)
Sixth Report	Regeneration	HC 1014 (CM 8264)
Seventh Report	Pre-appointment hearing for the Government's preferred nominee for Chair of the Homes and Communities Agency Regulation Committee	HC 1612
Eighth Report	The National Planning Policy Framework	HC 1526 (CM 8322)
Ninth Report	Taking forward Community Budgets	HC 1750
Tenth Report	Building regulations applying to electrical and gas installation and repairs in dwellings	HC 1851 (CM 8369)
Fourth Special Report	Preventing violent extremism: Government response to the Committee's Sixth Report of Session 2009–10	HC 1951
Eleventh Report	Financing of new housing supply	HC 1652 (CM 8401)