# A CALL FOR GREATER FISCAL AUTONOMY FOR OUR CITIES

Metro — Dynamics

CORE CITIES

## METRO DYNAMICS

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# EXECUTIVE SUMMARY

The granting of greater fiscal autonomy to local government is a necessary step to improving the economic prospects of our cities and of the United Kingdom.

This report sets out our view that a three stage process is needed to give local authorities greater fiscal autonomy:

1. **In the short term, we need to achieve a sensible programme of business rate retention at a local level.**
2. **In the medium term, the Government should work with cities to explore the potential for local government control of a wider pool of taxation.**
3. **In the longer term, we should move towards fuller fiscal devolution in line with international competitor cities, including greater discretion over the setting of local tax rates and enhanced borrowing powers.**

Increasingly cities, rather than national governments, are driving economic growth. UK cities are expected to compete in an increasingly globalised and rapidly developing world. And yet we persist in handicapping our cities against this competition.

It is widely acknowledged that even taking into account the most recent proposals to change the business rates system, and the most recent devolution deals to UK city regions, we still have one of the most centralised systems of government amongst developed nations. UK cities have less control over revenue raising, spending and investment decisions, and their borrowing, than their international peers. Government funding to UK cities is generally ring-fenced, silo-based and short term. **There is a mismatch between what we expect from our cities, the vision of our city leaders for the cities they govern, and the centrally-determined, policies of governments.**

Recent governments have taken steps to address this centralisation and introduced measures designed to effect a transfer of some powers from Westminster to local government. The current Government has indicated it is prepared to embrace change, as evident in the recent devolution deals and the proposed changes to business rates. London, Manchester and many of the Core Cities have been beneficiaries of these changes. Scotland, Wales and Northern Ireland have been beneficiaries of the political pressure for full devolution, which is gradually beginning to be felt at a city level too.

**But there remains much more that could be done to unshackle our cities, to free-up their latent economic potential, and to enable them to compete internationally on a more level playing field. It is becoming increasingly important to equip our city leaders with the appropriate fiscal freedoms and powers they need to enable them to compete internationally.** Indeed, there is a strong line of argument that the devolutionary measures that the Government is implementing merely makes the case for our cities to have a greater degree of fiscal autonomy even stronger.

For those cities with the ambition, the capacity, and the mandate, the arguments in favour of greater fiscal autonomy for local government have been well rehearsed: the need to reshape our public services, to deliver more for less, to address the productivity gap, and deal with the historic underperformance of many of our major cities. These issues are so entrenched in our economy, that far-reaching solutions are needed. In his 2010 Mais Lecture, the Chancellor argued for a New Economic Model rooted in more investment, more savings and more exports. He recognised the importance of reforming the public sector, re-balancing the economy, and unleashing the forces of enterprise. Greater fiscal autonomy would address all three of these ambitions, and we argue should form part of that New Economic Model.[1]

We recognise that providing councils with greater fiscal autonomy is not a panacea. It places additional risks and burdens on local authorities. Ironically, the more cautious the approach to fiscal devolution and the fewer taxes which are devolved, the greater the volatility and therefore the higher the potential risk to councils. We recognise that not all local authorities are going to want to assume these risks, and fiscal autonomy should therefore not be imposed on authorities. We argue that local authorities should have access to appropriate information to enable them to evaluate the advantages and disadvantages of various forms of fiscal devolution and to enable them to consider the level of fiscal devolution to which they would aspire. This may result in a 'multi-speed' system, with different places having different levels of fiscal autonomy according to their willingness to take on additional powers, but this is not a problem in our view.

# WHAT IS FISCAL AUTONOMY?

Fiscal autonomy is not about imposing new taxes. It is about giving local authorities greater control over their finances so they can produce better economic outcomes than are currently possible within the existing centrally-controlled system of local government finance. Better economic outcomes at city level equate to better economic outcomes at a national level.

Greater autonomy is achieved by removing ring-fencing from funding sources, enabling place-based settlements, providing funding as part of multi-year settlements, relaxing certain borrowing restrictions, and enabling local authorities to set and retain certain taxes, charges and levies.

We draw a distinction between improving fiscal autonomy for local government and the 'devolution' of fiscal powers to local and combined authorities. We see fiscal autonomy as being about improving the freedoms of local government to manage their own finances and plan for the future, in line with their democratic mandate to local people. Fiscal devolution is a longer term process involving a more fundamental change in the relationship between local and central government, tax raising powers and service provision.

There is a strong argument that greater fiscal autonomy should go hand-in-hand with functional devolution, by which we mean the devolution of more areas of responsibility, for example, when local government takes on the provision of services previously provided by central government. In our view, if local authorities are to be asked to take on greater spending responsibilities, they should have a matching increase in control over their revenue raising powers.

# THE CASE FOR GREATER FISCAL AUTONOMY

The UK has one of the most centralised systems of public finance of any major OECD country. Prior to the recent changes in business rates, sub-national tax accounted for only 1.7 percent of UK GDP compared to 5 percent in France and 16 percent in Sweden.[2] To put this into context, for every £1 raised in tax, local authorities received 9 pence. The remaining 91 pence was retained by the Exchequer.[3]

The only two taxes over which English local authorities have any degree of control are council tax and business rates. Most other OECD cities have control (setting, levying and spending) over many more taxation streams and many also receive a direct allocation of national or federal taxes including income tax and VAT.[4]

If the UK economy was growing consistently, in line with international benchmarks, and in a balanced manner, the highly centralised nature of our public finance system might not be an issue. However, as we outline below, it is not.

Britain has a productivity problem: its economy is neither as productive as other developed national economies, nor is it as productive as it used to be. In the 25 years leading up to the 2008 recession, output per worker, one of the principal measures of productivity, rose at an average rate of more than 2 percent per annum. But in the last seven years there has been almost no increase in output per worker.[5] In 2013, productivity was recorded at 4 percent below the pre-recession level and 16 percent below the level expected from the pre-crisis trend. Unusually, many of our cities are growing at a slower rate than our national economy: the difference between the Core Cities and the UK average economic output is estimated to be £66 billion a year.[6]

Britain's growth has not been consistent. Whilst the economy is now growing – in Q4 of 2015, ONS estimates had GDP at 6.6 percent higher than the pre-recessionary peak in Q1 2008 – that growth has been uneven.[7] In geographical terms, growth has been most evident in London and the South East. Looking at a 10-year period from 2004 to 2013, most economic measures show a widening gap between cities in the South which benefit from their proximity to London and cities in the North which benefit to a lesser extent from the strength of the London economy.[8] Our cities have to close this gap.

All cities are different. The issues faced by some of our northern cities are fundamentally different to those faced by London. Westminster feels remote for many cities, particularly in the North and West of the country. Good sense dictates that local authority leaders should have more knowledge of what drives their local economy than politicians and civil servants based many miles away in Westminster.

# THE LINK BETWEEN FISCAL AUTONOMY AND ECONOMIC GROWTH

Much has been written about the relationship between greater fiscal autonomy and economic growth. In an ideal world, it would be possible to provide evidence derived from international comparisons, to the effect that fiscally devolved models of city governance are associated with higher rates of economic growth. Regrettably, cities are such complex organisms operating within very different governance frameworks that international comparisons are difficult to make.

However, there is plenty of anecdotal evidence to support this view. In Germany, for example, between 2000 and 2007 all eight of the largest cities outside Berlin outperformed the national average in terms of GDP per capita and all 14 second-tier cities had productivity growth rates better than the capital's.[10] By comparison, in England, seven of the eight core cities have consistency performed below the national average in terms of GDP per capita.[11] Whilst this cannot be attributed solely to different levels of fiscal autonomy, the tax powers which German cities enjoy are a stark contrast to those enjoyed by major UK cities.[12]

Furthermore, as the London Finance Commission concluded, there is "no evidence [which] conclusively shows that England's highly centralised arrangements as they stand at present promote growth or are in any way objectively better than a localised solution."[9]

For this reason alone, it has to be worth seriously considering the role sub-national government, set free with a far greater degree of fiscal autonomy than it currently enjoys, can play in growing national economic output and closing the productivity gap.

## WE SEE PROGRESS TOWARDS GREATER FISCAL AUTONOMY AS A THREE STAGE PROCESS:

**1.**

In the short term, achieving a sensible programme of business rate retention at a local level. This will involve much greater consideration of the Government's current proposals, including a reasonable apportionment of responsibilities in line with the funds being transferred. It will also require much greater clarity about a number of issues that are as yet unresolved. The Government must work with cities to ensure that the reform of business rates works for central government, and is supportive of economic growth.

**2.**

In the medium term, for the Government to work with cities to explore the potential for local government control of a wider pool of taxation, in order to provide for greater stability and certainty of financing. This stage might also involve looking at smaller local taxes such as a tourism tax in conversation with the private sector.

**3.**

In the longer term, to move towards fuller fiscal devolution in line with international competitor cities, including stronger discretion over local tax rates and stronger borrowing powers.

## A KEY ELEMENT OF THESE THREE STAGES IS ENSURING THAT THESE CHANGES ARE NOT IMPOSED ON CITIES BUT ARE THE RESULT OF CAREFUL NEGOTIATION BETWEEN GOVERNMENT AND UK CITIES.

# PROPOSED REFORMS TO BUSINESS RATES

The Government's proposals to reform the business rates system to allow local authorities to retain the full income from business rates is potentially a promising step in the right direction. Reformed business rates could provide councils with an important tool with which to incentivise local growth.

The business rate reforms arguably represent the most radical change to the system of local government finance for the last 10 years. For this reason, it is vitally important that not only are they properly considered and consulted upon before their introduction, but that Government works closely with the biggest cities, including those piloting retention, to create a workable system that is capable of achieving its stated aims. There is still an alarming lack of information in the public domain about how these proposals will operate, which are compounded by announcements in Budget 2016 that there will be significant exemptions to the rate, effectively reducing the available pool of finance over future years. It is incumbent upon Government to spell out in detail the implications of this decision.

There are many deficiencies inherent in the current system of business rates and it is vitally important that the new business rates proposals do not simply roll forward these deficiencies into the new system. Greater clarity is especially needed around additional responsibilities that local government will be required to take on as part of the business rate reform.

# THE NEED FOR GREATER RETENTION OF THE TAX BASE

Whilst the proposed devolution of business rates is welcome, albeit with the caveat that the details need to be clarified, there is a need for a commitment over the medium term to improve fiscal autonomy for local government.

This arises because of two inter-related factors. The first issue is the challenge relating to relatively low levels of public funding. The National Audit Office estimates a real terms reduction in government funding to local authorities between 2010/11 to 2015/16 of 37 percent.[13] Councils have largely dealt with this to date by finding efficiencies in existing services, but are reaching the point where such efficiencies are exhausted. The LGA estimates that by 2019/20, this situation will have become so serious that local authorities will be facing a funding gap (namely the difference between their income and expenditure) of £9.5 billion.[14]

The second issue is that control over business rates alone will not enable local government to plan effectively, manage financial risk and make sensible investments where needed. In the medium term local government will need control over a broader range of taxes to ensure financial stability and reduce volatility.

Therefore, an important medium term step is to ensure that local authorities have control over their own tax base to enable them to better manage their activities.

# THE NEED FOR LONGER TERM FISCAL DEVOLUTION

In the longer term, it is important that UK cities are equipped with the financial tools and powers to enable them to compete effectively alongside the global competition, where stronger fiscal devolution and local control over taxation and borrowing is the norm.

We therefore propose that Government commits to a longer term programme of devolution. This will involve dialogue with cities to understand their ambitions, and developing a commitment to explore each aspect of these over the remainder of this parliament, in order to give cities a clear sense of direction.

# NEXT STEPS

## WE THEREFORE RECOMMEND:

- The Government, London and the Core Cities, with representation from the LGA, should come together to deliver a workable, co-designed and reformed business rate system.
- The Government should commit to a longer term – but timetabled – programme of wider fiscal reform, with retention of more of the tax base first and full devolution second, placing this at the heart of its programme to rebalance the economy and increase productivity. This would involve seeing business rate reform as the beginning and not the end of a journey towards fuller fiscal devolution, empowering cities across the UK.
- The Government should signal this commitment by initiating a series of events with city authorities and private sector representatives, working closely with big cities, including those piloting business rate retention to set out the principles and operation of fiscal devolution (how it will work, not simply what the barriers might be).
- Accepting that broader fiscal reform may need to be undertaken across parliamentary periods, cross-party support should be sought by the Government and cities for the principles and process of fiscal devolution, including space within the legislative schedule where needed.

# 1 INTRODUCTION

Thousands of pages have been written in recent years on the subject of fiscal devolution: the London Finance Commission, the City Growth Commission, the Communities and Local Government Select Committee on Devolution in England, two reports by ResPublica, an Independent Commission on Local Government Finance, and countless articles and opinion pieces in various newspapers and journals. These pages strongly support the view that fiscal devolution is an important and necessary complement to devolution of functional powers.

The Government has announced several very welcome reforms. These include the 100 percent retention of business rates and the early piloting of this in a number of our cities, a number of bespoke devolution deals with cities, and the announcement in the 2015 Local Government Finance Settlement of four year settlements for councils. In recent years we have also seen the enactment of emerging models of fiscal devolution for Scotland, Wales and Northern Ireland, albeit largely to deal with the groundswell of public opinion in favour of broader devolution.

Whilst this is an important start, in the longer term the Government needs to go further, enabling local government to use a range of financial tools to promote economic growth and investment. Indeed, broadening the range of taxes, duties and levies available to local authorities would go a long way to reducing the risks inherent in devolving business rates to councils. Underlying all this, the arguments in favour of empowering our cities to actively manage local economic growth and reform public services remain unchanged. Indeed, it is hard to see how else the scale of public sector reform and economic growth the United Kingdom requires is going to be delivered if not by sub-national interventions.

Few of the arguments against the granting of greater fiscal autonomy to those cities ready to assume greater control over their futures, really stand up to scrutiny. Local government, for its part, needs to demonstrate to central government, that it is capable of delivering a better return, at both a sub-national and a national basis, on the tax revenues they wish to have devolved to them. **The proposed business rate reforms provide an excellent backdrop against which this debate should take place. The stakes are high, and for this reason, it is essential that the Government engages with local government and its various representative bodies on the detail of these reforms at the earliest opportunity.**

**It would be easy to get carried away by the recent encouraging progress towards greater fiscal autonomy, but it is worth remembering that not one single UK tax is fully devolved to local government:**

- Local authorities may not raise the business rate. Under current proposals for the devolution of business rates, only local authorities with an elected mayor would be able to increase the rate. And even then, this is to be capped at 2 percent and only with the approval of the LEP.
- Council tax capping is still in place and controlled by referendum.
- Mandatory exemptions remain in place for both council tax and business rates.
- Other property taxes, levies and duties have not been devolved as proposed by the London Finance Commission (including, crucially, stamp duty).

This paper considers afresh the arguments for greater fiscal autonomy. It considers fiscal autonomy within the broader context of granting our cities the freedom to tailor taxes and spending programmes to their very particular and often unique circumstances. It reviews the progress to date in delivering that fiscal autonomy and considers the measures that might be potentially explored as part of a longer-run programme of fiscal devolution. It concludes by making a series of recommendations for the future.

Throughout this paper, we draw a distinction between improving fiscal autonomy for local government and 'devolution' of fiscal powers to local and combined authorities. We see fiscal autonomy as being about improving the freedoms of local government to manage their own finances and plan for the future, in line with their democratic mandate to local people. Fiscal devolution is a longer term process involving more fundamental change in the relationship between local and central government, tax raising powers and service provision.

# 2 WHY PURSUE GREATER FISCAL AUTONOMY?

## WHAT DO WE MEAN BY FISCAL AUTONOMY?

Fiscal autonomy refers to the process by which local authorities are granted greater control over their income so they can produce better economic outcomes than are currently possible within our highly-centralised system of local government finance. In the UK context, this would enable our cities to deliver greater productivity improvements and move towards the point where they become self-sustaining. Better economic outcomes at city level equate to better economic outcomes at a national level.

The end point of greater fiscal autonomy is fiscal devolution. We talk about fiscal devolution in the context of tax streams. For a tax stream to be fully devolved, the local authority would have responsibility for establishing the tax base, setting the tax rate, determining exemptions and discounts, and collecting and retaining the tax. Despite the recent proposed changes to business rates and other local government finance reforms, no English taxes are fully devolved to local government.

**Fiscal devolution is not just about control over taxation. It refers to a broader range of measures including:**

- The removal of ring-fencing from centralised funding sources;
- Providing committed funding as part of multi-year settlements; and
- The relaxation of certain borrowing restrictions.

These reforms are all needed to give local government greater freedom to tailor tax raising and spending decisions to the needs and circumstances of its locality.

This paper makes a strong argument for greater fiscal autonomy for our cities, leading to fuller fiscal devolution in the long term.

Greater fiscal autonomy should go hand-in-hand with functional devolution. This refers to the process of devolving responsibility for service delivery from Westminster to local authorities. The devolved responsibility is generally matched by a devolved budget to finance the additional responsibilities the local authority assumes.

Effective local government requires that functional devolution and fiscal autonomy go hand-in-hand. Local authorities cannot be granted greater functional spending responsibilities without having compensating freedoms and powers over their revenues.

## WHAT IS THE PROBLEM THAT GREATER FISCAL AUTONOMY WOULD SOLVE?

The English system of local government finance is one of the most centralised in the developed world. Of the £548 billion raised in tax every year, local authorities retain just £50.7 billion. For every pound raised, local authorities kept just nine pence, with the remaining ninety-one pence being retained by the Exchequer.[15]

This system of local government finance is at odds with the situation in most developed countries, and in that respect England is an outlier. The London Finance Commission commissioned an international comparison of global city financing in 2013 from the University of Toronto. The study provided a detailed comparison of the current methods of revenue raising methods in seven global cities: London, Paris, Berlin, Frankfurt, Madrid and Tokyo.

The table overleaf shows the percentage of both locally raised taxes and taxes passed back to the city by central government as a percentage of a city's total income for a handful of major OECD cities. At one end of the spectrum, London is reliant on transfers from Westminster for almost three-quarters of its total income. At the other end of the spectrum, Tokyo receives only 8 percent of its total income from the Japanese central government.

## TABLE 1: GOVERNMENT TRANSFERS TO SELECTED OECD CITIES

| | **Government transfers as a percentage of total income** (ie central government grant) |
|---|---|
| London | 74 |
| Berlin | 26 |
| Madrid | 37 |
| New York | 31 |
| Paris | 18 |
| Tokyo | 8 |

**Source:** Slack, E./University of Toronto (2013), International Comparison of Global City Financing

**Table 2,** overleaf, adapted from the University of Toronto study, demonstrates the vastly more comprehensive suite of taxes available to other cities. The only local tax in London is council tax. Whilst local authorities collect and spend the council tax, the mechanism by which the council tax operates is determined by Westminster. Central government determines the tax base, the operation of the tax, discounts and exemptions, and effectively caps the annual increase, and by implication, local budgets for those heads of expenditure funded by the council tax. Thus even council tax would not fulfil a definition of a truly devolved tax.

This study took place before the 2013 changes to business rates, which allowed local authorities to retain up to half of business rates raised in their area. Had the table been compiled more recently, business rates would have been included under the London heading. However, central government still determines levies, safety nets, resets and control of revaluations. So even then, the business rate does not fulfil the definition of a truly devolved tax.

## **TABLE 2:** LOCAL AND SHARED TAXES AMONGST SELECTED OECD CITIES

| | | | | |
|---|---|---|---|---|
| <br>**London** | Council Tax | | | |
| <br>**Paris** | Property Tax on developed land<br>Property Tax on undeveloped land | Residence Tax<br>Local Economic contribution (on business premises and business value added)<br>Tax on refuse/garbage collection | Front walk sweeping Tax<br>Parking fees<br>Electricity consumption Tax<br>Real estate Taxes (e.g. land transfer Tax) | |
| <br>**Madrid** | Property Tax<br>Business Tax<br>Vehicle Tax<br>Tax on construction | Tax on land value increase | Shared Taxes:<br>Personal income Tax<br>Value added Tax<br>Excise Tax | |
| <br>**Frankfurt** | Property Tax | Estate Tax<br>Business Tax on income<br>Municipal Sales Tax<br>Community share of sales Tax | Other Taxes, including gaming Taxes and dog Taxes<br>Key allocations made by the federal government<br>-Land transfer Tax allocation<br>-Trade Tax allocation | |
| <br>**Berlin** | State Taxes:<br>Wealth Tax<br>Inheritance Tax<br>Real estate transfer Tax<br>Motor vehicle Tax<br>Racing and betting Tax<br>Beer Tax<br>Fire protection Tax | Local Taxes:<br>Tax on land<br>Business Tax<br>Trade Tax allocation<br>Entertainment Tax<br>Dog licence Tax<br>Second home Tax | State share of national Taxes:<br>Wage Tax<br>Assessed income Tax<br>Non-assessed Tax on earnings<br>Interest income Tax<br>Corporation<br>VAT<br>Import VAT<br>Other | Local share of state Taxes:<br>VAT<br>Wage and income Tax<br>Withholding |
| <br>**Toyko** | Metropolitan inhabitant Tax on individuals, corporations, interest income<br>Enterprise Tax on individuals and corporations<br>Real property acquisition Tax<br>Golf links Tax<br>Automobile acquisition Tax<br>light-oil (oil-gas) delivery Tax | Automobile Tax<br>Mine-lot Tax<br>Fixed assets Tax | Special Tax on landholding<br>Hunter Tax<br>Establishment Tax<br>Urban planning Tax<br>Accommodation Tax | Shared Taxes:<br>Local consumption Tax<br>Metropolitan tobacco Tax<br>Local transfer Taxes |
| <br>**New York** | Real estate Taxes<br>Payments in lieu of Taxes (for property Tax)<br>Sales and Use Taxes:<br>General sale<br>Cigarette<br>Commercial motor vehicle<br>Mortgage<br>Stock transfer | Auto use<br>Income Taxes:<br>Personal income<br>General corporation<br>Financial corporation<br>Unincorporated business income<br>Personal income (non-resident city employees)<br>Utility | Other Taxes<br>Hotel room occupancy<br>Commercial rent<br>Horse race admissions<br>Conveyance of real property<br>Beer and liquor excise<br>Taxi medallion transfer | Surcharge on liquor licences<br>Refund of other Taxes<br>Off-track betting surTax |

Source: Slack, E./University of Toronto (2013), International Comparison of Global City Financing

What is noticeable from this analysis is the role that property taxes play in all these cities:

| | |
|---|---|
| **Frankfurt** | Property tax |
| **Madrid** | Property tax<br>Construction tax<br>Land value uplift tax |
| **Paris** | Property tax on developed land<br>Property tax on undeveloped land residence tax<br>Local economic contribution tax on business premises<br>Real estate taxes on land transfers |
| **Tokyo** | Real property acquisition tax<br>Special tax on land holding<br>Urban planning tax<br>Accommodation tax |
| **Berlin** | Land tax<br>Real estate transfer tax |
| **New York** | Real estate tax<br>Hotel room occupancy tax<br>Commercial rent tax<br>Tax on the conveyance of real property |

Source: Slack, E./University of Toronto (2013), International Comparison of Global City Financing

**It is clear that for many developed countries, devolved property taxes are a cornerstone of the revenue raising powers of cities. There are clear benefits in devolving land and property taxes. Unlike workers, land and property are tied to a place, and so the devolution of such taxes to authorities does not distort the system in the same way as income tax would (workers are more mobile than land and property). And land and property taxes only account for approximately 11 percent of total tax take at the national levels.**[16]

**This high degree of centralisation has a number of serious ramifications for English local government:**

1. Local government is almost wholly dependent on central government for its financing.
2. Central government tax strategy is largely formulated on a national basis, and takes little account of significant regional and sub-regional variation.
3. Central government funding has historically only been made available on a year-by-year basis. This lack of committed funding means local government investment is heavily constrained. This in turn restricts the development of 'invest to save' type models, which in turn means cities will struggle to reduce public spending much further. An element of multi-year budgeting was included in the 2015 Spending Review but it remains limited.
4. Local government has few flexibilities in deciding how it should spend the money it receives from Government as most of it comes with strings attached. It is often siloed, so local government cannot align budgets with other services across a place.
5. A significant proportion of central government funding has to be bid for by local authorities. This pits council against council in a competitive bidding process, which is time consuming and expensive.
6. There is little financial incentive for local authorities to invest in their local infrastructure in pursuit of economic growth, when the tax revenues generated by that growth accrue to central government rather than local government. Nor do local authorities have the freedom to generate more investment through more innovative financing models.
7. Finance cannot be deployed in a place-based fashion, to support service integration and reform. Centralisation of funding simply reinforces antiquated departmental and service silos, resulting in duplication, waste and poor value for the public purse.

Cities are not all created equally. They differ in a number of fundamental respects. Some are large, some are small. Each has different sources of competitive advantage, different industrial clusters, demographics, transport issues, welfare needs, educational provision, situational issues and cultural offerings. In this context, the historic one-size-fits-all approach to tax raising and spending is no longer appropriate. There is a general mismatch in government policy where cities are understood to be engines of growth on one hand, but are then undermined by the way in which the totality of public resources are deployed across them. In some instances, this leads to perverse outcomes:

## COUNCIL TAX

The ratio of the highest council tax band to the lowest band is relatively small. For instance, Band A properties in the London Borough of Southwark pay £804.25 in council tax whilst Band H properties pay £2,412.76 in council tax – only three times more.[17] The current system of council tax, when applied to London, under taxes its wealthiest residents. The council tax is not sufficiently flexible to deal with the vastly differing tax base in the UK.

## NEW HOMES BONUS

The New Homes Bonus ('NHB') was introduced to give councils a share of the increases in council tax revenues where those councils deliver more homes, and is top sliced from the Revenue Support Grant (RSG). In 2014, the Financial Times estimated that the New Homes Bonus had reallocated funding from the most deprived councils (the 50 most deprived councils had lost out on £111m) to the least deprived (the 50 least deprived had gained £96m).[18] Whilst the NHB may well incentivise housing in the South East of the country and in the Shires, the evidence suggests that it may be doing so at the expenses of deprived city areas. This is an adverse consequence of a well-intentioned national strategy.

If the UK had a balanced and growing economy, with economic indicators on a par with other comparable OECD countries, there might be an argument that this highly centralised approach was working. This is not the case, and it is more likely that the high degree of centralisation is holding our cities back, and by implication acting as a brake on the national economy.

This manifests itself in four major economic challenges:

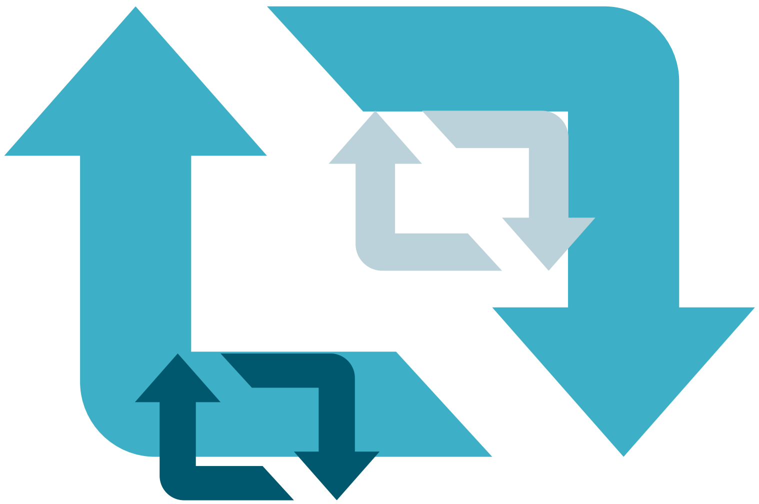
1. The continuing productivity gap;
2. The rebalancing of the British economy;
3. The threat to our economic growth from global competition and equally, the risk that our cities will not be able to take advantage of the new opportunities provided by increased globalisation and urbanisation; and
4. The contraction in spending on welfare, health and social care at a time when these needs are expanding, and the need to deliver more with ever-shrinking resources.

We look at each of these challenges in the next section.

# THE UK'S 4 ECONOMIC CHALLENGES

## CHALLENGE ONE

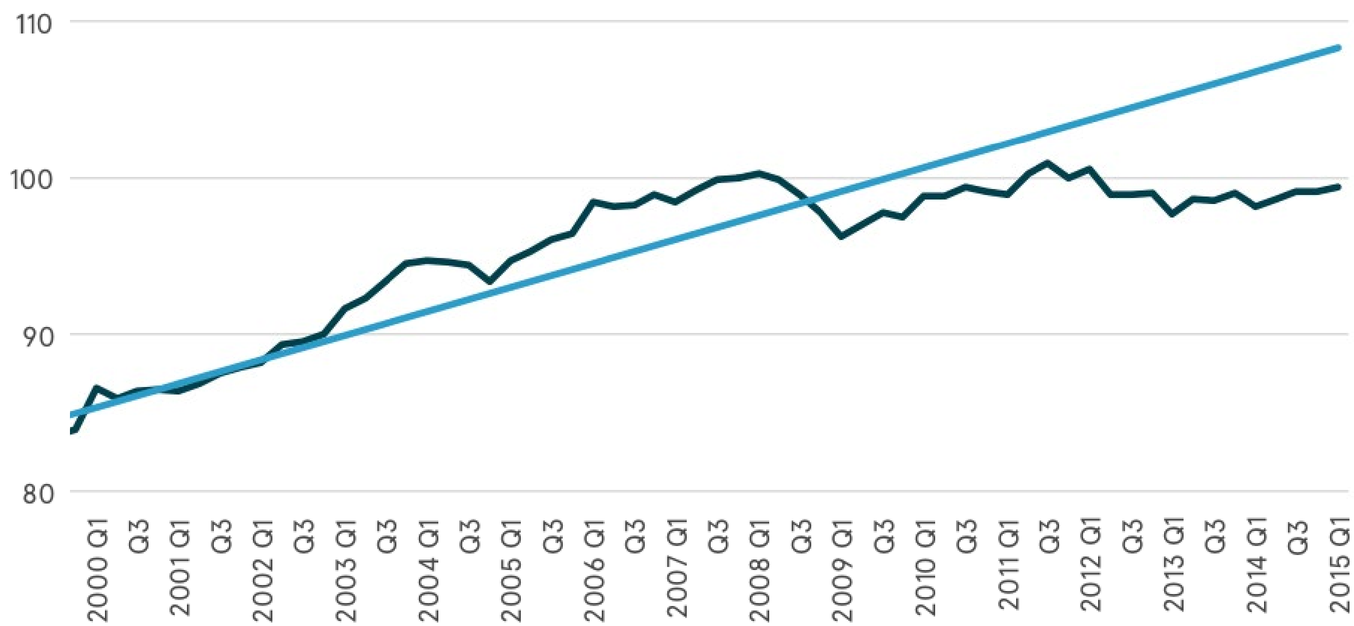
# THE NATIONAL PRODUCTIVITY DEBATE



Productivity is the oxygen of our economy. In the 25 years leading up to the 2008 recession, output per worker, one of the principal measures of productivity rose at an average rate of more than 2 percent per annum. But in 2008, the economic heart missed a beat, and as the chart overleaf shows, in the last seven years, there has been almost no increase in output per worker in the UK.[19]

## FIGURE 1:
## OUTPUT PER HOUR Q1 1971 TO Q1 2015 (2011=100) AND TREND OUTPUT PER HOUR 1971-2007

**Source:** ONS (2015) UK Labour Market, July statistical bulletin




In short, our economy is neither as productive as other developed country economies, nor is it as productive as it used to be. Productivity is now 16 percent lower than the level predicted from the pre-crisis trend.[20] This is the productivity gap.

The productivity gap is particularly evident at the level of the Core Cities. The difference between the Core Cities' average economic output and the UK national average is equivalent to some £66 billion per annum.[21] This is now contributing to the widest regional economic disparity in Western Europe. Compared to the Core Cities' average, productivity per person in Munich is 88 percent higher, in Frankfurt it is 81 percent higher, in Rotterdam it is 43 percent higher and in Barcelona it is 27 percent.[22] Outside London, only Bristol is more productive than the UK national average.[23]

To close the productivity gap, solutions need to focus on a number of areas including:

- Creating more jobs in high-productivity sectors of the economy.
- Encouraging companies to boost the productivity of their existing workforces.
- Accelerating investment in infrastructure to address decades of under-investment
- Measures to increase investment in R&D and innovation.

It is the precise combination of these measures in different parts of the country that will really deliver the growth potential of a place, that will deal with the underperformance of some of our cities as outlined above, and that will help close the national productivity gap. Local authorities are going to need greater fiscal autonomy than they have at present for them to be most effective in delivering the required change. Each of our cities has a particular series of structural issues which they need to address to retain and grow their economies, particularly in the light of increasing globalisation and international competition. These issues reach into the fields of housing (the need for more affordable, more intermediate and more aspirational executive homes), better transport (smart ticketing, better investment and investment better linked to housing development), less congestion, less pollution and better infrastructure.

London, which has benefitted from greater devolution since the establishment of the mayoralty in 2000, serves as a good example. London can only pull some of the policy levers needed for its effective management and growth. By way of example:

- London is responsible for economic growth, but it has no control over unemployment and related benefits.
- London is responsible for housing provision, and yet central government can announce a policy resulting in the forced sale of high value council house properties, and a reallocation of a significant proportion of the sale proceeds to other parts of the country.
- London is responsible for transport investment, but is restricted in the amount it can borrow to fund these projects.

Fundamentally, London is unable to capture much of the upside of the investment it makes in its growth to support the future borrowings it needs to accelerate and promote further growth. If London, our national capital and one of the world's leading cities, doesn't have these powers, what hope is there for our other cities?

## CHALLENGE TWO

# REBALANCING THE NATIONAL ECONOMY

Whilst the economy is now growing – in Q4 of 2015, ONS estimates had GDP at 6.6 percent higher than the pre-recessionary peak in Q1 2008 - that growth has been uneven:[24]

- The North South divide has continued to widen.
- There are too many low quality jobs in our economy.
- We have a chronic housing shortage.
- Our national income and wealth is some way below the G7 average.
- Levels of labour market participation compare poorly by some international measures.
- Despite an austerity programme since 2010, further significant cuts to public expenditure are still needed to reduce the deficit.

In response to this uneven growth, both the Coalition Government (2010-2015) and the Government stated their intention to rebalance our economy. The Northern Powerhouse, the Midlands Engine, and the Great Western Cities have received much attention - but the rebalancing will need to go much further. London has benefited from agglomeration economics, and it is entirely right that the Northern and Midlands cities should be encouraged to work together to derive similar benefits. However, rebalancing is not about playing one part of the country off against another. It is not about pitching London against our other cities. Nor is it about setting rural areas against urban areas or playing North against South. It is not a zero sum game, where a defined pot of economic growth is shifted around the country and reallocated in some arbitrary manner. Such a strategy would inevitably result in the suppression of enterprise, innovation and growth and is the opposite of what we are calling for.

The real rebalancing needs to take place at an economic, rather than geographical level. We need to rebalance the economy between:

- High and low productivity sectors.
- Savings and spending.
- The individual and the state.
- Exports and domestic consumption.

Alongside this rebalancing, there also needs to be a recognition that London and our cities act as a system of cities, playing to their individual strengths and sources of competitive advantage, enhancing and connecting their economic power for the benefit of the national economy.

Greater fiscal autonomy for our cities will enable them to source the tailored investment they need to provide the infrastructure to support future economic growth, through giving them greater power to use taxation and borrowing to tackle local priorities. It will ensure our cities can continue to invest in those sectors where we have competitive advantage, whilst identifying, investing in, and growing those sectors that will enhance our long term position in the global economy.

## CHALLENGE THREE

# PREPARING FOR FUTURE ECONOMIC CHALLENGES

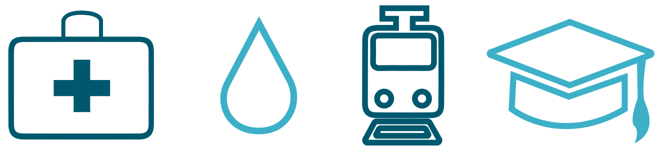
Half of the world's population already lives in cites. Those cities generate some 80 percent of GDP today. However, only 600 cities, accounting for one fifth of the world's population, account for approximately 60 percent of GDP. The cities with which British cities compete are largely drawn from these 600 cities. Worryingly, the make-up of these 600 cities is going to change very considerably over the next 10-15 years. By 2025, the McKinsey Global Institute estimates that 136 new cities will have entered the top 600. All of them will be from the developing world, and more than 100 of those new cities will be from China. India will contribute 13 new cities, and Latin America will contribute a further 8 cities.[25]

Increasingly cities, rather than national governments are driving economic growth. As these statistics demonstrate, UK cities are expected to compete in an increasingly globalised and rapidly developing world. And yet, we persist in handicapping our cities against this competition. There is a mismatch between what we expect from our cities, the vision of our city leaders for the cities they govern, and the centrally-determined, often short termist policies of past governments.

Most importantly, we need to equip our city leaders with the freedoms and powers to enable them to compete internationally on a more level playing field. Increasingly globalisation will reward those cities able to respond with precision and confidence over the longer term. As the next section will demonstrate, recent governments have taken steps to address our over-centralised system. The pace of change accelerated with the Coalition, and the current wave of bespoke devolution deals is encouraging. But there is much more that could be done to unshackle our cities, free-up their latent economic potential, and enable them to compete internationally on a more level playing field – for that they need far greater fiscal autonomy than they have at present.

## CHALLENGE FOUR

# FUNDING PUBLIC SERVICES



With all the austerity cuts made to date, councils have so far managed to balance their budgets and fulfil their statutory obligations as well as delivering an increasing range of statutory services, which promote growth, look after the most vulnerable in our society, and ensure community cohesion.

Between 2010/11 and 2013/14, savings of £10 billion were made by local authorities, largely through efficiency savings.[26] These efficiencies are going to run out. The funding gap across local authorities is growing at an average of £2.1 billion a year, adding up to £12.4 billion by the end of the decade.[27]

Public spending is going to continue to contract until at last 2018/19. The LGA estimate that on the same trajectory of cuts that has been experienced to date, over the period to 2019/20 (and excluding ring-fenced public health expenditure), spending must fall by 21 percent in cash terms or 33 percent in real terms.[28] With social care absorbing a rising proportion of the resources available to councils, funding for other council services is expected to fall by 43 percent in cash terms by the end of the decade from £26.6 billion in 2010/11 to £15 billion in 2019/20.[29]

One of the main ways in which local authorities have experienced cuts is through the Revenue Support Grant, which has fallen by 40 percent over the three-year period from 2013/14 to 2015/16,[30] and is expected to be phased out by 2020/1 as part of the business rate localisation proposals.

Unlike central government, local authorities are unable to run a budget deficit or to borrow to fill a hole in their annual revenue budgets. This makes local authorities' deteriorating financial position a very real issue.

Many local authorities are concerned about the future funding of public services. Education, social care, housing, parks and green spaces are just a few of the services at risk. The status quo is not good enough, and councils need to look at alternative delivery and funding models.

There has already been a trend towards place-based budgets, notably through initiatives such as Total Place, Whole Place Community Budget Pilots and the Troubled Families Initiative. These initiatives aim to produce more effective services in response to rising demand and reduced funding across the public sector. They are designed to integrate and improve service provision, to reduce duplications and to save taxpayers' money. At least part of the solution to continuing to provide public service lies in an extension of place-based budgets, with funds pooled and invested to address a particular social issue. There isn't a great deal of evidence on the impact of place-based interventions, but the Core Cities estimate that modest efficiency savings through the initiatives described above would deliver significant real savings for the public sector. For these savings to materialise, local government will need far greater fiscal autonomy than they have had present, most notably, addressing the continuing ring-fencing of funding and removing restrictions on their use.

There is also a critical linkage between the provision of public services and economic growth. High quality public services make our cities good places to live. They turn cities into vibrant, dynamic environments which attract businesses, capital and talent – all of which are pre-requisites for healthy growing local economies. They add value to places. They partially explain why some cities always consistently top 'liveability' and 'top city' indices. If local authorities cannot adequately fund their public services, economic growth is also affected.

# WHAT IS HOLDING BACK GREATER FISCAL AUTONOMY?

There have been a number of recurring concerns expressed about the granting of greater fiscal autonomy and fiscal devolution to local government, that are largely unfounded. These are dealt with below:

## CONCERN 1:

**Fiscal devolution will mean local authorities will raise taxes.** The need for greater fiscal autonomy is not driven by local authorities' desire to increase taxes. It is about ensuring that local authorities have the appropriate range of fiscal powers at their disposal to enable them to tailor their financial resources to reflect the unique circumstances of their locality. We accept that this may involve the increase of existing taxes or even the imposition of new taxes, but it is equally as likely to involve the reduction of some taxes, their abolition, a change in their scope, or potentially their replacement.

## CONCERN 2:

**Fiscal devolution is a grab for resources by some parts of the country at the expense of other areas.** It is fully accepted that greater fiscal autonomy needs to take place within the context of an equalisation settlement across local government, which is fiscally neutral. Fiscal neutrality in this context means that a local authority's financial settlement at the point of devolution should be fiscally equivalent to the settlement immediately prior to devolution. For this to happen, it is recognised that as a local authority assumes responsibility for a greater share of the national tax revenues, there will be a compensating reduction in grants received from central government.

## CONCERN 3:

**Local authorities are poorly run, inefficient and greater fiscal autonomy would put too much control in their hands.** Local government is the most efficient arm of the public sector. It is regulated by one of the strongest systems of local government finance of anywhere in the world, which means the actions of our local authorities are highly scrutinised. Local government wants to play its part in the UK's economic growth and it can only do that with appropriately devolved powers within the framework of checks and balances provided by our local government finance system.

## CONCERN 4:

**Councils won't take the hard decisions that Government currently have to take to balance the economic book.** Councils have a statutory duty to balance their books. Their response to the austerity measures introduced in response to the recession has been exemplary. They have demonstrated their ability to take the toughest decisions – decisions which have been informed by greater understanding and sensitivity to the many local issues involved than could ever be demonstrated by the government in Westminster.

## CONCERN 5:

**Greater fiscal autonomy will lead to tax competition between cities.** Greater fiscal autonomy would allow city governments to identify productive sectors with the potential for economic growth and provide incentives (e.g. through business rate system) for their growth. These will vary between cities and it is likely that cities will increasingly complement each other, benefiting from each other's comparative advantage, rather than competing for central government funding.

## CONCERN 6:

**We don't need greater fiscal autonomy for local government – we've managed so far without it.** As we have seen above, productivity in the UK's greatest cities lags behind those of many international cities, to the detriment of the UK economy.

**Much has been written and spoken about the risks of greater fiscal autonomy. We need to move away from this discussion, to focus on the risk of not devolving fiscal powers to our city regions. The biggest risk is that it will be international cities, rather than UK cities, driving global economic growth.**

# 3 BUSINESS RATE DEVOLUTION

Such was the support for business rate devolution, that a significant majority of the 38 devolution proposals submitted to Government in September 2015 proposed either a greater degree of retention of the local business rates than the 50 percent allowed since 2013, or proposed the retention of incremental growth over and above the 50 percent already retained.[31]

At the Conservative Party Conference in October 2015, the Chancellor of the Exchequer went further than any of those councils could have expected and announced proposals for local authorities to retain 100 percent of business rates raised by the end of the current parliament (2020). He also announced:

- The abolition of the Uniform Business Rate thereby enabling local authorities greater freedom to cut rates to (a) incentivise local businesses to grow and (b) incentivise the development of more business space.
- The power to raise business rates to fund infrastructure investment by up to 2p in the pound with the consent of the Local Enterprise Partnership, but only if the authority has a directly-elected mayor in place.
- The phasing out of the Revenue Support Grant (RSG) in return for the retention of the full business rate.
- That local authorities would be expected to take on additional spending responsibilities to reflect the fact that the increased business rates being retained currently exceeds the RSG paid to councils – in this way, the impact of the Chancellor's changes would be fiscally neutral at the outset.
- The system of 'top-ups' and 'tariffs' would remain in place – thus councils that raise more in business rates than they need to meet public spending will continue to support areas that raise less in business rates that they need.
- The levy that raises money from councils that raise the most from business rates would be abolished.
- The retention of a safety net for any area that loses more than 7.5 percent of their business rates revenue in any year, and a baseline approach for year one, so that no council will lose at first.
- A review of the system after 5 years and a possible reset.

In making these announcement, the Chancellor's explanation for the change in policy was based on his belief that devolving the business rate would stimulate economic growth:

*"Attract a business, and you attract more money, regenerate a high street, and you'll reap the benefits, grow your area and you'll grow your revenue too."*[32]

The full retention of business rates had been one of the key recommendations of the London Finance Commission (LFC) and of just about every report on fiscal devolution published before or after the LFC reported. These arguments all hang on the Chancellor's argument that devolving control of the business rate will act as a powerful incentive to local government to invest to grow their business rate income. For that to happen, the new reformed system of business rates must be equitable for all councils, and will require stability, transparency, and long term committed income streams. The Government cannot expect to periodically reallocate surplus business rates which councils are relying on to finance long term investment. These principles must lie behind any reform of the business rates system.

This announcement was followed by the 2015 Spending Review, in which the Chancellor indicated:

- Three areas of responsibility were under consideration for devolving to local authorities. These were:
  - The administration of housing benefit for pensioners
  - Public health
  - [and in London] Transport for London's capital projects.
- There would be a consultation on changes to business rates and additional responsibilities which would take into account the main resources currently available to councils, including council tax and business rates.

**To put these changes into context, total business rates for 2015/16 are projected to amount to £23.1 billion.**[33] **Half of this will be retained by the councils which collect the rates, and the balance remitted to Westminster to finance the Revenue Support Grant. In 2015/16, it is estimated that there will be a surplus of around £3 billion after the locally retained share of business rates and the RSG is deducted from the total business rates figure. This gives a guide to the level of additional responsibilities the Government is seeking to transfer to local authorities. This surplus is expected to grow over time as the projected business rates rise.**

Whilst we accept the necessity of ensuring that the net effect is fiscally neutral, it is important to recognise that the additional responsibilities being considered, particularly public health, will impose significant new costs on local authorities. Further, the switch from RSG to business rates creates additional volatility for local authorities that, without further devolution of borrowing and other sources of revenue, they will struggle to deal with. Therefore, the detail of these proposals will require greater scrutiny to ensure that they do not simply impose further cuts (in real terms) on local government. In principle, greater responsibility sits well with the devolution agenda, but the details of what is being proposed are important to understand.

In the March 2016 Budget, the Government proposed a number of cuts to business rates, chiefly by increasing the Small Business Rate Relief (SBRR) from 50 percent to 100 percent, such that business rates revenue will drop by a forecast £6.7 billion nationally over the next 5 years.[34]

The Government has said that local government will be compensated for this loss of income, but has not explained how this compensation will be managed. Subsequent to this the Chairman of the Office for Budgetary Responsibility (OBR) stated that the OBR would be reporting back on whether the local councils would be compensated or not.[35] Experts at the Institute for Fiscal Studies have suggested that compensation would be a 'very difficult' issue for the Government to manage.[36]

Clearly, between the lack of information about additional responsibilities for local government, and the lack of certainty as to how the Government's business rates cuts will be funded, local government has been left with a great deal of uncertainty about the current proposals. There are also a number of points of detail which local government will need the Government to clarify, including:

## TOP-UPS AND TARIFFS

There are very significant disparities within the business rate model. At one extreme, the London Borough of Westminster generates more than £1.8 billion per annum in business rate revenue, whereas at the other extreme, West Devon generates £27 million per annum. A top-up and tariff model will continue to be needed to deal with widely different levels of need and business rate income in local authorities across the country.

## APPEALS

There have been some well-publicised appeals, which have seen businesses recover substantial sums in back-dated business rates. Last year, Virgin Media recovered over £10 million pounds, half of which will be financed by Tewkesbury Council.[37] Hartlepool Borough Council also had to find £3.9 million following a revaluation of its power station.[38] Whilst not material at a national level, these sums are highly material at a local level. The Hartlepool Council finance team calculated that over time, their lost income from this appeal decision will be equivalent to the finance required to provide 2,700 new homes.[39] Under the 50 percent retention regime, the costs of successful appeals were split 50/50 between local and national government. Under the new regime, local government will pick up the full cost of these appeals. **This raises three issues:**

**1.**

The high volume of appeals. Between January and March 2015 alone, there were over 201,000 appeals submitted to the Valuation Office Agency (VOA), many of which were purely speculative, submitted by agents on a 'no win, no fee' basis.[40] As the Government admitted in its recent consultation document, the whole appeals process is in need of reform so business rate payers understand more clearly the basis for the assessment of their business rates. The consultation period on its proposed 'Check, Challenge, Appeal' reforms has now closed, and it is to be hoped that what emerges is a more streamlined and efficient appeals system with a considerable reduction in speculative appeals.

**2.**

The role of the Valuation Office Agency. The VOA is the body responsible for overseeing business rate appeals. Both business and local government have been critical of its performance in dealing in appeals, despite a major focus on clearing the backlog of business rate appeals in 2014-15. The VOA's interests need to be aligned with those of local government in the new system. It needs to be incentivised to process appeals quickly, and its information systems need to be reviewed to ensure that it can provide local government with the detailed granular information councils will need to manage their business rate base effectively. This means that the VOA's future governance structures need to clearly represent the interests of its most important customers: local government and the private sector.

**3.**

Local government is unfairly shouldering the cost of appeals. Under the 50/50 retention regime, 50 percent of the cost of a back-dated settlement was borne by the local authority, even though that local authority may not have received the income in the first place as part of the back-dated period may have related to when central government received the full business rate. This is a simple point to address in the new system – local government should not be asked to repay business rate income it has not received and national government should therefore be expected to cover back-dated awards relating to income it has received.

## REVALUATIONS

Under the current system, business rate premises are revalued every 5 years. The most recent revaluation came into effect in England and Wales on 1 April 2010, based on rateable values established as at 1 April 2008. The 2013 revaluation (which would have come into effect in April 2015) was postponed because of the recession, and the next revaluation will come into effect on 1 April 2017, based on 2015 valuations. When the 2015 revaluation was deferred, much was made of the fact that many businesses outside London would lose from this decision as they would be paying unfairly high business rates based on pre-recession 2008 data. Bilfinger GVA estimated that businesses in the North and Midlands would lose £2.3 billion because of the deferment. Conversely, they argued that London would save more than £1.5 billion, but would then bear the brunt of the rise in business rates in 2017 due to steeply increasing property values in the capital.[41] Either way, it is clear that under the current 5 yearly revaluation system, business rates are unlikely to genuinely reflect either improving or declining economic conditions. The Government has taken this on board and is currently consulting on whether revaluation periods should be reduced to 3 years, which is a step in the right direction.

## MANDATORY RELIEFS

Under the current system of business rates, relief from all or part of the business rate is provided under the mandatory reliefs regime. This requires councils to provide a minimum level of relief to certain categories of premises, including those occupied by small business, certain rural businesses, and charities (including certain colleges and universities), and land/buildings used for agricultural purposes, the training and welfare of disabled people, worship, and empty properties for up to 3 months. In addition, since April 2012, councils have had very wide discretion to offer business rates discounts, where funded from their own resources, for almost any business, limited only by state aid regulations and the need to be reasonable by reference to the interests of council tax payers.

There is a strongly held view emerging across local government that the system of mandatory reliefs should be reformed, with councils being granted the freedom to focus reliefs on those aspects of their local economy where they belief that reliefs could have most economic impact. Some of the mandatory reliefs are a clear reflection of national policy and may not be supported at a local level by a council determined to invest for economic growth, for example, agricultural and charitable premises relief. Furthermore, a system of national mandatory relief cannot begin to deal with discrepancies and deliberate tax-avoidance attempts at local level. It is precisely the localisation of the proposed business rate reform that would enable councils to target business rate relief far more effectively to align them with the wider interests of the area and its economy. Accordingly, mandatory reliefs should therefore be removed.

## RESETS

Under the previous 50/50 regime, it was agreed that the system introduced would run until 2020, at which point the system would be 'reset' and baseline funding levels for individual local authorities would be adjusted to account for changes in circumstances at local level across the country.

The Government has made much of the argument that the full localisation of the business rate will provide a powerful incentive for local government to invest to promote local economic growth. It therefore seems perverse that in 2020 (and 5 yearly thereafter), a proportion of that growth will be removed from more productive areas for reallocation to less productive areas.

There is a further issue at play here. Much of the infrastructure investment under consideration by councils requires long term committed funding, which for any major infrastructure projects, would require a pay-back period of one or two decades. Local authority treasurers may well struggle to make this investment, where it is to be funded through business rates income, under the Prudential Borrowing Code, as there is risk that the future uplift in business rates on which the investment relies could be removed by central government as part of a reset (i.e. a 10-20 year scheme would not be able to guarantee repayment levels for the whole of that period). This policy risks dampening the incentive for growth and may well lead to sub-optimal investment decisions by local authorities.

**At the heart of this particular issue is how to determine whether growth in business rates genuinely reflects the efforts of local government as opposed to merely being a fortunate outcome. In the former, it seems genuinely fair that those councils should keep the growth (after all they have borne the financial risk, and should therefore keep the financial return), whilst in the latter case, it seems equally fair that those councils should be expected to share the proceeds of that growth. In practice, this would be a subjective analysis, and highly unlikely to provide a robust basis for reallocating increased business rate income.**

Various alternative mechanisms have been suggested which would address the reset issue and the dampening of the growth incentive. These include extending the reset period to, say, 10 years (which would create a degree of additional stability although may still distort the timing of investment decisions by local authorities); allowing councils to keep the business rates from new development within a defined geography for a fixed period of years (the principle on which current TIF schemes operate); and allowing councils to keep all the business rate growth over and above a national average growth rate. All have advantages and disadvantages, but they should be explored with councils as an alternative to the 5 year reset mechanism.

## STUDENT ACCOMMODATION AND PROPERTY LETTING

A number of local authorities are seeking to impose business rates on providers of student accommodation, in order to provide for the additional costs that students create in terms of additional rubbish collection, etc. At present, students do not pay council taxes and landlords are able to get exemptions when all tenants in a property are registered students. This creates a local financial burden for local authorities.

Currently HMRC treats property letting as an investment rather than a business, making it exempt from business rates, though landlords letting holiday property do pay business rates. As part of greater devolution of business rates it will be important for the Government to consider whether local authorities should have greater discretion over the application of taxes.

## GOING FORWARD – THE ROLL OUT OF BUSINESS RATE RETENTION

The Government will be consulting on the implementation of business rate retention in the summer of 2016. The March 2016 Budget also stated that the GLA will move towards full retention of rates from April 2017, ahead of schedule. In addition, Liverpool City Region and Greater Manchester will pilot 100 percent rates retention from 2017.

# 4 A PROGRAMME OF LONGER TERM FISCAL DEVOLUTION

**Whilst the devolution of business rates is to be welcomed, this should only represent the beginning of a longer journey towards the devolution of a much wider-ranging set of fiscal powers and financial freedoms for local government.**

## WE SEE THIS LONGER TERM JOURNEY AS INVOLVING TWO DISTINCT STAGES:

- In the medium term, the Government will need to work with cities to explore the potential for local government control of a wider pool of taxation, without varying powers. This is necessary in order to provide for greater stability and certainty of financing. This stage might also involve looking at smaller local taxes such as a tourism tax in conversation with the private sector.
- In the longer term, it is our view that the UK should move towards fuller fiscal devolution in line with international competitor cities, including stronger discretion over local tax rates and stronger borrowing powers.

## A HIERARCHY OF TAXATION

Of course some fiscal competencies are best left at the national level, particularly those taxes that are highly volatile, easy to avoid or the devolution of which would likely lead to unhealthy tax competition. But, as we have already pointed out, functional devolution should go hand-in-hand with fiscal devolution. And just as some functions are best executed at the local level, so too are some taxes.

There is a hierarchy of taxes that can potentially be devolved, set out below. As you progress though the hierarchy, devolving the tax increases the administrative burden, risk of avoidance, risk of tax competition, and significant, detrimental behavioural change and volatility. The hierarchy includes taxes currently set by central government. It does not include new taxes that could potentially be introduced by local government to replace or complement other taxes.

## PROPERTY TAXES

The decision to devolve the suite of UK property taxes to Scotland and Wales (council tax, business rates and Stamp Duty Land Tax) was taken some years ago and in 2018 this will be completed with the devolution of Stamp Duty Land Tax to Wales. Property is fixed, its ownership is traceable, and property taxes are relatively easy to recover in the event of non-payment. Property taxes are relatively transparent and generate little behavioural change.

Devolution of property taxes should also encourage local authorities to build more housing by allowing them to keep the financial benefits of building more homes. Increasing the supply of affordable housing is crucial in maintaining a city's competitiveness and is also a key government priority. The Centre for Cities has also argued that devolution of property taxes should go hand-in-hand with devolution of the housing benefit bill. Responsibility for Britain's high and rising housing benefit bill would further encourage local authorities to ensure more homes are built.[42]

## LOCAL FEES AND CHARGES

These could include a local hotel tax and greater autonomy over planning and licensing fees. More control over such taxes would allow cities to support or capitalise on local strengths and combat specific local challenges. They are also less likely to lead to detrimental tax competition.

## AIR PASSENGER DUTY

The devolution of Air Passenger Duty to Scotland has prompted fears that this will have a detrimental impact on airports in Northern England. As with property taxes, allowing local authorities to retain the financial benefits of hosting an airport might ease the often thorny issue of airport expansion.

## VAT

This is relatively easy to assign, but differentials in VAT rates would almost certainly lead to unhealthy competitive behaviours between sub-national areas, and in any event, national VAT rates have to comply with the European restrictions. For these reasons, setting the rate of VAT should be reserved for central government.

## INCOME TAXES

Many countries already have differential income taxes across different areas of the country. Arguments have been made that National Insurance is too closely linked to our social security and pensions system that would it be almost impossible to devolve it. However, as Britain has been moving further and further away from a contributory welfare system, devolution of National Insurance might not be as hard as it seems – particularly if, as is occasionally mooted, income tax and National Insurance are merged.

However, in a country as geographically small as Britain, devolution of income taxes is not without its risks and critics often point to fears that it may lead to a 'race to the bottom.' This might not be a problem between the different nations of the United Kingdom, but could be between Britain's close together major cities (particularly in Northern England).

On the other hand, the Scottish Government has argued that increasing the threshold at which employers would need to start paying national insurance contributions could promote employment.

## CORPORATION TAXES

The cost and bureaucracy of a devolved corporation tax would be disproportionate to the benefit realised. Assignment would be difficult as well because of the difficulty of localising corporation tax. The risk of avoidance is high with 'brass plating and shifting transactions' to low tax regimes.

The exception is Northern Ireland, where there is an argument that Northern Ireland is competing with the lower rates of corporation tax in Ireland (12.5 percent compared to the UK's 20 percent). In 2015, the government legislated to allow the Northern Ireland Assembly to set its own rate of corporation tax. Stormont has indicated that it will reduce the rate to 12.5 percent by in 2018.[43] The issues behind the devolution of the power to set the corporation tax rate do not apply to the other parts of the UK, and therefore this measure is unlikely to be a precedent for other corporation tax concessions.

Despite this, the Scottish Government has argued that fully devolving corporation tax (including rates, reliefs, thresholds and the tax base) would allow them to better reflect the specific strengths and challenges in the Scottish economy.[44]

## CAPITAL TAXES

These are potentially the easiest of such taxes to avoid. They are also highly volatile. Despite this, the Scottish Government has argued that by devolving capital gains tax, they could create tax incentives to boost entrepreneurship to redress Scotland's lower rates of entrepreneurship and business start-ups.

# 5 CONCLUSIONS AND RECOMMENDATIONS

Whilst the proposed reforms to the business rate system represent an important step in the right direction, much of the detail around this needs to be resolved. Furthermore, it is our view that the reform of the business rate is one step on a longer journey towards granting local government the fuller suite of fiscal freedoms and autonomies they need to play their full part in promoting local economic growth and reforming public services, and putting them on a level with the international competition.

## WE THEREFORE RECOMMEND:

- The Government, the Core Cities, London and the Local Government Association, should come together to deliver a workable, co-designed and reformed business rate system including the following:
  - Reforming the underlying business rate system to ensure appropriate and transparent redistribution, coherence, and stability.
  - Dealing with the legacy of the current system, reforming and streamlining the operation of the VOA; and
  - Ensuring any additional financial responsibilities support cities' ambitions to: incentivise growth and productivity, unlock public service reform, and deliver financially sustainable cities. **It cannot be about just delegating the management of the status quo – it has to be about the delivery of sustainable public finances**.
- Government should commit to a longer term – but timetabled – programme of wider fiscal reform, with retention of more of the tax base first, and full devolution second, placing this at the heart its programme to rebalance the economy and increase productivity. It should be about seeing business rate reform as the beginning and not the end of a journey towards fuller fiscal devolution, empowering cities across the UK.
- Government should signal this commitment by initiating a series of events with city authority and private sector representatives, and working closely with big cities, including those piloting business rate retention, to set out the principles and operation of fiscal devolution (how it will work, not simply what the barriers might be).
- This work should:
  - Include as a minimum, the full suite of property taxes recommended by the London Finance Commission: business rates as above, council tax reforms, stamp duty, capital gains tax on high value residential property, and the annual tax on enveloped dwellings;
  - Explore other potential fiscal tools including: the retention of an element of income tax, and local sales and tourism taxes; and
  - Be published and consulted upon in a Green and then White Paper.
- Accepting that broader fiscal reform may need to be undertaken across parliamentary periods, cross-party support should be sought by Government and cities for the principles and process of fiscal devolution, including the creation of time within the legislative schedule where needed.

# APPENDIX 1:

# FISCAL DEVOLUTION TO SCOTLAND, WALES AND NORTHERN IRELAND

Scotland, Wales and Northern Ireland have been granted substantial devolved powers including fiscal powers over recent years. Of these, the most significant for the purposes of this discussion are the fiscal powers granted to Scotland following the recommendations of the Smith Commission in late 2014, and the successful passage of the Scotland Act 2016. This built on fiscal powers devolved to Holyrood in the Scotland Act 2012.

## SCOTLAND

Following the recommendations of the Calman Commission, The Scotland Act 2012 granted additional powers to the Scottish Parliament. Prior to this the Scottish Parliament only had control of council tax and business rates. The Act gave Holyrood the power to implement a Scottish rate of income tax, which came into effect in April 2016. UK income tax rates will be reduced by 10 pence in the pound across all bands in Scotland, with the Scottish Parliament having the power to set annually the Scottish rate at any value from 0 percent upwards in half pence units, with no upper limit. For the tax year 2016/2017 the Scottish Parliament has set the Scottish rate at 10 percent, meaning that Scottish taxpayers and the rest of the UK will be paying the same overall income tax.

**There are a further two devolved fiscal powers which were granted in the Scotland Act 2012. These are:**

- The introduction of a tax on land transactions, replacing the UK's Stamp Duty Land Tax; and,
- The introduction of a tax on waste disposal from landfill, replacing the UK's Landfill Tax.

Following the failed Scottish Independence Referendum in 2014, significant extra powers were granted to the Scottish Parliament, based on recommendations made in the Smith Commission. Following the successful passage of the Scotland Act 2016, Holyrood will now control approximately 60 percent of spending in Scotland.

New fiscal powers include:

- Setting thresholds and rates for the non-savings and non-dividend income tax.
- Retention of half of all VAT receipts.
- Devolution of Air Passenger Duty and the Aggregates Levy.

The Smith Commission also recommended an adjustment to the block grant equal to the Scottish Government's additional revenue from these measures. Thereafter, adjustments to the block grant, which would continue to be determined using the Barnett Formula, would be indexed. The block grant would also be adjusted to reflect any new devolved spending powers. Notably in the context of English fiscal devolution, the Scottish Government has far greater discretion over how to spend funds allocated to them by Westminster. There is, by way of example, no requirement to spend increases from the application of the Barnett Formula, arising because of increased spending on a particular budget head, on the same budget head in Scotland.

The Smith Commission recognised that these measures would involve the substitution of relatively predictable sources of revenue (the block grant) with less predictable sources of revenue (more volatile tax revenues). It therefore proposed that the Scottish Government would receive further borrowing powers to manage the fiscal risks involved in this exchange.

There was a further important recommendation that there should be no detriment to either the UK or Scottish Governments following policy decisions by one government, which effect the tax receipts or expenditure of the other. In this case, the decision-making government would either reimburse the other if there is an additional cost, or receive a transfer from the other if there is a saving.

The IFS estimated that as at the end of 2014, around 13 percent of the Scottish Government and Scottish local government expenditure was funded by devolved taxes (namely business rates and council taxes). This increased to around 25 percent following the Scotland Act 2012 changes. Following the Smith Commission's proposals, over half of Scottish Government spending would be funded by devolved tax revenues. The IFS went on to conclude that "This brings Scotland and the UK closer to the position in most other OECD countries, where sub-national governments…. are responsible for raising a substantial proportion of what they spend"[47].

## TABLE 3: SCOTTISH TAXES DEVOLVED FOLLOWING THE SMITH COMMISSION PROPOSALS AND SCOTLAND ACT 2012

| Tax Revenues | Revenues (£s billions) | Devolution proposed |
|---|---|---|
| Income Tax | 10.9 | Over 90 percent of revenues devolved |
| National insurance | 8.5 | No |
| VAT | 8.3 | Approx. half revenues assigned |
| North Sea taxes | 5.6 | No |
| Onshore corporation tax | 2.9 | No |
| Council tax | 2.4 | Already devolved |
| Fuel duties | 2.3 | No |
| Non-domestic rates | 2.2 | Already devolved |
| Alcohol and tobacco duties | 1.6 | No |
| Stamp duty land tax | 0.3 | Devolved under Scotland Act 2012 |
| Air passenger duty | 0.2 | Yes |
| Stamp duty on shares | 0.2 | No |
| Landfill tax | 0.1 | Devolved under Scotland Act 2012 |
| Aggregates levy | <0.1 | Yes, subject to state aid rules |
| Other taxes | 1.7 | No |
| **Memo** | | |
| Scottish Govt spending (inc proposed devolved benefits) | 36.8 | n/a |
| Approximate tax revenues to be devolved | 19.4 | n/a |

Source: Philips, D (2014), The Smith Commission's Proposals – how big a change do they represent? And what questions remain to be addressed: Institute for Fiscal Studies

## WALES

As with the Smith Commission in Scotland, the Silk Commission (echoing the work of the previous Holtham Commission in 2010) has made an important contribution to driving the fiscal devolution agenda in Wales. The Silk Commission reported in late 2012.

The Wales Act 2014 implemented some of the recommendations of the Silk Commission around fiscal powers. Key fiscal elements of the Act include:

- Devolution of business rates to Wales.
- Devolution of stamp duty to Wales.
- Devolution of landfill tax to Wales.
- Ability to replace the above taxes with new taxes specific to Wales.
- Providing for a referendum to determine whether the Welsh Government should be granted power over a devolved element of income tax.

Devolution of business rates, stamp duty and landfill tax will be complete by April 2018. The Welsh Government also received the power to borrow up to £1 billion, in order to help with the practicalities of greater uncertainty around revenues.

The Autumn Spending Review 2015 removed the requirement for the Welsh Government to hold a referendum in order to implement the Welsh rates of income tax. As a result, the Welsh Government will now be able to implement a new rate of income tax from 2020 onwards. The Welsh Government will have the power to vary the rate of income tax by up to 10 percent over and above the rate set by the Government.

It has been estimated previously by the Welsh Government that control of income taxes will mean that the Welsh Government has control over 20 percent of Welsh taxation and 50 percent of spending.

Unlike in Scotland, the Government did not accept the recommendations of the Silk Commission on the devolution of Air Passenger Duty and the Aggregates Levy to the Welsh Government, and they will therefore remain centrally determined and collected.

## NORTHERN IRELAND

Under the Northern Ireland Act of 1998 which created the Northern Ireland Assembly, taxation was an excepted matter which remained under the control of the UK Government. For a variety of reasons, progress towards fiscal devolution has been much slower in Northern Ireland than in either Scotland or Wales, and it has not had a dedicated commission in the way that Scotland and Wales have benefited from the Smith Commission and the Silk Commission respectively (as well as the commissions that preceded these).

Unlike in Scotland and Wales, the Northern Ireland Assembly does not currently have (or have plans to obtain) powers over income taxes, stamp duty, or landfill taxation. However, in terms of business rates, both the Northern Ireland Executive and the district councils set separate rating multipliers, with the full rate liability collected by the councils.

Whilst in Scotland and Wales the focus has been on further devolution of fiscal powers, the main area of discussion for Northern Ireland has been reducing the local rate of corporation tax to match that of the neighbouring Republic of Ireland, which has a corporation tax of 12.5 percent. The Corporation Tax (Northern Ireland) 2015 Act made provision for a Northern Ireland rate of corporation tax. The Spending Review 2015 confirmed the Government's commitment to pursuing this and suggested that it might be implemented in April 2018.

One challenge associated with devolving (and, in practice, significantly reducing) the rate of corporation tax, is that this would be subject to the EU Azores Judgement which allows sub-national governments to operate different tax rates from the national rate only on the provision that there is no unfair 'subsidy' provided by the national authorities. This is in order to reduce the risk of state aid. In Northern Ireland, the implication would be a significant reduction in the block grant received by the Northern Ireland Assembly. Therefore, the Northern Ireland Assembly would in effect be taking on far more fiscal risk with the potential for growth in the tax base weighed against a certain loss of revenue.[48]

# APPENDIX 2:
# PROGRESS TOWARDS GREATER FISCAL AUTONOMY SO FAR IN ENGLAND

Fiscal devolution in the UK to date has come in a series of waves.

Firstly, we have seen a number series of measures granting greater fiscal freedoms to English cities over the past 15 years. With the exception of business rates, these measures have been piecemeal, and largely focused on more minor, local revenues (principally supplements, fees and charges). Examples include:

- A Business Rate Supplement in London to finance Crossrail.
- A council tax precept in London hypothecated for the Olympics. A number of candidates for London Mayor have pledged to keep this and use the money raised for housing.
- Congestion charging in Durham and London (a referendum was also held in Manchester).
- Off-street parking levies such as that introduced in Nottingham.
- Business Improvement Districts. In these areas, a levy is charged on all business rate payers for projects that benefit local businesses.
- Enterprise Zones. Local Enterprise Partnerships and Local Authorities retain any growth in business rates generated by Enterprise Zones for up to 25 years.
- Tax Increment Financing projects in a number of Core Cities and in London (such as the Battersea Extension).

All these in their own way have been minor, but progressive examples of granting local government greater fiscal autonomy and all have been successful in their own way.

The only city to have achieved any significant degree of fiscal autonomy during this period was London. With the establishment of a mayoralty and the setting-up of the London Assembly, came devolved powers over transport, policing, economic development, planning, and emergency services. But whilst council tax precepts, business rate supplements and congestion charging have been key sources of revenue for funding these new powers, 74 percent of London's revenue still comes from central government.

Secondly, there were the fiscal freedoms granted to the national governments of Scotland, Wales and Northern Ireland. In the case of Scotland and Wales, these have been politically driven by the need to grant greater devolved authority in the face of a groundswell of opinion in favour of greater devolution. In the case of Northern Ireland, corporation tax reform has been necessitated by the impact of significantly lower levels of corporation tax in Ireland. Fuller details of these devolution proposals are included in Appendix 1.

The fiscal powers being granted to Scotland following the recommendations of the Smith Commission in late 2014, and subject to the enactment of the Scotland Act 2016, are by far the most significant, involving both full tax devolution and a first attempt at tax assignment:[49]

- The power to set income tax on earned income.
- The full devolution of Air Passenger Duty and the Aggregates Levy.
- The assignment of the first 10 percentage points of the standard rate of VAT.

These powers were granted on top of the earlier devolution of council tax and business rates, a new land tax to replace the UK's stamp duty land tax and a new tax on waste disposal.

Although these taxes were devolved to the Scottish government, rather than to the Scottish cities, the actual operation of these measures will provide a useful test bed for the introduction of similar measures to UK cities, including those within Scotland.

The situation in Northern Ireland, where Stormont was granted the power to set the Northern Irish corporation tax rate, was a response from Westminster to the particular circumstances of Northern Ireland having to compete with a significantly lower (12 percent) corporation tax rate than in the UK (21 percent at the time, now 20 percent, and anticipated in the most recent budget to fall to 17 percent by 2020), which distorted the local Northern Irish economy. Again, this devolved power is going to provide invaluable information to help shape the future successful devolution of similar fiscal powers to English cities.

Thirdly, there was then a wave of City Deals in 2012-14. The first City Deals were with the eight Core Cities and a second wave saw a further 20 deals struck with the next largest or fastest growing cities in England. Further City Deals in cities including Cardiff and Glasgow have also been struck and they continue to be made.

Fiscal elements included in City Deals included an earn back deal with Greater Manchester, tax increment financing deals in cities including Newcastle and Sheffield and economic investment funds (allowing councils to pool multiple funding streams and business rate income into single investment funds) in cities including Leeds City Region and Greater Birmingham and Solihull.

City Deals were followed by bespoke and more substantial devolution deals. The first of these deals was the Greater Manchester devolution deal in November 2014. A Memorandum of Understanding on the devolution of health and social care budgets was also signed in February 2015.

In the May 2015 General Election, the current Government was elected on a manifesto committed to rebalancing the economy, introducing metro-mayors and building a Northern Powerhouse by devolving "far reaching-powers over economic development, transport and social care to large cities which choose to have elected mayors."[50]

The Government followed-up on this manifesto commitment with the Cities and Local Government Devolution Bill (received Royal Assent in January 2016), which enabled the Greater Manchester devolution deal, and a series of deals subsequently agreed with other cities, to be enacted. During the summer of 2015, a second devolution deal with Manchester was agreed, as well as a deal with Cornwall, signifying the Government's intent for devolution to not be a policy exclusively for urban areas.

The deals followed the invitation by the Secretary of State for Communities and Local Government in July 2015 for local government to submit proposals for devolution by 4 September 2015. This approach generated 38 responses from both urban and rural areas requesting a combination of measures for both fiscal and functional devolution.

Given the short period of time allowed by the Government for these proposals to be put together, they were inevitably high level, and lacking in detail. The proposals effectively acted as menus for the devolution negotiations while a more extensive evaluation of the risks and rewards of these proposals were evaluated by the relevant councils' finance teams. Some cities concluded that securing an initial deal with Government was an important first step in a longer term devolution process that would bring more significant devolution of funding, resources and powers to the councils further down the line (as has been the case with Greater Manchester).

Over the course of Autumn 2015, six city devolution deals were put in place, covering the combined authorities of Greater Manchester, Sheffield City Region, the Tees Valley, the North East, Liverpool City Region and the West Midlands. All of these combined authorities will be headed by a directly-elected Mayor.

These six deals all contained a mix of devolved and consolidated Whitehall budgets and some limited new tax-raising powers and revenue streams. Overall they fell short of full fiscal devolution and the financial freedoms that combined authorities will enjoy will be relatively constrained. A concern is that the deals, as negotiated, could increase the volatility of revenues in these combined authority areas, without providing the tools, in terms of borrowing and other powers, to manage that volatility.

Borrowing is an essential part of fiscal devolution. It is needed for two reasons. Firstly, to enable cities to pursue their strategic investment priorities for the benefits of their local economies. Secondly, to allow cities to manage volatile revenue flows without having to make 'emergency' cuts to services to balance the books – in ways that are likely to have a serious negative impact on quality of services. Both of these are valid reasons for borrowing and are common in international cities of comparable size to the Core Cities.

**Although each of the six devolution deals were different with no 'one-size-fits-all' approach, there were many similarities in the way in which they were put together, and they broadly cover the same policy areas, the fiscal elements of which are summarised below:**

## TRANSPORT

Government agreed to pool and devolve all relevant local transport funding and provide a multi-year settlement.

## SKILLS

All combined authorities will receive full devolution of the 19+ adult skills budget and there were varying provisions for other skills funding.

## HOUSING, LAND AND PLANNING

Most devolution proposals give the Mayor strategic planning powers, rather than any additional or devolved financial resources. However, Greater Manchester has control of a £300 million housing investment fund and Sheffield City Region and the West Midlands are exploring the establishment of their own housing investment funds. Crucially, there is no devolution of any of the suite of property taxes proposed by the London Finance Commission included in any of the individual deals.

## HEALTH AND SOCIAL CARE

In April 2016, Greater Manchester gained control of its £6 billion health and social care budget, allowing the city-region to integrate health and social care and target specific health issues.

A Commission for Health and Social Care Integration is currently establishing the ground for health and social care devolution in the North East, whilst Liverpool City Region has indicated that they will explore health and social care devolution and integration further.

## SINGLE INVESTMENT FUNDS

Combined authorities will pool all relevant budgets for their devolved powers and treat this as a single pot. These will then effectively be topped-up by central government to form a single investment fund for each combined authority. Manchester, Sheffield, the North East and Liverpool will all receive an additional £30 million a year for 30 years, the Tees Valley an additional £15 million for 30 years, and the West Midlands will receive an additional £36.5 million a year for 30 years. Crucially, much of this money is to be treated as resource money, and therefore could be used to service the interest on debt raised to finance investment in local infrastructure.

## EUROPEAN FUNDING

The Government is also committed to granting all combined authorities intermediate status for the European Regional Development Fund (ERDF) and European Social Fund (ESF), giving combined authorities management of European funding in their area. Although not a new funding stream, such a development will give local authorities greater flexibility over a significant source of income. For instance, the notional allocation of ERDF and ESF funding to the Greater Manchester Local Enterprise Partnership in the 2014-20 period was £415.6 million.[51]

With regard to the six devolution deals agreed, the focus over the coming 12 months will be the implementation of those devolution agreements. These agreements are essentially 'an agreement to agree' – how could they be more given the very limited timescales in which the proposals were submitted and the deals agreed and documented? Capacity will need to be built across local government to implement these deals. Strategic economic plans will need to be drafted, economic models will need to be written, and investment frameworks agreed. Councils will need to engage at an early stage with DCLG on the 5-year review process to ensure that the evaluation measures to be used by Government are adequately represented in the investment evaluation frameworks to be adopted by local government. Expectations also need to be managed as to what can be achieved within the first 5-year post-deal period – it is going to be take some time before the building blocks required to support investment decisions are in place, an investment pipeline agreed, and projects are ready for investment.

## A NEW ROUND OF DEALS: 2016

In the March 2016 budget, a devolution deal was announced for the West of England, and a city deal was announced for the Cardiff City Region. The Government opened negotiations for city deals with Edinburgh and Swansea, following on from the Cardiff City Region deal and the Aberdeen City Deal agreed earlier in 2016. The Government has also agreed a City Deal with Inverness and has left the door open for a North Wales growth deal to help the region take advantage of its proximity to the Northern Powerhouse.

Liverpool agreed a further deal with government, securing additional new powers over transport, piloting the approach to 100 percent business rate retention across the city region, and committing the city region and government to work together on children's services, health, housing and justice. East Anglia and Greater Lincolnshire also agreed mayoral devolution deals, thus indicating that devolution will encompass non-metropolitan regions as well. Greater Manchester will also pilot 100 percent business rate retention, and will also gain new powers over criminal justice.

The majority of these new deals echoed the powers granted through previous deals in other city regions. Of note, however, was the £175 million housing fund for East Anglia, which will be used to deliver an ambitious target of 69,000 homes needed over the period 2016-2021 and 275,000 homes over the longer period of Local Plans.

There now appears to be a process established, albeit an as yet uncodified process, by which city regions and non-metropolitan regions can negotiate devolution deals with Government provided they accept an elected mayor as part of a revised governance structure. The deals agreed so far provide a template for future agreements, with limited scope for local particularism. What is also clear is that the Government sees devolution as an iterative process, with successive deals paving the way for deeper and more meaningful devolution.

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