City Money

centreforcities

# Ways and means:

## money management and power in local government

Zach Wilcox and Joe Sarling, May 2013

**"The Centre for Cities is a research and policy institute, dedicated to improving the economic success of UK cities. We are a charity that works with cities, business and Whitehall to develop and implement policy that supports the performance of urban economies. We do this through impartial research and knowledge exchange."**

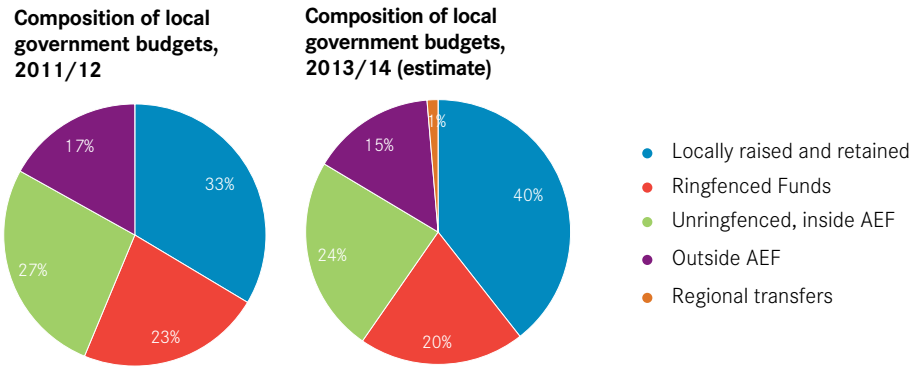
**www.centreforcities.org**

*"Finance for cities is in a halfway house - progress has been made but much more needs to be done"*

## Executive Summary

Since the Spending Review in 2010, the Coalition Government has devolved powers and funding streams to local government. But, Whitehall still directly determines almost 60 per cent of local government budgets and national rules and regulations mean there are central government controls over much of the remaining 40 per cent.

**Change in sources of local government funding under localism agenda**




So whilst the onus is on local government to deliver local services and support economic growth, it still lacks some of the resources, tools and freedoms to deliver the growth the country needs. In fact, Council Tax and a portion of Business Rates (the only locally raised and retained taxes) account for only 18 per cent of local government budgets on average in 2013/14.

Government is taking strides to give local authorities more power over their budgets. Business rates retention, for example, lets local authorities retain more money in their area by growing their commercial property base from 2013/14. But the sums are rather small - less than they earn from sales, fees and charges for services.

Crucially, many of the enhanced powers local government has gained are often counterbalanced by their requirement to deliver nationally-set statutory services. Thus, local government has gained freedoms more in name than in practice.

**This paper explores 10 key issues which are critical for understanding the state of local government funding and power.**

- Local government has limited financial control over the public services it delivers.
- Budgets are organised by administrative boundaries rather than reflecting the 'real' economy at city-region level, making it harder to respond efficiently to local economic needs.
- Central government determines the funding for the majority of local authorities' budgets.
- National government exercises varying degrees of control over how local government spends grants.
- Local taxes, like Council Tax, are a small portion of local government budgets; Council Tax is less than 15 per cent of budgets on average.
- Councils spend most of their money on nationally-set statutory services, with limited flexibility available to spend money according to local priorities.

*"Greater localism and freedom could lead to greater disparities among places in the short-term"*

- Government is giving local authorities more power as well as taking some away, such as requiring referenda for Council Tax raises.
- Newly-localised funding through business rates retention provides a small pot of funds and minimal growth incentive for local government.
- Local councils rarely benefit financially from being more efficient; cost savings or additional revenues often accrue to HM Treasury.
- City Deals, the Heseltine Review and Community Budgets are all promising, but on their own they are too limited in scope and scale to drive the economic growth the country needs.

In order for local authorities to fulfil their charge of delivering economic growth, budgets and services need to be better coordinated in two ways: first, across departments and second, across administrative boundaries.

**Budget and service silos hinder the design and delivery of efficient, joined-up services.** Artificial borders between departments do not reflect the real economy, or the way people live their lives. Without means and reason to take into account knock-on impacts from one service onto another (like skills impact on worklessness or cycling programmes' impact on both reducing congestion and improving health), local government is not able to coordinate their funding and services to reflect how the real economy works.

In addition, because much of local government budgets are centrally-determined, authorities do not benefit by being more efficient. Instead, joined-up services and new ways of working often create savings and new tax revenues that accrue to Whitehall departments. This makes investing in better services unsustainable, as local government bears the cost while Whitehall benefits.

**Better coordination across authorities on economic issues is needed so that budgets reflect the geographic coverage of the local economy.** Businesses, workers and residents do not operate within one local authority's boundaries; they commute, consume, and work across several authorities on a day-to-day basis. Thus, planning, coordinating and funding programmes that support the economy should reflect economic geographies rather than administrative boundaries.

As localism brings further devolution of powers to local governments and cities, the evidence in this report suggests that:

- Better coordination is needed across central government department budgets, breaking down silos to improve outcomes and use resources more effectively.
- Greater devolution of financial freedoms would result in services that adapt to local economic need and are likely to better support economic growth.
- Councils' focus on economic development will become more important as funding is localised, meaning authorities will rely more on local economic growth for budget increases.
- Greater financial coordination is needed across local areas to fund services that match economic geographies.
- Greater localism could lead to wider disparities between places in the short-term. One way to mitigate this risk is to support more collaborative governance structures across and within local government.

*"Whitehall and local governments alike should take on the challenge of coordinating their budgets across borders and beyond silos"*

## Introduction: Power and control in public services

In the drive to manage the deficit, national government continues to cut spending, leaving local government with fewer resources to provide local services. At a time when demand for statutory services such as adult social care and children's services is continuing to grow, local government is increasingly facing the need to undertake a fundamental transformation of how it manages its finances.

Yet it is impossible to undertake such a rethink without understanding how local government funding is used and what conditions and controls are attached to it. While there is much research surrounding the sources of local government finance, little evidence exists about control over and use of that funding. This paper aims to fill that gap.

By understanding how cities are funded – with the silos, rules and barriers they face – this paper provides better insight into how Whitehall and local government can continue on the road towards localism and deliver better services more efficiently.

**Cuts to local government budgets have been swift and deep, forcing important decisions to be made around which services should be preserved at the expense of others.** In real terms, revenue expenditure per person dropped 5.8 per cent from 2007/08 to 2011/12.[1] Central revenues for local government will fall from £28.5 billion in 2010/11 to £22.9 billion in 2014/15 – a reduction of almost 20 per cent. At the time of the Spending Review in 2010, grants from government accounted for approximately two-thirds of local government revenues, meaning the cuts are having big impacts on local authorities' budgets.[2]

**More powers have been devolved to local authorities - but not the ability to raise taxes or reduce the level of statutory services provided.** One of the first steps was un-ringfencing grants, reducing the restrictions on what local government can spend their grant money on. In 2011, the Localism Act gave local government the General Power of Competence, allowing them to do anything a normal citizen can do, such as work together to provide services. Notably, though, this did not grant local government the power to raise taxes or reduce statutory services, ensuring austerity measures would not be counterbalanced with new local revenues. So, local government must provide the same services with much less funding from Whitehall.

**Whilst local authorities have been given more freedoms to manage their resources as they wish, their overall resource levels are still dependent on central government.** From 2013/14, local government will raise and retain about 40p of every £1 it spends. In fact, this has risen for 2013/14 with the onset of business rates retention and Housing Revenues Accounts localisation. These revenue streams were previously collected locally, pooled at the centre, then redistributed based on complex formulae. But, councils still cannot set the business rate and face regulations on how some locally-raised monies are spent.

The Government's two key agendas, austerity and greater localism, have shed light on two issues at the crux of providing efficient and effective public services: how the money is raised and the degree to which resources can be flexed to meet local needs.

Locally-raised revenues used for local services should – for the most part – be under local control, with checks and balances through local democracy. But, even those revenues that local authorities raise themselves – from Sales, Fees and Charges, for

1. DCLG. (2012), *Local Authority Revenue Expenditure and Financing, England 2011-12 Final Outturn,* London: DCLG
2. DCLG. (2011), *Local Authority Revenue Expenditure and Financing, England 2010-11 Final Outturn,* London: DCLG

*"Local government needs new flexibilities, freedoms and ways of collaboration"*

example – come with rules set by central government. Other funds are passed on to councils from central government, but the rules about what they can be spent on are stricter and sometimes ringfenced (meaning local government has pretty much no control over them). It is only a very recent development that central government has loosened control over how local monies are spent, cutting the number of smaller, ringfenced grants by almost 90 per cent since 2008/09.

**The financial and management challenges for local government give rise to three imperatives for improving public services, especially in a time of austerity.**

1. Whitehall's rules, regulations and limits on how local government can raise money and spend its budgets impedes a local area's ability to raise and use funds to meet local needs. Government also sets statutes on the services local government must provide; given a set budget, this further reduces the freedoms local authorities have to provide non-statutory services that support economic growth.
2. A lack of collaboration among Whitehall departments with local government means that addressing the day-to-day needs of a city can be quite challenging. Spending on one service often has knock-on effects for other services, and these cannot be budgeted for or managed well without proper coordination and planning. This is not happening systematically.
3. Administrative boundaries rarely align with those of the city-region, meaning budgets do not align with the functional economic area. Thus, coordinating skills investment to boost jobs, for example, can be difficult.

Localism will not be an easy road to go down for central or local government. Moving from being one of the most centralised countries in the OECD requires devolving money, power and responsibility systematically to ensure the right powers are being transferred and under the right conditions. More local autonomy brings challenges for central government, which needs to join up across departments to make this work. It also brings more risks for local areas. As more of local government's resources and powers are devolved, they will face a steeper risk-reward structure. In other words, the more reliant an authority is on its local tax base for its total budget, the more likely it is to see higher volatility in the council's funding.

This report serves as an evidence base for Whitehall and local government leaders to understand how localism and devolution have brought about change in local government finance. Rather than being policy-prescriptive, this research provides insights into:

- How local government is funded and the rules associated with various funding streams.
- The relationship between local government resources and administrative geographies.
- The challenges associated with funding services across economic geographies.
- The challenges and opportunities for expanding Community Budgets and breaking down silos.
- The future direction of local government finance reform.

The structure of this paper is as follows. Section 1 sets out what city governments do. Section 2 outlines where their revenues come from, what that means for control over resources and spending, and how this has changed under the Coalition Government. Section 3 outlines the implications of the Government's changes to local government

funding. Section 4 discusses how local government can do more with less with increased flexibility and joined up services, and the final section explores the progression of localism and city budgets in the future. Throughout the paper, common misconceptions of how local government works are set out and explored to highlight the complexities and challenges of the local government funding system.

*"More local resource and management control can make services more responsive to local residents' needs"*

**Box 1: Why should services be provided at the local level?**

The localism debate is not about "national government bad, local governemnt good." Neither total centralisation nor complete localism will provide the best governance for cities. Instead, government needs to be working towards providing powers and governance at the right levels of government.

**Accordingly, government budgets should be provided at a scale that is suitable for their effective provision.** For example, strategic networks (like railways) and services of national interest (like national security) are best managed by administrations with wider geographic coverage. Where policies have impacts on multiple cities, national government is best-placed to manage the policy response.[3] But, many services, such as skills provision, require bespoke responses from government that are best managed at the local level (to fill skills gaps of local employers, in this example).

Different cities have different economic needs, and localism recognises the importance of adapting policies to varying needs. The Review of Sub-national Economic Development and Regeneration stated that working at the sub-regional level supports economic development.[4] At the moment, too much control for local services lies in the hands of Whitehall rather than in the hands of authorities that are closer to the people they serve.

**Providing services at the local level can help coordinate services better.** Devolution of funding and powers can make it easier for local government to join up funding streams, remove duplication and prioritise services that matter most to residents – saving money that can be reinvested in other local services.[5]

**More local resource and management control can make services more responsive to local residents' needs.** Giving local government more power brings government closer to the people affected by services. Local approaches to services are often more democratically accountable and respond more to local needs, tastes and preferences.[6] In addition, there is more place-specific knowledge within local decision-making bodies, so local government officials can respond more effectively to residents' and businesses' needs. As a result, public service decision making is more closely aligned with local preferences.[7]

3. DCLG. (2006). Why Place Matters and Implications for the Role of Central, Regional and Local Government Economic Paper 2 London: DCLG
4. Shaw K & Greenhalhg P. (2010). Revisiting the 'Missing Middle' in English Sub-National Governance. Local Economy Volume 25 Nos 5-6, pp 457-475.
5. HMT. (2009). Operational Efficiency Programme: Final Report. London: HMT.
6. Rodriguez-Pose A & Ezcurra R. (2010). Is Fiscal Decentralisation Harmful for Economic Growth. Evidence from the OECD Countries SETC Discussion Paper 2. London: SERC
7. For more exploration see: Oates W (1999), 'An Essay on Fiscal Federalism,' Journal of Economic Literature, XXXVII, 3 Nashville: American Economic Association; Azfar O et al (2009), Decentralisation Governance and Public Services, Maryland: Centre for Institutional Reform and the Informal Sector

*"From improving education to bin collection, Government plays a big role in our day-to-day lives"*

## 1. What do city governments do?

**Government plays a big role in our day-to-day lives, but most people do not know who within government is responsible for different services.** This raises many challenges in ensuring accountability, feedback, and efficiency within government. Therefore, this report begins with outlining the complexity of knowing who is in charge of the things that matter to citizens and business.

Public services are – for the most part – either provided through central Whitehall departments, local government, or agencies and organisations that receive government money. Each of these providers offers different levels of citizen-responsiveness and accountability. Thus, *who* controls *what* matters for the quality and efficiency of services as well as how services are coordinated across government departments – for example, providing public transport that supports people accessing jobs.

**Myth #1: Local councils have control over all of the day-to-day public services their residents use.**

**Local government's control over local services varies widely, depending on the service and who funds it.** Two examples – education and housing – demonstrate the range of powers local government has over managing services. Education is largely outside the hands of local government (Box 2). On the other hand, the funding and management of housing services is shared between Whitehall and local government (Box 3).

**Box 2: Schools funding and management**

**Government services are a tangled web of funding and management, that are not easy to unpick**. Education is a great example of this.

- Government controls the amount of money spent (total budget) and sets policies and standards.
- Local government manages school places and closings, transportation and school support.
- Schools manage their performance, budgets, staff, and premises.

Recent reports have detailed a nation-wide £3.5 billion shortfall for school repairs and maintenance. Many residents may turn to the local authority about the poor condition of school buildings, but these services are largely under the control of each school with budgets from Whitehall.[8] Schools "manage their budgets; many employ their own staff, own the land and buildings and only come into contact with the LA [local authority] when they choose to make use of our [the authority's] services."[9]

**Box 3: Funding structures for local housing provision**

**Housing is an example of the complicated system of financial and management control over local services.** Local government needs to ensure there is enough quality and affordable housing to meet its residents' needs as well as the infrastructure to support housing growth. Local government also collects money through Council Tax, which is used to pay for a wide variety of services that support

8. Publicservice.co.uk, Schools repair budget is "£3.5 billion short," accessed 12 April, 2013, http://www.publicservice.co.uk/news_story.asp?id=22671
9. Essex County Council (2012) 'The role of the local authority,' accessed 10 March, 2013. http://www.essex.gov.uk/Education-Schools/Schools/Delivering-Education-Essex/Pages/The-Role-of-the-Local-Authority.aspx

*"Local government tries to ensure there is enough quality and affordable housing to meet its residents' needs"*

housing and living in the area. But, much funding for housing comes from central government, and they are passed on to local government for specific purposes. Figure 1 below shows where money comes from to support housing.

**Figure 1: Funding services for housing**

| Funding stream | Funding source |
|---|---|
| Housing Benefit and Council Tax Benefit Administration Subsidy | DWP |
| Housing growth & Housing Market Renewal Transitional Fund | CLG |
| New Homes Bonus | CLG |
| Council Tax Freeze Grant | CLG |
| Council Tax Benefit: subsidy | DWP |
| Discretionary Housing Payments (DHPs) | DWP |
| Mandatory Rent Allowances: subsidy | DWP |
| Mandatory Rent Rebates outside HRA: subsidy | DWP |
| Rent Rebates Granted to HRA Tenants: subsidy | DWP |
| Housing Acts Urban Developments: contribution towards cost of loans | CLG |
| Rural Community Action Network (RCAN) | Defra |
| Other grants within AEF | Various |
| Other grants outside AEF | Various |
| Council Tax | LA |
| Business Rates | LA |
| Local Services Support Grant (LSSG) | CLG, Defra, HO |
| Revenue Support Grant | CLG |

The remainder of this section sets out what local government does – in broad categories – and the implications of the level of power they have over their services. Ultimately, this highlights the challenges for achieving greater levels of efficiency in service provision, especially for interconnected services that cut across government departments and work through administrative boundaries to a city-region level.

## Services in cities: who does what?

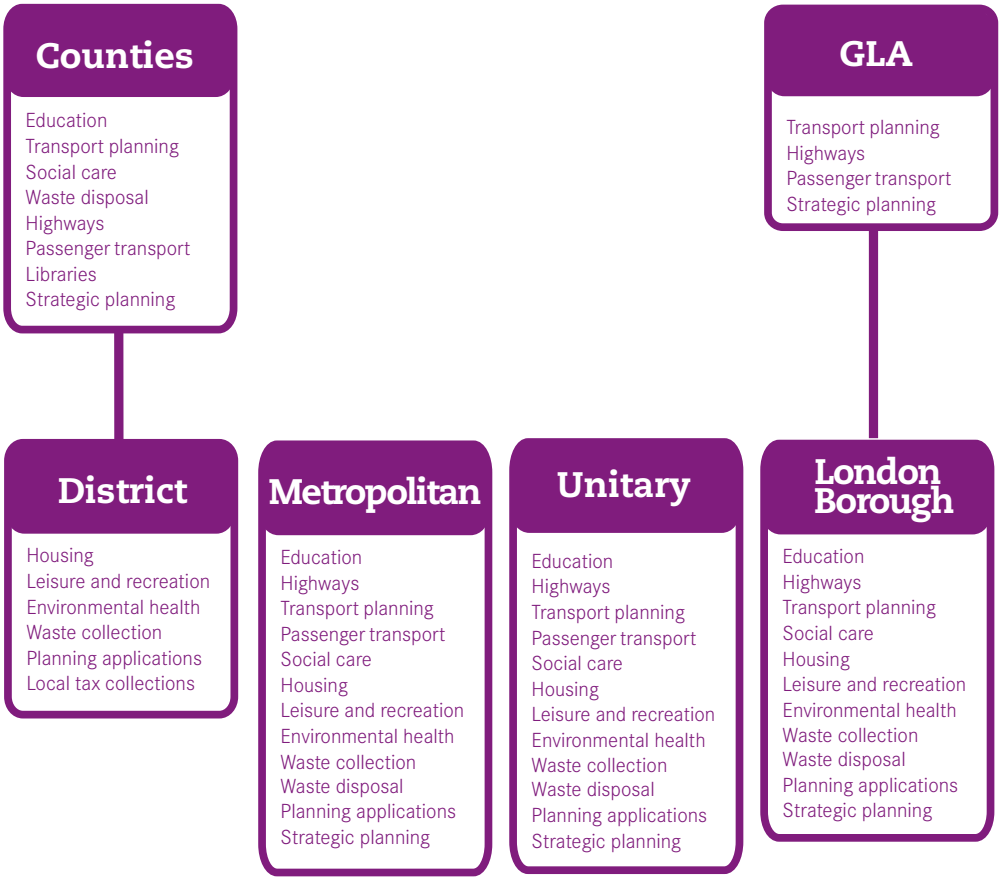
**Myth #2: Local government budgets coordinate across authorities to provide services for city economies.**

**Different local authorities have different responsibilities for providing services (Figure 2).** Some authorities are Metropolitan Districts and Unitary Authorities, which do anything and everything local government can. Other authorities are Shire Districts, which have some responsibilities, such as housing, planning applications and leisure and recreation, but they also work with their Shire Counties to provide wider, cross-cutting services.

**The variation and complexity around which services are provided by different authorities is heightened when thinking specifically about UK cities.** Cities are often made up of several authorities of different types – Shire Districts, Unitary Authorities and Metropolitan Districts – and rarely have single budgets for providing services. This is important because it means that the administration of budgets often does not coordinate services across functional economies.

*"Local authority boundaries do not always align with the real economy"*

**Figure 2: The responsibilities of local government by administrative type**

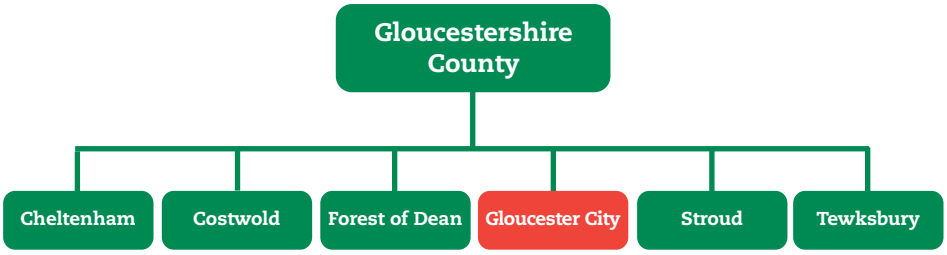



## What administrations make up cities? Three examples of matching administrative and economic geographies

Gloucester, Manchester and Blackpool illustrate how administrative boundaries do not necessarily align with a functional economy and what that means for organising budgets across authorities.

**Some cities' budgets are largely under the control of an upper-tier authority, like a Shire County.** The city of Gloucester, for example, is a single Shire District covering the Gloucester local authority, but most of the responsibility for those services supporting economic growth (like transport, strategic planning and social care) lie in the hands of the County. This has two major implications.

**Figure 3: Gloucestershire County Council structure**



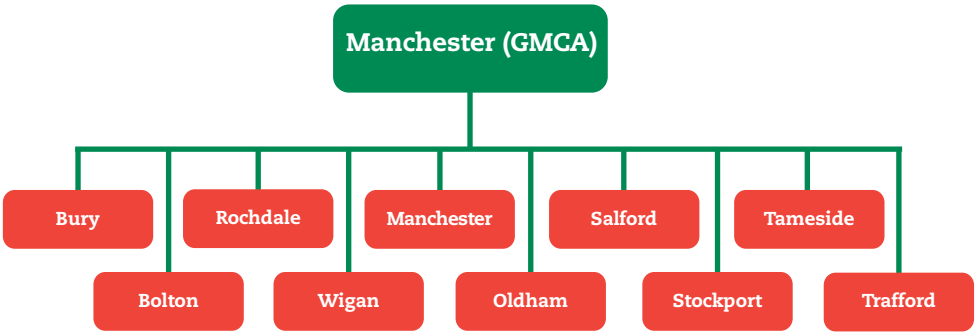

First, Gloucester must automatically transfer over 40 per cent of its income to the County as Council Tax transfers to fund those services. Thus, its locally-raised and retained income is relatively small compared to its tax base, and the costs and benefits of tax revenue and spending may not be aligned at the local level.

*"Some cities are made up of Metropolitan Districts and Unitary Authorities, which do anything and everything local government can"*

Second, Gloucester's resources are spent by the County Council, which must balance its urban priorities with the suburban and rural needs of its five other districts. While districts and counties may have the same aspirations, that may or may not translate into collaboration to the same end.

**Some cities have much more control and coordination between their local budgets and services.** In Manchester, for example, each of the authorities that comprise the Greater Manchester Combined Authority (GMCA) are metropolitan districts. This means each authority has management control over the same set of local services. These authorities are able to retain the majority of their locally-raised Council Tax and retained business rates, which aligns the incentives that promote economic growth. As a result, the authorities in Manchester are in a stronger position to support economic growth through the management of services from skills to planning to transport.

**Figure 4: Manchester (GMCA) structure**




In addition, GMCA coordinates city-region development areas such as regional transport, health and wellbeing, planning and housing. This provides for much more coordination among the indvidual local administrations than in many other cities in England.

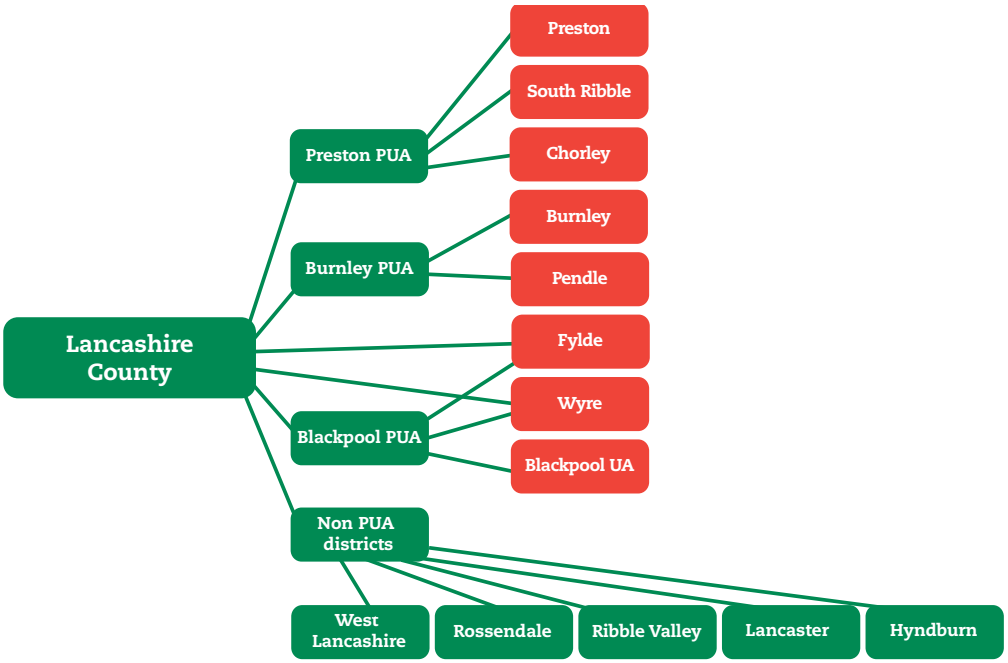
However, these authorities still receive a large portion of their budget via government grants (as opposed to Shire Districts, where it is managed by the county). This means that there are significant elements of their budgets which they cannot grow or always control how the money is spent.

**Other UK cities are comprised of more than one type of authority.** Within Lancashire County, for example, there are three cities – Preston, Burnley and Blackpool, each made up of more than one authority. The first two cities, Preston and Burnley are made up of Shire Districts. With smaller budgets and fewer responsibilities, they rely on the County Council for most major services.

Blackpool, on the other hand is made up of two Shire Districts as well as a Unitary Authority. This means that the County has varying levers to pull to support growth in cities across Lancashire, and coordination within and among cities' budgets is quite complex for each functional economic area. For Blackpool as a city, matching services to the real economy would require budget coordination across Blackpool UA, Fylde and Wye District Councils and Lancashire County.

*"Some cities have much more control and coordination between their local budgets"*

**Figure 5:** **Blackpool and Lancashire**




**Because of their varying administrative makeups, city budgets across the UK look very different from one another**. This makes thinking about how cities invest in their economy and provide services for their residents and workers challenging. But, by looking at some of the overall statistics of local government money, and using examples of Unitary Authorities or Metropolitan districts (which provide all their local services), we can better understand how localism is changing the balance of power for different cities.

*"Where cities' money comes from matters as it determines - at least in part - how the money is spent"*

## 2. Where does the money come from and who has control?

Understanding the remit of local government and how that varies across authorities is just the first step in getting to grips with how localism affects city budgets. This section details how the localism agenda has changed local government funding in both the resources authorities have and the power they have to manage them.

### Financial and managerial control: balancing power at the right level of government

**Myth #3: Local government can decide how it spends locally-raised money.**

**Control over city budgets is exercised in two ways: 1) by those who determine the amount of money and 2) by those who decide how the money is spent.** Understanding who is in control of local budgets is important for knowing where to direct policy change when things aren't going well or who to learn from when things are working well in government. It also highlights where responsibility for coordination and control lies when policy areas intersect – such as coordinating youth centres with apprenticeship schemes to provide skills support.

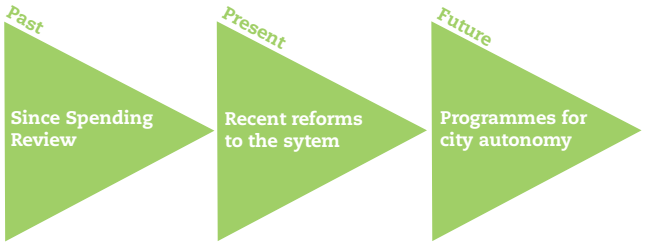
**Where cities' money comes from matters, because it often determines how the money is spent and what it is spent on in the current government finance system.** Local taxes, like Council Tax, provide the most freedom for councils to raise the money they need to spend on the things the local community cares about. At the other end of the spectrum, government grants determine the amount of money available for a local service and how it should be spent.

**Some issues that are important to the performance of city economies have very little input from local government.** It is important to match funding for and managerial control of services at the appropriate level of governance (see Box 1). For example, skills gaps and low GCSE attainment create structural challenges in local economies. But, Dedicated Schools Grant and the Pupil Premium[10] Grant sit outside of local government's control almost entirely, and most of the higher and further education grants sit outside AEF (Aggregate External Finance), meaning local government cannot determine how the money is spent.

### Local government finance: then and now

**There have been some very recent shifts in who has control over raising and managing revenues.** This section first address the system as it has been under the current Government. It then follows on to discuss the new system starting with the 2013/14 financial year (Figure 6).

**Figure 6: Outline for discussion of local government finance**




10. In most cases the Pupil Premium is paid directly to the schools who decide what to spend it on. However, for pupils within low-income families or non-mainstream schools, the local authority decides where it would be best to spend the money. http://www.education.gov.uk/schools/pupilsupport/premium/a0076063/pp

*"Overall, there is a wide spectrum of control over how much money local government has to provide services and how they can spend it to meet local needs"*

## The local government finance system as we knew it: pre-2013/14

**Local government received funds from three main sources: government grants, local taxes and locally-raised sales, fees and charges.**[11] The latter two made up those funds that local government raises and retains locally. At roughly 25 per cent of the total revenue budget for Unitary Authorities and Metropolitan Districts, this means that local government did not have much control over the size of their total budgets – the amount of money they had to work with. Government grants, on the other hand, made up roughly 75 per cent of Unitary and Metropolitan Authority spending budgets.

Counties and service (fire, police, etc) districts receive funding from both central government and local authorities. Counties receive funds from their Shire Districts, mainly as a precept from Council Tax, that pays for services. In Manchester, GMCA provides a range of services, mainly centred on strategic planning and transport. The Greater London Authority receives funding from government and the London Boroughs.

**Because of the funding structure of local government, residents bear a large proportion of the costs of budget increases.** The high proportion of funds received from central government means that, if local government wanted to raise its budget by 1 per cent, it had to increase locally-raised revenues by 3 per cent. Because Council Tax was the only locally-raised and retained tax prior to 2013/14, it was the only tax local government had to increase its income through the tax base. Other income, such as Sales, Fees and Charges that could also be used to raise funds are subject to service provision and can only be used to recoup costs.

***Sources of income and the spectrum of managerial control***

### Myth #4: All local government money can be used in the same way.

Local government revenues can be classified into groups based on the financial and management powers local authorities have over them. Some funds are passed down from central government, and local authorities have little say over how they are used. Other revenues are locally raised, retained and managed by the authority. Figure 7 outlines the spectrum of control government has over different local government funding streams.

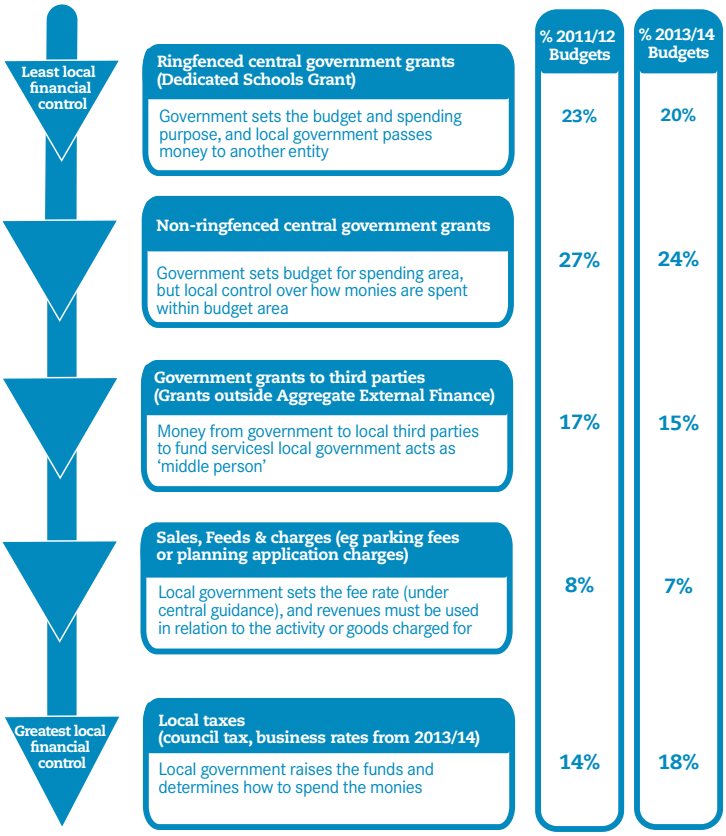
**Ringfenced government grants are largely out of local government's control, accounting for 23 per cent of local government spending in 2011/12.** Education and public health are some of the highest spending areas for local government, but they have relatively little say on the size of their local budget or how it is spent.

In the 2010 Spending Review, the Government ended ring-fencing of all main revenue grants from 2011/12, reducing the number of specific grants from government from 90 to 10 (Figure 8).[12] The removal of ring-fencing gave councils greater freedom over the management of money they receive.[13] However, those grants only accounted for approxiamtely £4 billion, with Whitehall holding on to major grants for education and public health, collectively eight times the size. Also, government did not lift the statutory requirements of services local government must provide, so the remit of local government remained the same, with simply fewer lines drawn between funding streams.

11. DCLG
12. HM Treasury (2010) *Spending Review.* http://cdn.hm-treasury.gov.uk/sr2010_completereport.pdf
13. HM Treasury (2010) *Spending Review. Recounted by Cabinet Office Mid-Term Review* (2013). http://midtermreview.cabinetoffice.gov.uk/programme-for-government-update/chapter-4-communities-and-local-government/

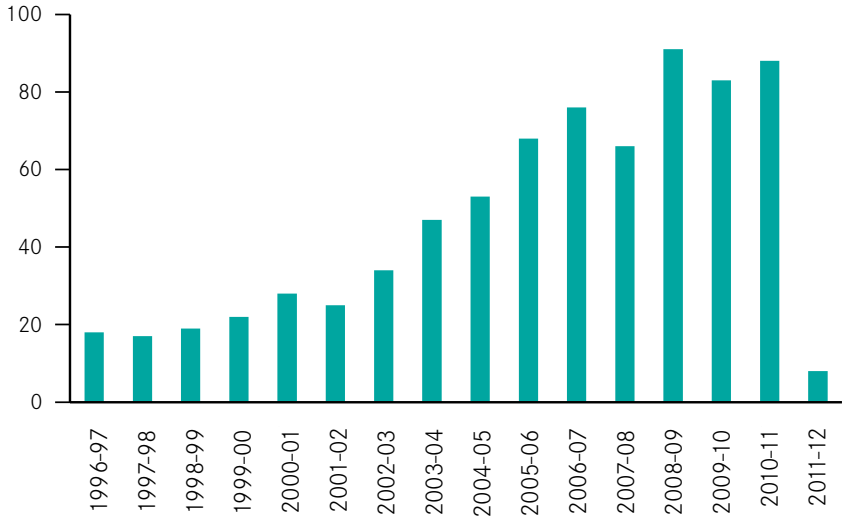
*"The organisation that determines what resources local government has sets the resource constraint"*

**Figure 7: The spectrum of control Government has over local government income streams**




Note: The numbers above do not total to 100 percent. Councils also receive income from interest, investments and transfers from other authorities. In addition, Housing Revenue Account income is included in locally raised and retained income from 2013/14.

**Figure 8: Number of separate core revenue grants to local government over recent history**




Source: DCLG

**Non-ringfenced government grants determine the amount local government has to spend on a service or issue, but they give some freedom as to how it is spent.** They accounted for 27 per cent of local government budgets in 2011/12. Examples of non-ringfenced grants included Council Tax benefit or grants for higher education skills training. Government, in this sense, is mandating money to be spent in a specific amount on a specific service area, but the council is free in how it meets those requirements.

*"Locally-raised taxes are a small part of local government's budget, accounting for just 14 percent across all local authorities in England in 2011/12"*

For example, with reference to the Early Intervention Grant (EIG), Government determined that local authorities can decide the most effective use of funds from EIG and that: *"The EIG can support a full range of services for children, young people and families, which, subject to local decision making, may include: Sure Start children's centres; free early education places for disadvantaged two-year-olds; short breaks for disabled children; targeted support for vulnerable young people; targeted mental health in schools and; targeted support for families with multiple problems."*[14]

**Government grants to third parties are grants from government given to entities outside of local government.** They can still be responsive to local needs, though.

*"Specific Grants outside AEF (Aggregate External Finance) are revenue grants, which are paid to local authorities by individual government departments. However, the local authority usually only acts as the 'middle person', as the grants are passed over to a third party which administers the service. The local authority does not normally have any control over the service for which the grant was intended for. This responsibility rests solely with the third party that receives the grant."*[15]

**Sales, fees and charges accounted for an even smaller amount of local revenues (almost 8 per cent), and they have more strings attached.** Whilst local government can decide which services and goods it charges for, the fees and charges have restrictions (Box 4). First, they must not create substantive profit; they should be set at a price that recoups the cost of providing the good or service. Secondly, that money must be spent on providing the good or service (or repaying a loan on it). Therefore, parking charges cannot be used to fund better parks and public spaces or skills programmes.[16]

**Box 4: Restrictions on setting fees and charges**

Central government controls how councils charge for services. The Audit Commission outlined these principles as follows:

- Councils can only charge for some aspects of services and not others, for example, they can charge for lending audio-visual material from libraries, but not for books.
- Some charges are set by central government, for example, fees for planning applications and alcohol and entertainments licenses; and others are set locally by councils, such as charges for leisure services or car parking.
- In most cases, and especially in discretionary services, councils are restricted to recovering no more than the costs of service provision.[17]

## Myth #5: Most of local government budgets come from Council Tax.

**Locally-raised taxes are a small part of local government's budget, accounting for just 14 per cent across all local authorities in England in 2011/12.** Since the nationalisation of the business rates system in the 1980s, Council Tax has been the single

14. DfE (2012) *Early Intervention Grant FAQs*. http://www.education.gov.uk/childrenandyoungpeople/earlylearningandchildcare/delivery/funding/a0070357/eig-faqs
15. DCLG (2012) *Local Authority Revenue Expenditure and Financing, England 2011-12: Final Outturn*
16. This also limits local government's ability to use fees and charges for incentives to reduce behaviour with negative externalities. For instance, congestion charging to pay for asthma care may be quite difficult, even though car congestion/pollution contribute to respiratory problems.
17. Audit Commission (2008) Positively Charged: Maximising the benefits of local public service charges.http://archive.audit-commission.gov.uk/auditcommission/SiteCollectionDocuments/AuditCommissionReports/NationalStudies/PositivelyChargedREPJan08.pdf

*"There is significant variation in the funding structure of English cities"*

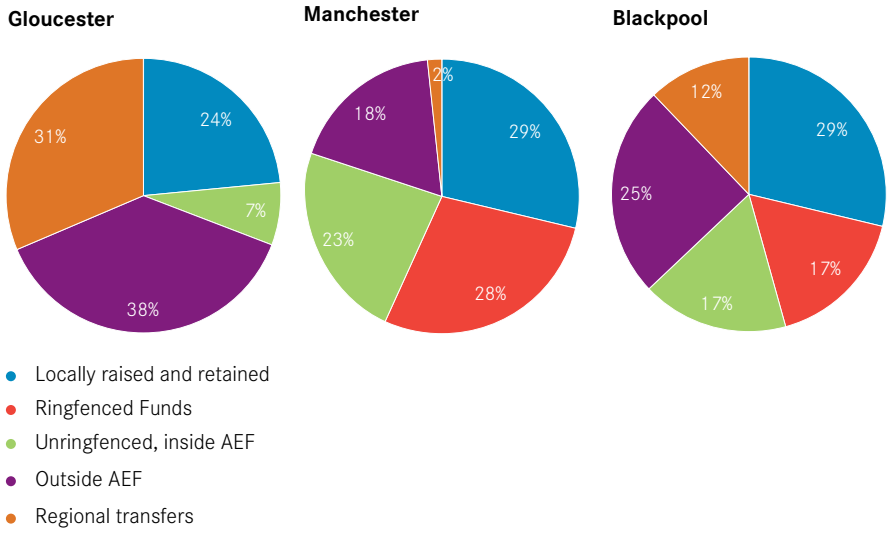
locally-raised and locally-retained tax by councils. In two-tier authorities, Council Tax funds are sent from the Shire Districts to the Counties to pay for services. In turn, local government across England has had very little control over the total amount of resources they can raise themselves, and this puts pressure on Council Tax to meet any budget shortfalls or to fund any new services wholly from the one tax.

**Other sources of income accounted for another 12 per cent of local government budgets.** This includes "income received to finance a function/project jointly or severally undertaken with other bodies. Contributions from other local authorities, value of costs recharged outside bodies including other committees and costs recharged to internal users."[18] In total, these income sources are largely under local control, but they are administrative and service partnerships, that do not allow for much freedom in how they are used beyond re-investing in the assets.

**Depsite raising funds through capital assets, local government cannot use those resources for services.** Managing assets effectively is an important practice for local government, including using capital such as land or property for income. Capital receipts can be used to reduce borrowing or fund new capital investments, for example. However, the sale of local government assets cannot fund shortfalls or additional spending in service budgets. In turn, this constrains local government's ability to develop an asset portfolio that they can use to fund spending on services with long-term growth effects (like transport or skills).

***Variation city-by-city***

**Figure 9: Variable funding structures of cities, 2011/12**

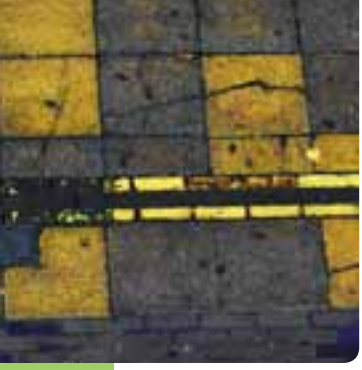



Source: DCLG

**The relative size of the various funding streams in proportion to total revenues varies widely across cities.** Some authorities retain all of their Council Tax, while others pass a portion of it on to an upper-tier County. Some authorities receive ringfenced grants for public health and education, but that remit doesn't fall under Shire Districts.

The variable responsibilities and administrative designations of local authorities comprising cities leads to significant variation in the funding structure of English

18. DCLG (2012) *Local Authority Revenue Expenditure and Financing, England 2011-12 Final Outturn*. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/15336/revenue_outturn_2011-12_final.pdf



*"Council remits determine their funding and how they spend their money"*

cities. This can be seen in the funding of Gloucester, Manchester and Blackpool cities (Figure 9), where government grants (ringfenced or not) account for 70 per cent of revenues in Manchester compared to 45 per cent in Gloucester and 60 per cent in Blackpool.

## How does local government spend its money?

**Myth #6: Councils can spend their money however they see fit.**

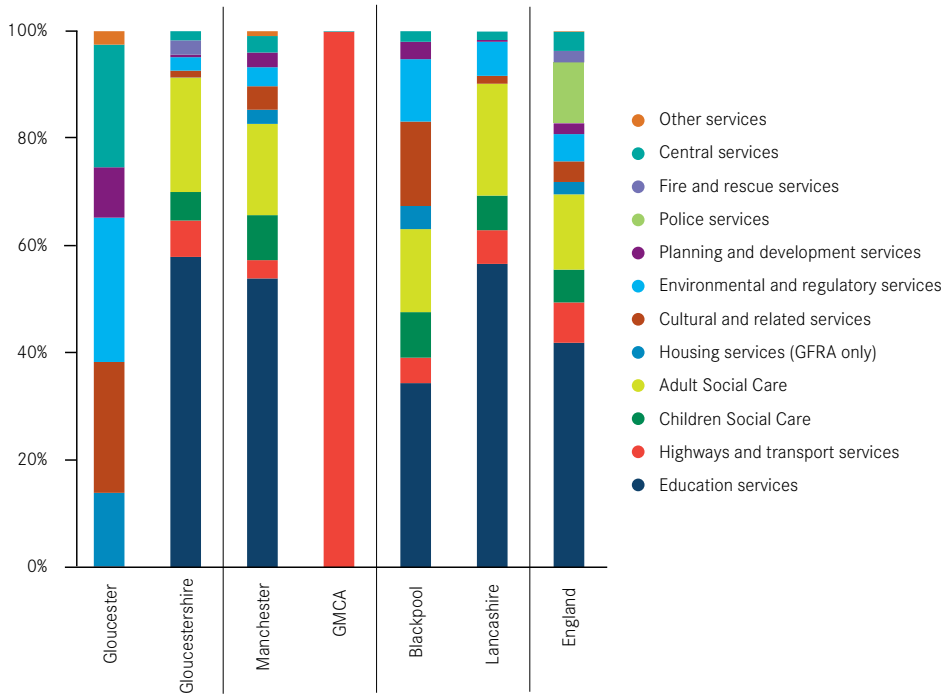
Alongside an understanding of where money comes from, it is important to understand how the money is spent. Just as with resource allocation, this depends on several factors:

- The responsibilities and remit of the local authority;
- The degree of control government has over an authority's funding;
- The local preferences and needs of the council.

Since local government receives a large portion of their revenues from central government – about two-thirds – they are also restricted (to greater and lesser degrees) in how they can spend that revenue to meet a place's needs. This has spurred local government to call for greater autonomy from Whitehall, and the Government has responded since the 2010 Spending Review.

**Council remits determine their funding and how they spend their money.** Shire Districts, for example, do not spend much (if any) on education, because the County Council bears that responsibility. Thus, funding streams and expenditure are intrinsically tied to the administrative responsibilities of councils that comprise cities.

**Figure 10: Expenditure by service type in three types of cities**




Because £42 billion of government grants were unringfenced in 2011/12, there was some additional limited flexibility in how that money was used. Manchester, for example, received a quarter of its budget in ringfenced grants for education, but over half of its spending was on education. Gloucester, on the other hand, receives just over one-third of its income from Council Tax and another one-third in unringfenced grants, so they have relatively more freedoms to spend their money as they wish. But they have a much

*"Local government is often put in the role of middleman"*

smaller remit with basically no spending on education or public health. These trends are illustrated in Figure 10.

## The new budget system: 2013/14 onwards

**Myth #7: Local government has the powers it needs to support economic growth.**

As part of the wider localism and deficit reduction agendas, government has devolved more resource and management powers to local government since the 2010 Spending Review. While some measures, such as the General Power of Competence and introduction of the Community Infrastructure Levy to pay for new roads, health centres and schools have come into effect already, other changes only took effect on April 1, 2013. The changes have both benefits and drawbacks for local government, introducing more control but also more risk into the local government funding system.

***Changes to local government for raising and managing resources***

**Despite the changes, central government still sets the budgets for local government's core functions through grants.** This is known as Aggregate External Finance (AEF) and it allocates funding to local government but allows authorities to determine how it is spent. AEF remains a large portion of cities' budgets, 27 per cent of the total budget in 2011/12, falling to 24 per cent in 2013/14.

The major ringfenced grants (Dedicated Schools Grant, Pupil Premium Grant and Public Health Grant) account for £35.5 billion of public expenditure in local government. As they are ringfenced, the budget is set nationally and utilised directly by local entities, so local government has no control over how those funds are spent. A number of grants were transferred into and out of AEF beginning in 2013/14, giving more funding and responsibilities to local government (Box 5).

**Local government is often put in the role of middleman.** Grants 'outside of AEF' are passed on from local government to a third party which administers the service, and the local authority does not normally have any control over the service the grant is used for. This includes Council Tax benefits, rent allowances and rent rebates to HRA tenants of £22.5 billion. Altogether, these account for £26.5 billion when including higher and further education grants and other grants outside AEF; that's equal to 15 per cent of local spending.

**The Local Government Finance Act has introduced several changes to local government funding and finance.** Some of the more important changes came in the form of local Business Rates retention, localised Council Tax Benefit and the movement of some separate unringfenced grants into the main local government funding stream.

**Myth #8: Business rates retention will transform local government funding and finance.**

Business Rates retention allows local government to retain up to 50 per cent of their locally-raised business rates from 1 April 2013. However, the ability of local government to increase revenues from business rates retention is limited. Depsite the changes, the system remains very complicated, and the growth incentives are unlikely to be strong enough to bring about major investment in local development.

Business rates, like Council Tax, are subject to local transfers to counties, fire and police districts, and so forth. Under the new Business Rates retention scheme, the proportion of business rates that local government retains is 49 per cent for Unitary

*"Government streamlined a number of grants into the main local government funding stream"*

Authorities and Metropolitan Districts and an average of 36 per cent for Shire Districts (after transfers to counties).[19]

Related to this, business rates pooling – a tool proposed to coordinate revenues and reduce funding risk across local authorities – has seen minimal progress and appetite. This stems mainly from insufficient benefits for collaboration compared to the risks.[20]

**Box 5: Transfer of grants into and out of local government control**

In May 2012, the Government announced its intention to streamline a number of grants into the main local government funding stream which were then paid out as individual, unringfenced grants. Beginning in the 2013/14 financial year, the following grants were streamlined:

- Council Tax Support Grant (£3,295 million)
- Learning Disability and Health Reform Grant (£1,413 million)
- Early Intervention Grant, excluding funding for free education for two year olds (£1,079 million)
- A proportion of Greater London Authority Transport Grant (£758 million)
- 2011/12 Council Tax Freeze Grant (£593 million)
- Homelessness Prevention Grant (£80 million)
- Greater London Authority General Grant (£46 million)
- Bus Service Operators' Grant for London (£45 million)
- A proportion of Lead Local Flood Authorities Grant (£21 million)

At the same time, one grant was transferred out of the main local government funding stream from 2013/14. This included the removal of Central Education Services within Authority Central Spend Equivalent Grant. That money is now administered and paid out as a separate unringfenced grant to local authorities and academies. This amounts to £1.039 billion in 2013/14 and £1.029 billion in 2014/15.

DCLG (2013) *Business rates retention and the local government finance settlement: A practitioner's guide (version 3)* London: DCLG

**Another funding reform came to Housing Revenue Accounts (HRA), which have traditionally transferred local authority housing rents to central government and redistributed them among local authorities.** HRA localisation has changed a system of local collection and central redistribution, similar to business rates, to one of local ownership, management and control over a major asset and funding stream. In theory, this should be fairer and allow local government to better manage and invest in their housing. In the future, rents from housing will be kept by the local authority and re-invested in housing.[21]

In reality, Housing Revenue Account localisation is unlikely to change revenue spending much. The transfer of housing assets to local authorities added a total of £13 billion of debt for local authorities, while wiping clean the HRA debt of other authorities by £6 billion. For many authorities, new HRA revenues will be used to either pay off their debts

19. DCLG, National Non-Domestic Rates Return 1, NNDR1 2013-14
20. Wilcox Z (2012) *Urban Outliers: Will the Local Government Finance Bill incentivise growth in all England's cities?* London: Centre for Cities.
21. DCLG (2012) *Housing Revenue Account Self-Financing: Introductory guide for councillors,* London: DCLG

*"The main source of locally raised revenues - Council Tax - has also seen increased control from central government"*

or invest in stock where they had been receiving assistance. Thus, HRA localisation is less about new money or more money and is more about simplifying and clarifying the system, creating a local stream of payments and adding certainty to investing in the local housing stock.

**Council Tax Benefit (CTB) grant has been localised.** CTB grant is provided by DWP to people whose income falls below a certain level; but the funds have been administered by local government. Government is now requiring local authorities to reduce CTB by 10 per cent, but councils are free to choose how the reduction is made (e.g., safeguarding reductions for the elderly or disabled).

**The main source of locally raised revenues – Council Tax – has seen increased control from central government.** For example, the Localism Act requires local councils to put Council Tax rises above two per cent to a local referendum. While this is good for local accountability, it represents further control by central government over local revenues. Together, these measures provide a strong downward pressure on authorities to keep Council Tax low, which reduces their income in real terms.

Another means of central control over Council Tax, the Council Tax freeze grant, encourages local government to refrain from using Council Tax increases to protect services during the austerity and efficiency measures. Government offers a grant equivalent to a one per cent rise in Council Tax if local authorities freeze it. Council Tax Freeze Grant totalled £450 million in 2013/14, but fewer councils are accepting it. In 2012/13, 85 per cent of local authorities accepted the grant in exchange for freezing Council Tax; that number fell to 60 per cent in 2013/14.[22] CIPFA stated this is likely because the rising intensity of the austerity measures has tipped the balance towards protecting services against maintaining tax levels on taxpayers.

**Community Infrastructure Levy (CIL) is a new levy local government can impose on developments to cover the associated infrastructure costs**. Each council sets charges based on the type of development. For example, one London borough, Redbridge, charges £70 per square metre for new residential and commercial developments. CIL offers local government many financial benefits, but it is not without its drawbacks.

The first CILs were initiated in 2011, while many more are still in consultation. The structure of CIL is interesting in that it gives local government more revenue-raising power and management power over resources than they have been granted in a decade. CIL has benefits for local authorities including:

- Giving councils the freedom to determine what the monies are spent on,
- Relatively predictable funding streams, allowing for effective financial planning
- Greater certainty for developers on how much they are expected to contribute, and
- Transparency for residents, as councils report what CIL monies were spent on each year.[23]

CIL should not be regarded as perfect. For example, some developers have challenged proposals from some councils to charge higher levies for larger developments (i.e. superstores).[24] Many developers also argue the up-front payment structure of some CILs

22. Sharman L, 'Nearly half of all councils will reject council tax freeze grant' in *LocalGov.co.uk,* 28 February, 2013.
23. DCLG (2013) *Giving communities more power in planning local development* London: DCLG. https://www.gov.uk/government/policies/giving-communities-more-power-in-planning-local-development/supporting-pages/community-infrastructure-levy
24. Carpenter J. (2013) CIL Watch, Planning. London.

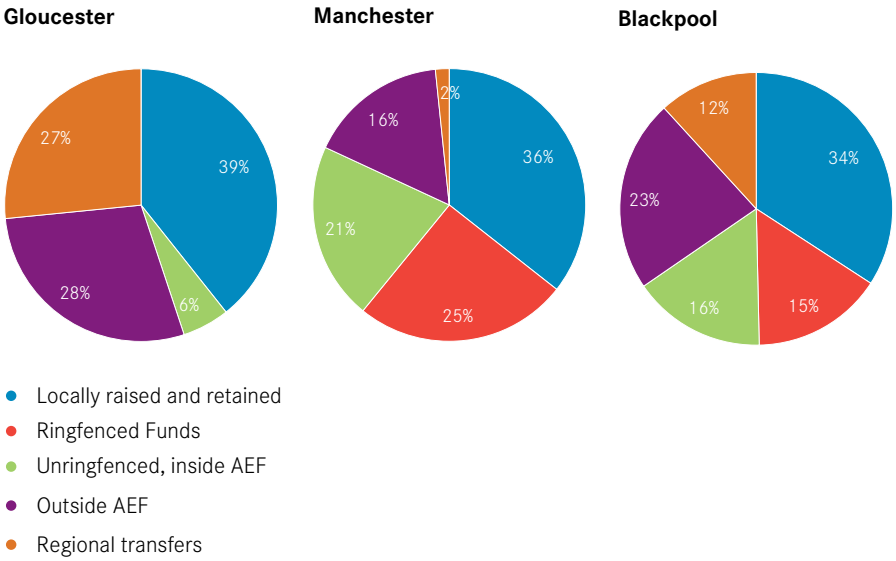
*"As a part of the wider localism agenda, government has devolved more fund raising and management powers to local government"*

require them to bear too much risk in the early stages of a project. Thus, while a new source of revenue, local government should recognise the shortfalls and limitations of CIL.

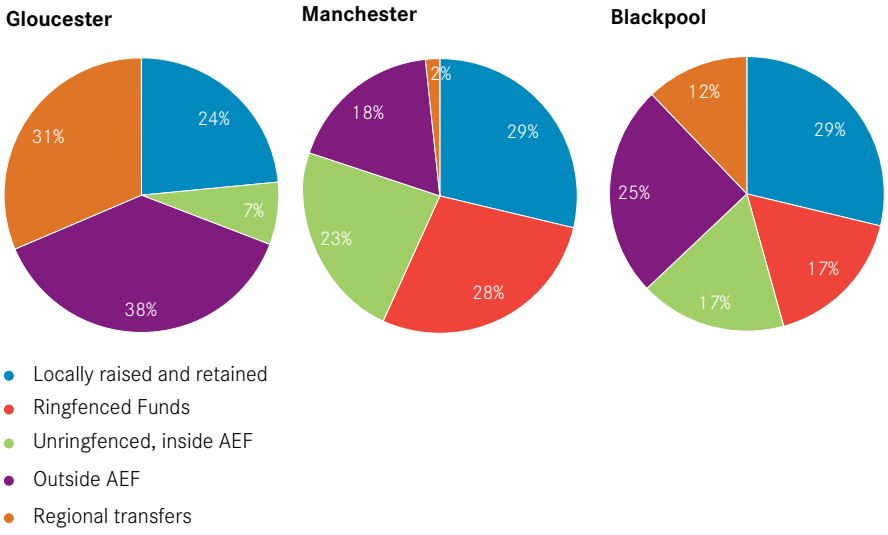
***Have the funding changes re-shaped the structure of local authority budgets?***

Whilst estimating the combined effects of recent funding and localism policies is difficult, the trend towards more locally-raised and locally-retained funding streams with fewer strings attached is clear. Figure 11 shows the change in composition of budgets in the three case study cities. There is a clear increase in the proportion of locally raised and retained monies.

**Figure 11: Proportion of local government revenue by sources of income for three city types, 2013-14 (estimate)**




**Proportion of local government revenue by sources of income for three city types, 2011/12**




Source: DCLG

*"In the UK, there are around 200 established BIDs varying in geographical and member size"*

**Councils are already showing on a small scale that using local funds to support local services can make their money go farther.** In particular, they are partnering with the private sector to support services which improve the local business environment.

Business Improvement Districts (BIDs), which are detailed in Box 6 below, demonstrate the potential for creative solutions and new opportunities for local government and private sector partners to work together when they are given more powers over local services.

**Box 6: Business Improvement Districts**

BIDs are companies created and run by the local business community and aim to improve the local area by focusing on areas ranging from street cleaning to community events to extra security to lobbying. They are funded through a small levy on businesses collected by the local authorities and often supplement this with other sources of income. Being a democratically decided body in terms of creation, exemptions and levy rates, allows local businesses to collaborate and invest in the local area.

**In the UK, there are around 200 established BIDs varying in geographical and member size.** For example, Newcastle's BID*, NE1,* is one of the largest with 1,200 members and has developed a scheme to increase the number of police officers and Street Rangers in the area as well as create a team of Street Cleaners. Croydon's BID has around 600 members within the retail, office, leisure, hospitality and public sectors. Similar to *NE1,* Croydon's BID have channelled resources into extra policing to target business crime and antisocial behaviour. They also run community and family-friendly events in order to try and improve community cohesion as well as highlight the cultural and historical roots of Croydon.

Other forms of locally-focused initiatives should be encouraged to allow local businesses and residents to co-fund services they want in order to improve their community and business environment.

**On a larger scale than BIDs, local authorities are beginning to use their locally raised and retained resources in new ways.** Some councils are combining funding streams to make their money work harder. For example, a few councils are examining how business rates retention could be used with CIL and New Homes Bonus to do more than the funding stream could achieve on its own. By bundling funding streams together, councils can achieve more with the same amount of money through creating economies of scale and reducing risks and transaction costs.

Finding new ways to use public resources to leverage private finance has become a challenging and important task for local authorities across England. There are challenges associated with bundling the various funding streams, particularly in managing volatility and uncertainty as well as building the expertise to navigate the financial frameworks. Because of this, some councils have become much more advanced than others in managing new funding options. With the new resources and powers local government has gained, local authorities are beginning to develop novel ways fund and manage services.

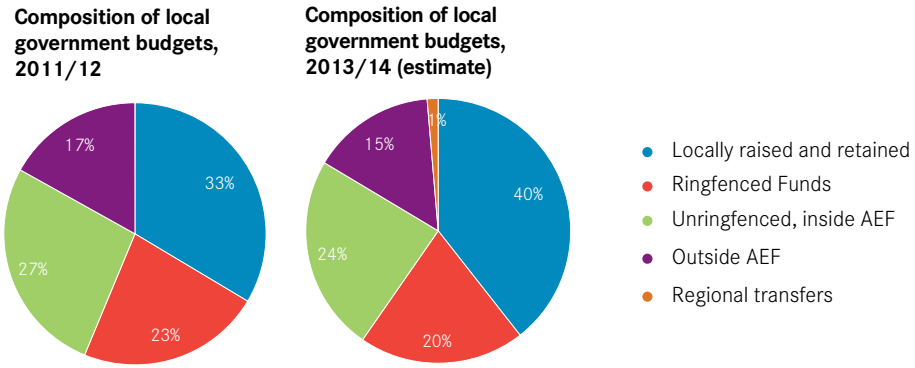
*"Government's reforms have increased the portion of local government budgets that are locally-raised and retained"*

## 3. Implications of localising funding

### Local authority budgets are now more reliant on their local tax base

**The cumulative effect of Government's reforms has increased the portion of local government budgets that are locally-raised and retained. In turn, the relative importance of central grants has fallen (Figure 12).** Local taxes now include retained Business Rates as well as Council Tax and now comprise a larger share of local government budgets up from from 14 to 18 per cent. But, with increased local funding comes increased responsibility. Many of the services central government provides are being transferred to local government through the Local Government Finance Bill, including administering Council Tax Benefit.

**Figure 12: Sources of local government funding due to changes**




### Localising funding brings more financial risk and reward potential

**A more localised approach to funding will mean cities will bear more financial risks, but that flexibility can produce greater rewards.** The volatility of different income streams for local government varies widely. For example, Council Tax revenue will rise or decline over the longer term in response to population change, which suggests it is a relatively stable revenue stream.

Business rates, on the other hand, are more volatile, as churn can be quite high, because the loss of one big firm could lead to a large reduction in business rates. 50 per cent of business rates are retained from 2013/14, meaning places that show a worsening economy will be hit through decreased revenues. However, this additional risk needs to be weighed against the potential for greater rewards for the local area.

**Other growth-dependent funding schemes will compound the impacts felt from locally-raised income streams.** New Homes Bonus and CIL , for example, will suffer in sluggish economies as both income streams are predicated on growth. Lower CIL revenues could have the knock on effect of less funding for infrastructure needed to support commercial and residential development, which could have negative effects on growth.

Figure 13 outlines the relative size of different revenue and expenditure streams at the local level and the risks and rewards authorities will likely experience during periods of economic decline or growth.

*"Revenue volatility will have an impact on expenditure"*

**Figure 13: Localised income and expenditure, compounding risks and rewards**

| | Proportion of budget (%) | Strong economy | Weak economy | Short run volatility |
|---|---|---|---|---|
| **Revenues (2013/14 estimates)** | | | | |
| Council Tax | 13 | Increase | Decrease | Low |
| Business rates, locally-retained after transfers | 5 | Increase | Decrease | High |
| Sales, fees and charges | 7 | Likely Increase | Likely Decrease | Medium |
| HRA | 5 | Uncertain | Uncertain | Low |
| Other, Interest & investment income | 11 | Uncertain | Uncertain | Low |
| **Revenue outturn (2011/12)** | | | | |
| Child and adult social care | 23 | Decrease | Increase | Low |
| Housing benefit | 13 | Decrease | Increase | High |
| Police services | 10 | Decrease | Increase | High |
| Central services | 3 | Increase | Decrease | Low |
| Environment | 4 | Increase | Decrease | Low |
| Highways | 5 | Increase | Decrease | Low |
| Planning | 1 | Increase | Decrease | High |
| Cultural | 3 | Increase | Decrease | High |

**Local authorities are working to identify and mitigate these risks as revenue volatility will have an impact on expenditure.** In a weak economy, lower revenues will mean less money to spend on local services. So, either efficiencies have to be sought or cuts will have to be made. While this may pose problems for people who are impacted by these cuts, it could be mitigated by greater flexibility for local authorities in how they spend their money.

**Places with weaker economies or wide-ranging social issues receive relatively more government grant but have fewer freedoms around how they use those resources to address local service needs.** These central grants target specific issues, and so have greater conditions attached to them. In turn, these grants may reduce the flexibility in how the money is spent to address social issues. For struggling places, ensuring flexibility in how funding is used could help target specific local issues in a more efficient way and help them adapt grant programmes to local needs.

**In contrast, places with stronger economies tend to raise and retain more of their revenue, giving them relatively more freedom in how they use their funds.** Putting greater emphasis on raising and retaining local revenues provides opportunities for greater rewards both in terms of revenues raised and better alignment between revenue income and expenditure. However, it also makes those cities' budgets succeptible to short-term volatility due to the nature of local funding streams.

**Because localism of funding means more self-funding, local government will need to focus more on supporting economic development.** Greater proportions of funding will come from local residents and businesses in the future, and increasing local

*"The challenge lies with the powers local government has to shift funding towards growth"*

government budgets will be more predicated on economic growth in places. Thus, now more than ever, local government is challenged with finding the right balance between spending on social care and spending on economic development that will support future growth and, ultimately, future budget growth.

Because local government has fewer resources to provide services as well as rules around how revenues are spent, councils may need to reduce their investment in non-statutory economic development services. For example, the main means of local government borrowing for development projects comes through prudential borrowing from the Public Works Loan Board. Historically, these loans have been repaid via capital receipts, hypothecated savings or revenue growth. But, central government's restrictions on how local government spends its capital revenues and how councils benefit financially from working across silos restricts their ability to repay any loans based on future income. These revenue income decisions, thus, have a direct impact on whether local government has the means to invest in capital projects to support growth.

**In order for local government to be able to pay for the up front costs of economic development services, authorities must be able to retain some of the financial benefits of growth over the longer term.** Currently, local government has no means to recoup those initial costs. If investing in shared services is going to be a sustainable way forward, local government needs a mechanism to capture the benefits of their investments. Else, local authorities will not have the future resources to invest in their local economy, with the additional costs accruing to Whitehall.

Ultimately, the challenge lies with the powers local government has to shift funding towards economic development in the short-term. The barriers can be either self-imposed (to please current residents with social services) or from Whitehall (because they do not have the freedoms and tools to do so). Either way, places experiencing negative or no growth will face an uphill battle in providing the services residents need and expect because they will have fewer freedoms around the way they use their funding to address local need.

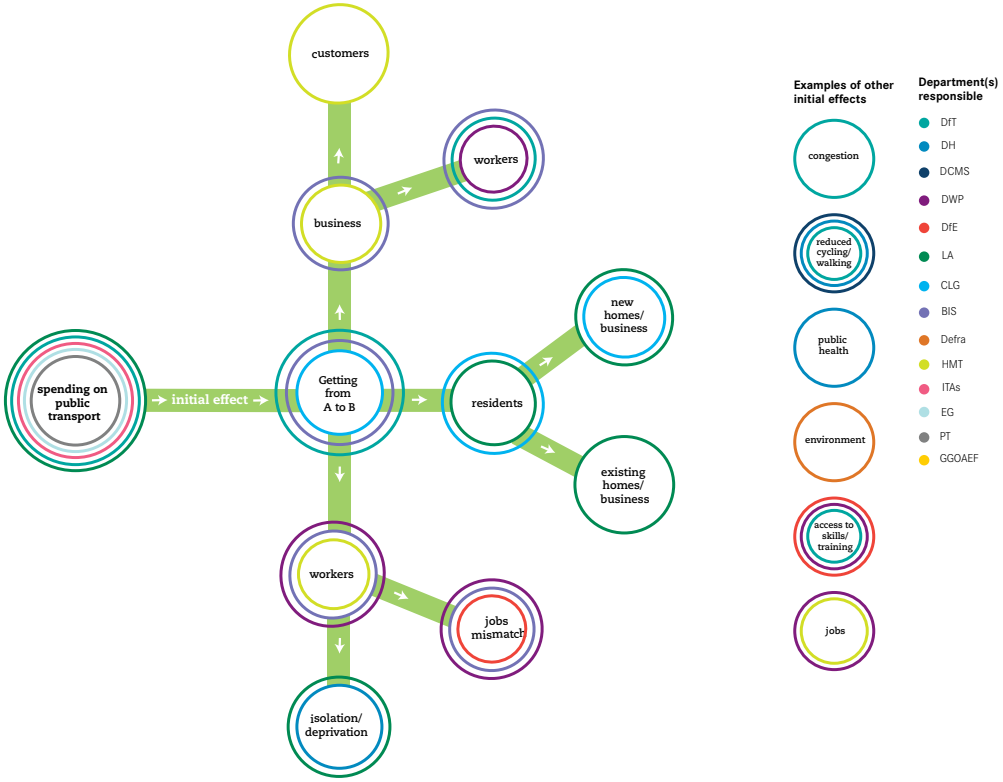
*"The Government's localism agenda has highlighted the challenges of providing services efficiently and effectively at the local level"*

## 4. Doing more with less: the importance of increasing flexibility and joined-up services

### Uncoordinated funding and services

**Working across government silos reduces duplications and minimises service gaps for local government.** Decisions taken by one government department has a ripple effect across other departments and local government. Figure 14 shows how local transport spending affects citizens and businesses in many different ways. Reduced spending on cycle lanes, for example, could increase public health issues and congestion; this would have an impact on the budgets and programmes of local authorities, the Department for Health, and the Department for Transport among others. But without coordination across these decisions, the ripple effects can be difficult to mitigate and manage.

**Figure 14: The knock-on effects of spending cuts across Government, businesses, and citizens: example of public transportation**




**The Government's localism agenda has highlighted the challenges of providing services efficiently and effectively at the local level.**

The structure of local government funding has historically reflected silos in government. This silo approach to funding and governance has, in turn, created institutional norms of siloed working and thinking throughout government, both in Whitehall and local authorities. The lack of coordination of funding and thinking about the interconnectedness of policies and programmes creates challenges for providing public services.

**Budget silos are a problem because they often result in uncoordinated services, which leads to inefficiencies, duplication, and gaps in services provided.** This is recognised in the Troubled Families Initiative, which is trying to join

*"Budget and management silos make coordination across departments difficult"*

up services for high-risk, high-cost families. The Initiative notes the system of funding and services currently in place has:

- High costs with overlapping interventions from multiple organisations
- Complexity and confusion among service providers
- Service users falling through the gaps
- Emphasis on reactive rather than preventative spending
- Poor data collection and management (including costs and outcomes data)
- Disincentives to invest because the benefits of up-front spending accrue across different public entities rather than to the local authority.[25]

But, these challenges are not unique to the Troubled Families Initiative. The Whole Place Community Budgets programme seeks to resolve similar issues across a range of local government services.

**Myth #9: By being more efficient and saving money, local government is financially better-off.**

**The mismatch between cost-saving investments and where the returns accrue are at the crux of tensions in government finance.** Joined-up service provision and budgeting requires up-front investments and coordination by local government, not to mention new systems and ways of working and new skill sets for public sector employees. However, the benefits often accrue to Whitehall departments as cost savings or reduced demand do not get passed on to local government to help them recoup their original investment.

For example, Essex County Council initiated a new employment and skills programme to better match training programmes to local job demand. Local government set up an Employment and Skills Board, bundled new funding streams, created a new coherent vocational programme, and supports better data collection and management. However, the benefits of the initiative will mostly accrue to Department for Work and Pensions with additional savings for Home Office, Department of Health, Ministry of Justice and Department for Education.

## How authorities are breaking through silos

**Budget and management silos make coordination across departments difficult.** Those families identified in the Troubled Families Programme use a larger proportion of resources for education and early years learning, crime and justice, health, welfare and protecting children programmes within Department for Health, Department for Workplace Pensions, Department for Education, Home Office, Ministry of Justice and local authorities. Budgets within these departments are kept separate from one another, and they are not necessarily coordinated within or across central government departments or at the local level.

The up-front costs of intervention with troubled families are borne by local government, and they often have no additional resources to tackle the challenges. A typical troubled family intervention costs £10,000, a cost which local authorities are absorbing at the same time as central funding grants for working with troubled families is falling.

25. HM Government and LGA (2013) *Local Public Service Transformation: A guide to whole place community budgets*

*"More needs to be done to reap the benefits of joined up services"*

The benefits of coordinated intervention, on the other hand, accrue to central government. If the intervention works, estimates show savings of £20,000 to £30,000 per year, most of which would accrue to central government and would actually result in a reduction of local governments resources (as they are based on need). It is easy to see that this could quickly become an unsustainable model for local government.

The siloed and centrally-set nature of government department funding often prevents local authorities from pooling funding that covers multiple governmental objectives. There is a need to bring local and central government together on allocating and managing funding to introduce more efficient and innovative ways of managing budgets.

**More needs to be done beyond the Troubled Families Intiative, on a larger scale and with wider scope, to reap the benefits of joined-up services. There have been incremental stepping stones in the drive towards localism.** After decades of centralisation, there is an appetite within local government and some areas of Whitehall to pilot new programmes and to encourage and incentivise local areas to take on greater responsibilities and funding in order to find efficiencies.

*"A joined-up approach to governance is the underlying theme of localist policies"*

## 5. What next: moving towards greater financial autonomy

### More coordination is needed between Whitehall departments and with local government

**A joined-up approach to governance is the underlying theme for many localist policies on the Government's agenda.** Though they vary in their main ambition, Community Budgets, City Deals and Lord Heseltine's recommendations all contain elements of joined-up services and working across silos under a more localist approach to governance. These policies and programmes offer new opportunities for local government to take on more responsibility for their budgets in an effort to support local economic growth. Clearly, both Whitehall and local government see new ways of working as an imperative for achieving innovation and efficiency in delivering public services.

### Policies for greater localism in government services

**Cities are actively working with Whitehall to prove they have the capabilities and willingness to take on the risks for more local control and coordination.** City Deals, Community Budget Pilots and recommendations from the *Heseltine Review* all are progressive initiatives, happening now that will give cities more freedoms over their budgets and overcome some of the challenges outlined in this paper.

***City Deals***

**A prominent means of working to overcome the barriers to funding and management for city growth has been the City Deals process.** The 'Deal' aspect of City Deals has emphasised the need for authorities to change mindset away from asking for more money (as a result of centralisation) towards having the power and ability to "increase their allowance/income by X, Y and Z *in order to do* A,B and C".

**City Deals offer ways for cities to gain more financial freedom and take on more responsibility.** Cities negotiate bespoke proposals with government, so that different options are pulled together into a tailored coherent package for each place. Operating across two rounds, the first of which are being negotiated between the eight core cities and the latter with 20 medium and smaller cities.

**Manchester's City Deal was a trailblazer for designing how cities can increase their resources.** The Earnback Model will allow Manchester to invest up to £1.2 billion in infrastructure which will be 'earned back' in incremental business rates earnings growth. This is freedom to raise more local resources in order to meet the locally-determined needs – the foundation of democratic governance.

**Other City Deals demonstrate how cities can break down the constraints on their budgets to support growth.** Bristol, for example, is taking on more powers for its transport funds to develop a new Metro transport system. Nottingham will provide support to enterprise through access to finance schemes as well as create a Youth Employment Hub to match young people to jobs.

***Community Budgets***

**Community Budgets are a way for local authorities to share departmental budgets in targeting specific community issues.** Following on from the previous Government's ideas on Total Place, the current Government has created

*"Give local government more responsibility over their budgets for those services best delviered at the local level"*

four 'Whole Place' pilots (and 16 Neighbourhood pilots) across the UK with a focus on families with multiple needs.

The idea is to encourage a greater joined up approach within local government by recognising that spending in one department can have positive effects for other departments. The programme incentivises local authorities to find efficiency savings within public service delivery, which will help in the short term as central budgets are cut. In the future, local authorities should be able to retain or claim back the upfront cost in preventative solutions otherwise the incentive will decline.

**The Community Budget Pilots are already seeing cost savings in both administrative efficiency and reduction in demand for public services.** The tri-boroughs of Westminster, Kensington & Chelsea and Hammersmith & Fulham have made strides in reducing re-offending, which requires coordination between Police, Probation Service, Youth Offending Team and the Local Authorities. To achieve their goals, they need government to refocus funding streams and commit to a longer-term and more sustainable approach of funding and financial governance.[26]

***The Heseltine Review***

**Lord Heseltine's Review *No Stone Unturned,* is refocusing government's attention back on local areas as the drivers of economic growth.** In his publication, Lord Heseltine proposed 89 recommendations, some of which directly address the challenges places face in managing their budgets:

**Single funding pot –** Pooling budgets for capital and revenue at a local level as an extension of City Deals and Community Budgets. Creating single pots directly addresses the financial aspect of silos in government.

**Emphasis on Local Enterprise Partnerships –** the functional economic areas in which a local economy operates should work up local strategies for growth and then have responsibilities and funding to drive them.

**Emphasis on public-private partnerships –** partnerships in planning, delivery and finance are key for local economic growth. The aim is to get Local Economic Partnerships facilitate and leverage this partnership to increase local investment for the local economy.

The Heseltine Review represents the most progressive and comprehensive call for breaking down the funding and management challenges to public services at the moment.

**Community Budgets, City Deals and the Heseltine Review give more financial and management power to places.** Each of these programmes offers clear ways to overcome the main challenge to local government budgets discussed in this research: giving local government more responsibility over their budgets for those services best delviered at the local level. From budgeting across authorities to coordinating budgets between government departments, they represent important progress for better local governance. However, these solutions will not be enough to drive growth at the level the country needs.

26. 'The Future of Public Services: Emerging findings form the Tri-borough Community Budget Pilot' June 2012. http://transact.westminster.gov.uk/docstores/publications_store/the_future_of_public_services.pdf

*"The greater challenge for localism is aligning the financial and management powers*

## 6. Conclusion

The local government funding system is undergoing change at a time of greater localism and austerity. This has put councils in a halfway house with the onus for supporting local economic growth but still not enough tools and powers to deliver growth at the levels needed.

City Deals, Community Budgets and Heseltine Review recommendations are important steps towards bringing more autonomy for cities' budgets. These initiatives provide bespoke answers to resolve the challenges around coordinating budgets and services at the local level. They give local government the power to retain more of the income they raise locally and break down the barriers to how the money can be spent to meet local objectives. However, these solutions are limited in both scope and scale.

The greater challenge for localism is aligning the financial and management powers of appropriate services for local government. Local authorities cannot and should not control all services in their area. However, the degree of central government control over what authorities do is hindering efficient provision of services.

**Local government reforms should consider the differences between places.** Because urban areas such as Manchester are made up of Metropolitan Districts with more powers, they automatically have a greater ability to drive change in their places than cities comprising Shire Districts. Cities with ageing populations or more residents out of work are more dependent on central government funding, and they will be hit harder by austerity measures. Localism will affect places across the UK in quite different ways, which should not be lost in the devolution process.

**Local government is gaining more powers over their resources.** The unringfencing of many grants gives local government relatively more freedom in determining how they manage local services, but Whitehall still determines the majority of the services local government must provide. Business rates retention will give more power to places to raise local revenues to support growth and fund social care. But, central government still sets the resource constraint on approximately half of local budgets. And the rules and regulations governing how local government spends money creates a system that often stifles innovation and efficiency within local government.

**As local government gains more financial power, authorities have taken on a bolder risk-reward structure.** Relying on the local tax base for revenues leads to increasing degrees of self-reinforcing cycles. Those places which can most effectively use the growth incentives of locally-raised funding streams will have more resources to fund economic development. On the other hand, those places with weak economies will find themselves with fewer resources to support growth and a greater proportion of resources from government that have strings attached.

**Currently, local government lies in a precarious position with more powers and responsibilities than they have had for some time, but not all the tools they need to respond to local needs and drive growth.** The principle challenges of realising effective service provision and financial planning lie in the administrative and departmental boundaries within government. Joined-up budgets should facilitate authorities providing services across their real economy; this will aid places in developing programmes that support the way their local economy works. Integrated budgets should also reduce departmental silos, recognising that deliberate coordination between

*"The public finance system needs to change to support and fund services in a cross-cutting and locally-responsive fashion"*

departments should account for the spillovers and knock-on effects local services have on one another. But, the partial manner in which this has been achieved in local government to date means that Whitehall's expectations of outcomes will likely outstrip the capabilities of local government to deliver change.

**Future research should focus on demonstrating how fewer silos and more coordination can unlock growth and create more efficient and effective services.** New ways of working, skill sets and financial management structures will be required to help local government adapt to joined-up budgeting and service provision.

Breaking down the barriers to collaboration between Whitehall Departments and within local government will create a system of governance that supports tackling problems and supporting growth from all angles. As more evidence shows the links and relationships between health and welfare, skills and employment, and transportation links and jobs, so the public finance system needs to change to support and fund services in a cross-cutting and locally-responsive fashion.

# Appendix

## Methodology

To understand how local government and city budgets are funded, we use Table 2.1 from the Local Government Financial Statistics Report for 2012. This table outlines all sources of income for local government. We have used the latest report data in order to create the 2011/12 estimates for city income. However, the estimates in the forthcoming year (2013/14) uses the data from 2011/12 but also includes additional data sources for Housing Revenue Accounts and Business Rates, for example, in order to be more reflective of the changing funding landscape. From this, we constructed individual local authority budgets for service provision using data from a wide range of government sources, which can be seen in Tables A1 and A2 below.

**Table A1: Data sources for constructing local government income for 2011/12**

| Indicator | Input | Source | Year |
|---|---|---|---|
| LA Income, locally-raised | Council Tax | Revenue Income: Revenue Outturn Summary (RS): 2011-12 data AND CT comparison: Table 7 : Council tax & non-domestic rates : collection amounts & rates - England : 2010-11 & 2011-12 | 2011/12 |
| LA Income, locally-raised | Sales, Fees and Charges | Revenue Outturn (RSX) Service Expenditure Summary: 2011-12 data \| RSX LA Data 2011-12 AND Revenue Outturn Summary (TSR): 2011-12 data for Sales, Fees & Charges, Other Income and Total Income | 2011/12 |
| LA Income, locally-raised | Interest and Investment income | Revenue Outturn Summary (RS): 2011-12 data \| RS LA Data 2011-12 (1) | 2011/12 |
| LA Income, locally-raised | Other income | Revenue Outturn Summary (TSR): 2011-12 data for Sales, Fees & Charges, Other Income and Total Income \| TSR LA Data 2011-12 (2) | 2011/12 |
| Central | Local Services Support Grant LSSG | Revenue Outturn Summary (RS): 2011-12 data \| RS LA Data 2011-12 (1) | 2011/12 |
| Central | Redistributed NNDR | Revenue Outturn Summary (RS): 2011-12 data \| RS LA Data 2011-12 (1) | 2011/12 |
| Central | Revenue Support Grant | Revenue Outturn Summary (RS): 2011-12 data \| RS LA Data 2011-12 (1) | 2011/12 |
| Government Grant, inside AEF | | Revenue Outturn (RG) Specific and Special Revenue Grants: 2011-12 data \| RG LA Data 2011-12 AND Table 1: 2013-14 and 2014-15 local authority public health allocations | 2011/12 and 2013/14 |
| Government Grant, outside AEF | | Revenue Outturn (RG) Specific and Special Revenue Grants: 2011-12 data \| RG LA Data 2011-12 \| | 2011/12 |

**Table A2: Data sources for constructing local government income for 2013/14**

| Indicator | Input | Source | Year |
|---|---|---|---|
| LA Income, locally-raised | Council Tax | Revenue Income: Revenue Outturn Summary (RS): 2011-12 data AND CT comparison: Table 7 : Council tax & non-domestic rates : collection amounts & rates - England : 2010-11 & 2011-12 | 2011/12 |

| | | | |
|---|---|---|---|
| LA Income, locally-raised | Retained Business Rates | NNDR1 2013-14 AND Revenue Outturn Summary (RS): 2011-12 data | 2013/14 and 2011/12 |
| LA Income, locally-raised | Sales, Fees and Charges | Revenue Outturn (RSX) Service Expenditure Summary: 2011-12 data \| RSX LA Data 2011-12 AND Revenue Outturn Summary (TSR): 2011-12 data for Sales, Fees & Charges, Other Income and Total Income | 2011/12 |
| LA Income, locally-raised | HRA | Revenue Account Budget (RA): 2012-13 data | 2012/13 |
| LA Income, locally-raised | Interest and Investment income | Revenue Outturn Summary (RS): 2011-12 data \| RS LA Data 2011-12 (1) | 2011/12 |
| LA Income, locally-raised | Other income | Revenue Outturn Summary (TSR): 2011-12 data for Sales, Fees & Charges, Other Income and Total Income \| TSR LA Data 2011-12 (2) | 2011/12 |
| Central | Local Services Support Grant LSSG | Revenue Outturn Summary (RS): 2011-12 data \| RS LA Data 2011-12 (1) | 2011/12 |
| Central | Redistributed NNDR | Revenue Outturn Summary (RS): 2011-12 data \| RS LA Data 2011-12 (1) | 2011/12 |
| Central | Revenue Support Grant | Revenue Outturn Summary (RS): 2011-12 data \| RS LA Data 2011-12 (1) | 2011/12 |
| Government Grant, inside AEF | | Revenue Outturn (RG) Specific and Special Revenue Grants: 2011-12 data \| RG LA Data 2011-12 AND Table 1: 2013-14 and 2014-15 local authority public health allocations | 2011/12 and 2013/14 |
| Government Grant, outside AEF | | Revenue Outturn (RG) Specific and Special Revenue Grants: 2011-12 data \| RG LA Data 2011-12 \| | 2011/12 |

It is important to note that the sources and responsibilities for local government income have changed significantly over the past few years and will continue to change. For example, from 2013/14, 50 per cent of business rates will be retained by the local authority and local authorities will also have the Housing Revenue Account on their books. From a statistical perspective, it makes the analysis more complex and inconsistent as we use data from 2011/12, 2012/13 as well as future budgets for 2013/14. However, the change in revenue from business rates has not changed a lot from 2011/12 to 2012/13 (the year on which 2013/14 budgets are calculated).

Furthermore, Housing Revenue Account used to be given as a grant from central Government but it now forms part of the revenue at a local level meaning local authorities will have to pay off debt and invest in housing themselves. The impact of this is not yet known. While not perfect, our model allows us to see where money comes from whilst simultaneously capturing future developments in local government finance.

As we use Primary Urban Areas as our definition of cities within the UK, data at a local authority level is required in order to aggregate up. In order to most accurately estimate local authority income, we have used a variety of local government finance statistics so we can define the source of the income and any conditions attached to them.

## Authors

Zach Wilcox is an Analyst at the Centre for Cities. Contact Zach on:
z.wilcox@centreforcities.org / 020 7803 4323

Joe Sarling was a Researcher at the Centre for Cities.

## Acknowledgements

The Centre for Cities would like to thank those who gave their time and expert opinion to this project, especially: officials at the Department for Communities and Local Government in the Local Government Finance division, HM Treasury, Audit Commission, London Councils, Leeds City Council, and Westminster City Council as well as Professor Tony Travers.

All views expressed in this report are those of the Centre for Cities and do not necessarily represent the views of those we interviewed. All mistakes are the author's own.

centreforcities

**May 2013**
**Centre for Cities**
Enterprise House
59 - 65 Upper Ground
London SE1 9PQ
**020 7803 4300**
**info@centreforcities.org**
www.centreforcities.org



**Centre for Cities is a registered charity (No 1119841) and a company limited by guarantee registered in England (No 6215397)**