



# The Lyons Inquiry into local government:

delivering devolution?

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## Key points

- *Delivering devolution:* the incremental approach put forward in the Lyons Inquiry's final report is practical and pragmatic. It sets out a range of 'quick wins' that would give England's cities and towns important new tools to support economic growth.
- *Role of local government:* Lyons's focus on 'place-shaping' is important. For place-shaping to work, however, both central and local government need to change. Central government must give local government greater freedom, and local government must rise to the occasion and deliver. This will take both time and effort.
- *Local government funding:* although most attention was focused on the future of the Council Tax, the Lyons Report makes three important recommendations on local government finance:
  - *Retain and reform the Council Tax* – take the pressure off Council Tax by revaluing, rebanding and helping those least able to pay.
  - *Supplementary business rates* to pay for transport infrastructure, as recommended by the Centre for Cities in its City Leadership report.
  - *Restructure the grants system* to give local authorities greater incentives to promote business and housing growth, as well as greater flexibility to deliver local priorities.
- *Ministers must now deliver* the parts of the Lyons agenda – supplementary business rates, better incentives, flexible grants, and improved Council Tax benefits – that are achievable in the short term. And in the long term, they must develop a more radical vision for devolution to local government – including a better mix of local taxes and funding sources.

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## 1. Introduction

Some two-and-a half years and four extensions after starting his review of local government, Sir Michael Lyons has finally reported back to Ministers.

In an atmosphere of high and sometimes unrealistic expectations, Lyons was never going to satisfy everyone. In the words of the *Guardian*'s editors, Sir Michael has delivered 'a 400-page report long on reason and short on radicalism' ('Tame Lyons', leader, *Guardian*, 22 March 2007). While accepting the merits of Sir Michael's conclusions, many sceptics believe that even his most basic and obvious recommendations could be kicked into touch. But is this attitude justified?

Against the odds, Sir Michael has delivered a sound and considered report on the role, functions and funding of local government. He challenges Ministers to prioritise swift action, rather than engage in endless debate. And he acknowledges that more radical change will take years, if not decades, to implement. In the foreword to the report, Lyons highlights the fact that 'my proposals for the future funding of local government and the taxation to support it are therefore explicitly developmental' (Lyons 2007: ii).

This briefing note does two things. First, it sets out the Lyons Inquiry's headline conclusions, focusing on the short-term 'quick wins' that could help to stabilise the local government finance system and re-build confidence in local taxation and local stewardship of resources. Second, it examines the Government's immediate reaction – and what will happen next.

## 2. The role and functions of local government

- 'Place-shaping': local leadership, convening, economic development
- Central government: reduce controls, improve incentives, clarify funding
- Local government: don't wait for the centre, use existing powers better

### *Place-shaping*

Over the course of Chapters 1 and 2 of his final report, Sir Michael sets out his vision for the future of local government – centred on the concept of 'place-shaping', which he defines as 'the creative use of powers and influence to promote the general well-being of a community and its citizens' (Lyons 2007: 60). This vision for local government is not new – as many of its key points were set out in Sir Michael's interim report (Lyons 2006).

Using their ability to bring together local stakeholders, as well as their financial and managerial resources, local authorities must concentrate on developing a vision for their areas, and make better use of the powers at their disposal. Lyons urges Government to stop treating local authorities as service delivery bodies – and challenges local councils to be proactive rather than constantly look to the centre for guidance and inspiration.

### *'Postcode preferences' – not 'postcode lotteries'*

More importantly, Lyons makes a passionate argument for greater flexibility in local service delivery, using the phrase 'managed difference' to describe a system in which local government designs and delivers its own interventions. As he states in the foreword to his report:

*'We should be... as interested in how we might develop the distinctiveness of different places... as we are about how we seek to achieve potentially expensive, and frequently elusive, "consistent" standards.'* (Lyons 2007: iii)

In order to empower local government, variation and innovation must be encouraged – rather

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than stifled by simplistic references to ‘winners and losers’ and postcode lotteries.

*‘Accepting these arguments means accepting some degree of variation and difference between different parts of the country in their decisions and their use of resources.’ (Lyons 2007: 2)*

This is critical. Lyons is arguing, in effect, that detailed national standards are not always the way to deliver better local outcomes – and that variation and local choice can have positive economic and social effects. This is an explicit rejection of the centralist narrative (for example, Walker 2002), and a boost for the supporters of localism and devolution (for example, Stoker 2005, Marshall and Finch 2006, Finch 2007). Lyons exposes the flaw in arguments about fairness: fair outcomes are not always best achieved through uniform delivery mechanisms and fully equalised financial resources. Localities should be able to express ‘postcode preferences’, especially when prioritising and spending their own resources.

### Central–local relations

#### *The centre must let go...*

Chapter 4 of the Inquiry’s final report finds, unsurprisingly, that over-centralisation is a key constraint on local government. Lyons calls on central government to initiate a ‘culture change’ in its relationship with local authorities – stepping back wherever possible.

Key recommendations to Government include:

“The centre must be clear about what it does, and help the public to better understand what local government is and should be doing.”

- *Clarify the respective roles of central and local government.* The centre must be clear about what it does, and help the public to better understand what local government is and should be doing.
- *Simpler performance management and reporting systems.* This was promised in October’s Local Government White Paper (DCLG 2006).
- *A less deterministic approach to local leadership.* Unlike the Government, Lyons believes that leadership ‘should not be reduced to a simple prescription’ (2007: 122), and that models need to emerge from the bottom up.
- *Fewer central government mandates.* Central government cannot expect local authorities to deliver on its own promises, especially when these come down as partially-funded or unfunded mandates.
- *Better information.* The centre must inform the public of who is responsible for what, as well as where the funding is coming from.
- *‘Resist the temptation’ of soft controls.* Government over-uses guidance, reporting requirements and meetings – often replacing targets with less formal, but equally restrictive, ‘suggestions’. These must be swept away for local government to improve.

#### *... And local government must raise its game*

Central government gets a bit of a pasting in Lyons’s final report – coming across as controlling and deterministic. But Lyons does not spare local government, either. His conclusions in Chapter 5 are unequivocal: local government must raise its game substantially.

Sir Michael criticises local authorities for their lack of pro-activity, tepid leadership, and the fact that most councils do not make effective use of their existing powers. Change, he notes, ‘is primarily about behaviours and attitudes rather than new powers or structures’ (Lyons 2007: 207).

In fact, Lyons finds that local government has adequate statutory powers – and that the key to

stronger local government lies in greater flexibility and better use of what is already on the table. This is a clear challenge to central government, which must deliver flexibility, and to local authorities, who need to demonstrate that they can use that flexibility to deliver better outcomes.

Critically, not everyone agrees that local government has the right powers to deliver the place-shaping agenda. Many councils, as well as the Local Government Association, believe that devolution will require additional statutory powers, as well as greater flexibility over budgets and implementation. The term ‘power’, and what it represents, must still be clarified.

### 3. Funding local government

“The Lyons report lays out some short-term ‘quick wins’ and longer-term ideas.”

- Business tax: local rate ‘top-ups’, reform reliefs, reform Local Authority Business Growth Incentives (LABGI)
- Council tax: revalue, new bands, automatic benefits, end capping
- Grants: greater local flexibility, less ring-fencing, better incentives
- Information: greater transparency over who pays for what

Though the future role and functions of local government are critical, many observers were far more interested in Sir Michael’s recommendations on how to fund local government. Four hefty sections of his final report – chapters 6 to 9 – deal with tough questions around the structure of the local government funding system, household taxes, business taxes, and the operation of the grant system.

Sensibly, Lyons adopts an incremental approach – focusing his detailed recommendations on the aspects of the local government finance system most in need of reform. Unlike the Balance of Funding Review (ODPM 2004), which attempted to deal with all of the complex issues surrounding local government finance, the Lyons report lays out some short-term ‘quick wins’ and longer-term ideas.

As Sir Michael states:

*‘There is ... no “golden key” to reform of local government funding. Reform will require a series of complementary measures, implemented over time, both to deal with the immediate challenges facing the funding system and to pave the way for wider choices in the future.’ (Lyons 2007: 211)*

The following sections focus on Sir Michael’s short-term funding proposals, and their potential impact on England’s cities and towns.

#### *Household taxation (Chapter 7)*

This, of course, is the most contentious section of Sir Michael’s report, as it deals with the thorny issues surrounding the unloved and poorly-understood Council Tax.

Sir Michael makes five key recommendations:

- *Retain and improve Council Tax in the short-to-medium term.* Investigate the possibilities for local income tax, or shared/assigned taxes, in the longer term.
- *Revaluation and re-banding.* Commit to revaluation and the introduction of new bands at the top and bottom of the scale as early as possible. This is crucial to improving the fairness and purpose of the Council Tax.

“Ministers – thinking politically rather than logically – have got it wrong. It is essential that Council Tax revaluation take place as soon as possible.”

- *Council Tax Benefit (CTB)*. Transform CTB into an automatic rebate.
- *Capping*. Reduce, and abolish, the capping of local government spending by Whitehall.
- *Charging*. Make better use of local charging powers – and introduce new powers that enable local authorities to charge for waste collection.

Broadly speaking, Sir Michael’s proposals are both sensible and achievable. Yet, in the Budget Red Book, Ministers make it abundantly clear that they have no intention of giving up their capping powers (HMT 2007: 6.68). And they have already put off decisions on revaluation and re-banding, stating that these are unlikely until 2011 at the earliest (see, for example, *Local Government Chronicle*, Friday 23 March 2007).

Ministers – thinking politically rather than logically – have got it wrong. It is essential that Council Tax revaluation take place as soon as possible. It is not sensible to have a property tax based on valuations that are 16 years out of date. At the same time, the capping of Council Tax reduces local flexibility, confuses residents, and in Lyons’s words, ‘is a sign that central and local government have together failed to make the system work’ (2007: 127).

This reduces the Council Tax’s transparency and clarity, and moves it further and further away from the principles of a ‘good local tax’, as developed by the OECD and others. The longer ministers leave revaluation and reform, the more painful they will be. And the pressures on Council Tax – which Lyons was initially commissioned to address – will worsen.

### *Business taxation (Chapter 8)*

Here, Sir Michael examines the disconnection between local government and the business community, which have not had a direct fiscal relationship since the nationalisation of business rates in the early 1990s. Proponents of devolution believe that this has negative consequences – and prevents cities from investing effectively in transport infrastructure, which is a key business priority.

Chapter 8 makes three key recommendations:

- *Short-term package of business rate reforms*:
  - Locally-set and retained supplementary business rates
  - Review and reform existing reliefs and exemptions
  - Better incentives to promote business growth.
- *Relocalisation*: no full scale relocalisation of business rates at present. Relocalisation could be a medium-to-long-term option.
- *Tourist tax*: in medium term, consider use of a bed tax in some areas.

### *Supplementary Business Rates (SBRs)*

This is potentially the most important short-term recommendation in the Lyons final report. While rejecting the wholesale re-localisation of the business rate, as demanded by the Local Government Association and others (LGA 2007), Sir Michael has made a pragmatic proposal that will help to bring business and local government closer together.

Sir Michael’s proposal – supplements of 1p to 4p in the pound, decided in consultation with business – mirror the Centre for Cities’ own call for supplementary business rates in *City Leadership* (Marshall and Finch 2006).

We believe that Sir Michael’s recommendation could help England’s cities to deliver key local transport infrastructure projects. The logic here is clear: city leaders and businesses agree that local transport improvements are crucial for economic growth. Yet cities lack the tools to put together the funding packages needed to get key schemes off the ground.

If Ministers accept Sir Michael’s argument, Birmingham could close the New Street Station

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funding gap, Greater Manchester could build Phase III of Metrolink, and London could finally break ground on Crossrail.

#### Supplementary business rates: examples

**Birmingham:** A 2p business rate ‘top up’ in Birmingham City would yield £15.4m per year – which would support a ten-year loan of £118m. This would eliminate the funding gap for the New Street Station redevelopment, which currently stands at £114m.

**Manchester:** A 2p business rate ‘top up’ across Greater Manchester (10 authorities) would yield £40.6m per year, and support a ten-year loan of £310m. This comes close to covering the local share of Metrolink Phase III (£380m – on top of £520 from the Department for Transport).

**Leeds:** A 2p business rate ‘top up’ in the Leeds City Council area would fund nearly 40 per cent of the cost of the proposed Bus Rapid Transit network – the successor to the cancelled Leeds Supertram.

Sources: Lyons (2007); published figures

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Reaction from business was mixed. Big business organisations came out against SBRs – but London First and local Chambers were more receptive.

Some local councils, meanwhile, argued that SBR receipts should be equalised, because big cities stand to gain the most.

It is true that Leeds would benefit far more from an SBR than Middlesbrough. But we have gone too far with equalisation in recent years. In the rush to avoid the ‘winners and losers’ debate, Whitehall has taken away councils’ incentive to promote growth. Locally controlled, locally retained SBRs – used by individual authorities or sub-regional partnerships – will help cities develop stronger local economies and deliver transport improvements.

#### Other business tax changes

Sir Michael has also recommended a full review of the existing reliefs and exemptions applied to business rates: with relation to empty properties, listed buildings, agricultural land, brownfields, and so on. Changes here could result in a larger business rate pot nationally, which could have trickle-down benefits for individual authorities.

Additionally, Sir Michael gave lukewarm support for the introduction of a tourist bed tax in some areas in the medium term. While welcomed by some authorities, this was quashed by Ministers in the Budget – who insisted flatly that ‘the Government does not intend to introduce a tourist tax’ (HMT 2007: 157).

#### Mainstream grant funding (Chapters 4 and 9)

Arguably, Sir Michael’s recommendations on the management of mainstream funding are far more important than marginal new local tax powers.

Chapter 4 sets out Sir Michael’s aspirations for a more flexible grant system – with central government reducing the number of specific and ring-fenced grants to local authorities. Along with statutory ring-fencing, ‘soft controls’ should be abolished (as above).

Chapter 9 takes the argument further – arguing that incentives and information would result in a more place-sensitive grant system. It makes two critical recommendations:

- *Better growth incentives:* investigate ways to incentivise housing and business growth in localities, starting with a reform of the Local Authority Business Growth Incentive (LABGI).

- *Better information:* Government should make clear who pays for what, including national spending figures on each locality's Council Tax bills.

Since most local authorities derive three quarters of their funding from central grants, greater flexibility over central grants could empower councils to innovate and deliver better outcomes. Conversely, it could also result in failed local experiments. There is no way to increase flexibility and simultaneously guarantee outcomes.

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But how can central government – with its instinct for careful stewardship of public money – really be convinced to let go? In the long term, ministers must find a way to make it clear that local leaders, not Whitehall, are responsible for local choices. And in the short term, Ministers must be convinced to accept the risks inherent in Sir Michael's approach.

Eliminating perverse incentives in existing grant schemes would be a good start. For example, strong economic performance in a locality can currently result in loss of formula grant – leaving a local authority worse off than it would be if its economy had remained stagnant.

Similarly, reforming the complex Local Authority Business Growth Incentive (LABGI) scheme would help to reward local authorities who make strong efforts to grow the local business base.

By concentrating on incentives that operate on the margins, Sir Michael has avoided a broader debate about the role of equalisation in the local government finance system. He notes that:

*‘...my proposals are not intended to dramatically reduce equalisation... rather, I want to find a way to provide space... to incentivise local government to grow their tax bases and crucially enable local communities to receive some reward for allowing their area to develop and grow.’*  
(Lyons 2007: 318)

Some observers believe that Lyons should have tackled the equalisation question head-on, as this would have helped to ground his long-term recommendation to shift the balance of funding. By opting for a pragmatic approach, Sir Michael has focused on the politically feasible – deferring the big and radical questions for now.

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Yet it appears that Sir Michael's short-term proposals are gaining traction. Ministers, so far, seem receptive to reforming the grant system – and to creating more positive incentives for housing and business growth. Lyons's own modelling proves that this is easier said than done, as incentives are often either complex or result in politically unpalatable winners and losers. Government must now find a way forward.

#### 4. What's next?

The Government's devolutionary credentials will come under scrutiny as Sir Michael's short-term proposals for action land on Ministers' desks during the coming weeks and months.

So far, the Government's rejection of Sir Michael's proposals on capping, Council Tax revaluation and tourist taxes, all within hours of the publication of his report, are not encouraging. But tourist taxes are small beer – and the big political decisions on Council Tax, from capping to revaluation, were put off long before Lyons reported back to Ministers.

A range of less visible, but bigger, reforms are still on the table. Supplementary Business Rates, a reformed Council Tax Benefit, and a flexible grant system that incentivises local housing and business growth must be taken forward.

If Sir Michael's sensible confidence-building measures are shelved by the Treasury, then successful 'place-shaping' and real financial devolution will remain a long way off. And the Council Tax –

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already unpopular and poorly understood – is likely to become even more contentious and opaque.

There are no more independent reviews for the Treasury to commission; no more justification for avoiding the incremental empowerment of English local government. Starting with this year’s Comprehensive Spending Review (and including the Treasury’s sub-national review of economic development and regeneration), cities and towns across England will expect concrete action to loosen the financial strait-jacket.

It is time to see just what Ministers – and for that matter, Whitehall civil servants – are ready to deliver. The Government’s carefully honed localist and devolutionary credentials are about to be put to the test.

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