

About Localis

Who we are

We are a leading, independent think tank that was established in 2001. Our work promotes neo-localist ideas through research, events and commentary, covering a range of local and national domestic policy issues.

Neo-localism

Our research and policy programme is guided by the concept of neo-localism. Neo-localism is about giving places and people more control over the effects of globalisation. It is positive about promoting economic prosperity, but also enhancing other aspects of people's lives such as family and culture. It is not anti-globalisation, but wants to bend the mainstream of social and economic policy so that place is put at the centre of political thinking.

In particular our work is focused on four areas:

- Decentralising political economy. Developing and differentiating regional economies and an accompanying devolution of democratic leadership.
- **Empowering local leadership.** Elevating the role and responsibilities of local leaders in shaping and directing their place.
- Extending local civil capacity. The mission of the strategic authority
 as a convener of civil society; from private to charity sector, household
 to community.
- **Reforming public services.** Ideas to help save the public services and institutions upon which many in society depend.

What we do

We publish research throughout the year, from extensive reports to shorter pamphlets, on a diverse range of policy areas. We run a broad events programme, including roundtable discussions, panel events and an extensive party conference programme. We also run a membership network of local authorities and corporate fellows.

1

Contents

	Acknowledgements	2
	Executive Summary	3
	Introduction	6
1	Crisis points for local authorities	8
	1.1 Temporary accommodation	9
	1.2 SEND education	10
	1.3 Social care	12
2	Options for reform	14
	2.1 Restructured grant funding	15
	2.1.1 Fair funding review	15
	2.2 Devolution of revenue raising powers	17
	2.2.1 Context for devolution	1 <i>7</i>
	2.2.2 Local fees, charges and levies	18
	2.3 Uniform reform of current powers	19
	2.3.1 Business rates	19
	2.3.2 Council tax	21
10	2.4 Reforming national taxes	29
	2.4.1 Distribution of income tax	29
1	2.4.2 Land value tax	30
3	Prospects for this Parliament	34

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Executive summary

The financial problems facing local government in England are well rehearsed. The deteriorating impact of shrinking budgets on public services and the state of the public realm formed an important part of the Labour Party's platform of 'change' in the 2024 general election campaign. Delivery of the promise to 'fix the foundations' and begin national renewal is urgently needed in local government, yet the challenges of doing so cannot be understated. This short report outlines some of the key pressures on council budgets in 2024 and provides some possible options for financial reform which, if part of wider, systemic reform, could help to restore sustainability to local government.

Crisis points

The funding gap in local government is driven by a multitude of factors but, for many local authorities, the most pressing challenges come from the difficulty of budgeting for three major pressures:

- Temporary Accommodation (TA): Rising rents, cost-of-living increases, frozen housing subsidies, and a lack of social housing have led to a significant rise in TA spending. London is particularly affected, with boroughs accounting for 60 percent of national TA expenditure. In all, 60 percent of overall housing services expenditure goes towards homelessness up from only 25 percent in 2010/11 while the total cost of temporary accommodation placements across England amounted to £1.8bn in 2022/23.
- Special Educational Needs and Disabilities (SEND) Education:
 Since 2014, the number of pupils with Education, Health and Care plans
 (representing 26 percent of all pupils with SEND) has increased significantly,
 putting a strain on austerity-hit budgets. Councils face rising costs for
 independent SEND provision due to state school capacity issues. Cumulative
 council SEND deficits have reached £3.2bn since 2019.
- **Social Care:** Demand for adult social care is increasing rapidly, outpacing funding. A workforce shortage, exacerbated by the pandemic, is adding further strain to the system. Councils are struggling to meet rising costs, leading to concerns about service quality and access. In 2022/23, local authorities in England spent £20.5bn on adult social care, and only two-thirds of councils are confident in their ability to delivery statutory adult social care by 2025/26.

Each crisis requires a mix of policy reform and financial support beyond shortterm patches, each will require difficult political decisions and far-reaching vision to move to sustainable provision. Part of the programme of reform must, however, include adjustments to how local government is funded.

Reform options

There are no quick, easy answers to heading off the crises laid out above and restoring sustainability to council finances. If the government are to return the sector to stable footing, steps to radical reform must be taken over the course of this Parliament, drawing on a range of possible options to pull together a new framework for funding local councils. An important first step to reform, committed to in the Autumn Budget, is to update the formula for allocating central government grants to local authorities. The current system, with its outdated methodology, is fragmented, uncertain, and misaligned with actual needs.

Beyond updating and rationalising the grant system, there are multiple options for restructuring local government finance:

- The devolution of revenue-raising powers could help raise small amounts of funding for place services. This could involve expanding local fees and charges, though these are unlikely to generate substantial revenue. Implementing new local taxes, such as a tourist tax or locally-specific environmental levies, drawing on international examples like the Netherlands, could also help to raise small amounts for targeted local expenditure.
- The uniform reform of current powers could be used to make the system fairer and potentially increase revenues, depending on the approach taken.
 - Business rate reform could move past the "brick and mortar" property value approach and consider alternatives like local corporation tax, or simply look to increase local retention beyond the current 50 percent.
 - The regressive nature of **council tax**, based on 1991 property valuations, has long been considered a potential target of reform. Options include revaluation, additional tax bands and removing the single-person discount but the politics and practicalities of any approach would have to be balanced, given the inevitable creation of winners and losers.
- Reforming national taxes would be a more radical approach, looking at
 the distribution of taxes like income tax and VAT. Following systems like Italy and
 Germany, there is potential for greater local discretion and financial stability
 from such an approach, but this would also raise concerns about regional
 disparities and would require a robust redistribution system based on need.

A further tax reform worth consideration is land value tax, which might
provide a stable revenue source for local government whilst discouraging
land speculation and promoting efficient land use, as well as enabling lower
transaction taxes to stimulate housing market mobility.

All of these options must be considered in the construction of a new settlement, which is sorely needed to accompany systemic reform to the policy of provision across core service lines.

Prospects for this Parliament

The Autumn Budget 2024 provided a modest increase in funding for local authorities, primarily through grant funding increases aimed at heading off the worst effects of the crisis points outlined above. While welcome, this increase is insufficient to address the long-term funding gaps faced by local authorities. Despite continuing with short-term measures, there were also signals of a move towards reform, focusing on devolution, local growth, and simplifying funding structures.

The prospects for genuine reform over this Parliament are therefore modest, but not insignificant:

- As with much recent central government policy aimed at the local level, the budget focused on combined authorities and, representing a longer-term trend, hinted at a move towards unitary authorities, although the effectiveness of such reorganisation is far from a proven 'silver bullet'. The fundamental problem of underfunded services cannot be solved through changes to governance structures alone.
- The reformulation and consolidation of revenue funding is crucial to the
 ongoing financial stability of local authorities. The announcement of such a
 review in the budget is therefore welcome, although the government must
 reckon with the requirement to increase funding even if systems are reformed
 which any genuine assessment of local need will reveal.
- The government have moved towards restructuring business rates to provide relief for certain businesses while ensuring local government income is unaffected. Over the course of this Parliament, there is a chance to go further, by allowing local authorities to levy additional taxes (like tourist taxes), and potentially reforming council tax or exploring land value capture.
- More radical reforms, such as a new business rates system based on turnover
 or devolution of a share of income tax, are unlikely in the current political
 climate. Nevertheless, such reforms should be argued for by proponents of
 better local public services and could be considered by future governments in
 the context of the long-term drive for national renewal.

Introduction

The financial problems facing local government in England are as well rehearsed as The Mousetrap – and the culprits as widely known. A decade of austerity, amounting to a 10 percent reduction in total spend¹ over the 2010s, which resulted in an 18 percent reduction in per-resident spend from 2011 to 2024,² has dovetailed with wider contextual factors such as demographic change, inflation and low economic growth to produce billions in funding shortfall over the next few years³. Time and again, local government has found itself bearing the brunt of central government reforms, rushing in to provide front-line support in times of crisis, all the while as capacity has steadily diminished.

The deteriorating impact this has had on local public services and the state of the public realm formed an important part of the Labour Party's platform of 'change' in the 2024 general election campaign. Since coming into government in July, this has materialised in a focus on 'fixing the foundations' of public finances, with the stated goal of stabilisation for a mission of national renewal. Such medicine is urgently needed in local government, yet the challenges of doing so cannot be understated. To restore councils to fiscal sustainability whilst enabling them to deliver public services of the quality expected by the British public, reforms must be undertaken across multiple policy areas and the very structure of council financing must be renewed and revitalised.

This short report focuses on three areas which drive major budgetary problems for the majority of local councils – the provision of temporary accommodation; Special Educational Needs and Disabilities (SEND) education; and social care. While they do not represent the totality of the problem, each provides insight into the longstanding, structural challenges of funding local government in 2024. These challenges include long-term underinvestment, demographic changes and councils acting as agents in centrally-set policy regimes which are not capable of delivering for users at the level of place.

¹ House of Lords Library (2024) – Local government finances: Impact on communities

² Institute for Fiscal Studies (2024) – Core funding for English councils still 18% lower per resident than in 2010–11, and costs are rising

³ LGA (2024) - Further funding cuts to councils would be disastrous

Each prescription requires a mix of policy reform and financial support beyond short-term patches, each will require taking difficult political decisions and supporting a far-reaching vision to move to sustainable provision. For the purposes of this report, we focus on potential reforms to the financing of local government which might, in the context of broader policy reforms, form part of a solution to current unsustainability. If the government are to return the sector to a stable footing, steps to radical reform must be taken over the course of this Parliament, drawing on a range of possible options to pull together a new framework for funding local councils. We examine some of the possibilities for long-term reform, beginning with the prerequisite of rationalising grant funding and moving towards more radical proposals like reforming national taxation.

The 2024 Autumn Budget was an important staging post on the journey to 'fixing the foundations'. The final section of this report looks at what was promising, and not so promising, in this first phase of the broader Spending Review 2025.

The report concludes with some steps that central government could take towards the various reform options laid out in section two. The ultimate goal is to provide insight and contribute to the discussion on how to truly fix the foundations of delivery at the local level, to help accelerate the improvements in service provision and renewal of the public realm sorely needed across the country.

CHAPTER ONE

Crisis points for local authorities

The financial pressures on local government balance sheets impact all areas of service delivery and are felt by residents in all kinds of direct and indirect ways. As a means of illustrating the multifaceted and deeply complex nature of the factors that drive these pressures, this section examines three of the most urgent crises underlying the funding gap in local government. Each of these crisis points stems from a complex web of causal factors, but the brunt is felt in the same way for service users who are impacted by the inevitable cuts and constraints to balance budgets.

1.1 Temporary accommodation

Recent years have seen a concatenation of negative impacts which have compounded the pressure on local authorities to provide temporary accommodation (TA) for an increasing number of households and exacerbated the sheer cost of doing so. These pressures include rising rents and increasing cost-of-living, pushing up demand and reducing affordability;⁴ the freezing of the Local Housing Allowance subsidy for TA from 2011 right up until 2024; and a chronic under-supply of social housing causing councils to rely on more expensive forms of accommodation, including a huge increase in the use of nightly paid accommodation⁵. The latter has been especially damaging, with a third of councils more than doubling their gross spending on nightly paid TA from 2018/19 to 2022/23⁶.

With this aggregation of pressures, local authority spend on homelessness services has ramped up by 113 percent from 2010/11 to 2022/23, totalling £2.44bn. In all, 60 percent of overall housing services' expenditure goes towards homelessness – up from only 25 percent in 2010/11 – while the total cost of temporary accommodation placements across England amounted to £1.8bn in 2022/23⁷. For some District Councils, spending on TA accounts for half of their total net budget⁸.

London has felt the worst of the crisis, with the capital's boroughs accounting for 60 percent of national expenditure on TA⁹ and an estimated one in 50 London residents living in TA¹⁰. Outside of the city, coastal towns in the south also see some of the highest levels of homelessness, and the North East has the highest proportion of homeless households living in TA¹¹.

⁴ LSE Consulting (2023) - Supply of Private Rented Sector Accommodation in London

⁵ New Economics Foundation (2024) – Cost of housing homeless people skyrocketing for councils

⁶ Inside Housing (2024) – Thinktank reveals rise in spending on most expensive type of temporary accommodation in England

⁷ Inside Housing (2024) - Thinktank reveals rise in spending on most expensive type of temporary accommodation in England

⁸ NAO (2024) – The effectiveness of government in tackling homelessness

⁹ New Economics Foundation (2024) - Cost of housing homeless people skyrocketing for councils

¹⁰ London Assembly Housing Committee (2024) - London's Temporary Accommodation Emergency

¹¹ GreaterChange (2022) - Where is homelessness the worst in the UK?

The most recent escalations in TA spend can be to some extent pinned on the Homelessness Reduction Act 2017, which extended the statutory duties of local authorities: doubling the timeframe for someone to be considered homeless or at threat of homelessness and therefore extending the Duty of Prevention; a Relief Duty to try and relieve homelessness for 56 days; and increased housing support for more people for longer¹². Concurrently, government funding arrangements for local authority homelessness services are often criticised as too complex, fragmented, and uncertain¹³.

Top-ups to local government funding for homelessness and affordable housing have come in thick and fast over the years, in the form of both capital funding, such as for rough sleeping programmes, and revenue funding for support services. However, it is widely agreed that tackling homelessness and reducing the numbers of those in TA relies on both early intervention by authorities and the expansion of capital funding for the building of genuinely affordable housing to prevent, rather than respond to, homelessness. Consequently, questions of mitigating TA spend must be concerned with short-term injections of cash towards social housing. The assumption is that, in providing more homes, consistently in-keeping with demand for affordable housing, the inefficiency of spend on TA, and particularly nightly paid accommodation, will lessen.

1.2 SEND education

While temporary accommodation is, in the round, a crisis of capital asset supply – primarily in the form of affordable and social housing provision – the more inherently demographic challenges that local authorities face centre primarily on the capacity to raise revenue to fund continued, effective, and often expanding, service provision.

Special Educational Needs and Disabilities (SEND) provision puts immense strain on the revenue budgets of local authorities, with expenditure having increased rapidly since 2015. Overall SEND-related expenditure was £4bn among councils in 2015. This is expected to rise to £12bn by 2026, a 70 percent increase since 2018/19¹⁴. Cumulative council SEND deficits currently have reached £3.2bn since 2019¹⁵. Budgeted expenditure on special schools and alternative provision

¹² Royal Borough of Kensington and Chelsea (2021) – Temporary Accommodation

¹³ NAO (2024) – The effectiveness of government in tackling homelessness

¹⁴ LocalGov (2024) - Council SEND spending up 70%

¹⁵ LGA (2024) – Educational outcomes for SEND pupils have failed to improve over last decade despite costs trebling, new independent report reveals

accounts for over five percent of all total net current expenditure for councils¹⁶. Devon; Bournemouth, Christchurch and Poole; Cheshire East; Bath and North East Somerset; and Dorset each have Dedicated Schools Grant deficits, as of 2022/23, of more than -25 percent¹⁷.

In 2014, reforms led to higher rates of identification of SEND in children. From 2015 to 2023/24, the number of pupils in England on an "Education, Health and Care plan" (EHC) – representing 26 percent of all pupils with SEN as of January 2024 – increased by 83.4 percent. Overall, the percentage of pupils with SEN rose from 11.6 percent to 13.6 percent in the same period. However, the rise in SEND identification has failed to lead to better educational attainment¹⁸ and the state school system has been unable to account for increasing demand – two-thirds of special schools are at capacity or full¹⁹. Consequently, local authorities have had to devote more funding towards the use of independent provision, ²⁰ and there have been recent concerns that the loss of VAT relief for private schools may exacerbate the issue.

Current measures to mitigate the crisis of SEND provision include the Department of Education's "safety valve", which produces additional funding for struggling local authorities under the understanding that they commit to "actions intended to eradicate their deficits." ²¹ However, both the safety valve and the 2023 SEND and Alternative Provision Improvement Plan have had mixed responses from local authorities, who remain sceptical about how far central government support is addressing the fundamental challenges in the system ²². The understanding is that full reform to the system is the only way that SEND provision will meet the changing needs of England's children and young people.

¹⁶ DLUHC (2022) – Local authority revenue expenditure and financing England: 2022 to 2023 budget individual local authority data

¹⁷ Institute for Government (2024) - SEND spending needs reform to stop local authorities going bust

¹⁸ LGA (2024) – Educational outcomes for SEND pupils have failed to improve over last decade despite costs trebling, new independent report reveals

¹⁹ BBC News (2024) - Council spending on special needs transport doubles

²⁰ Institute for Government (2024) – SEND spending needs reform to stop local authorities going bust

²¹ Institute for Government (2024) – SEND spending needs reform to stop local authorities going bust

²² LGA (2024) – Educational outcomes for SEND pupils have failed to improve over last decade despite costs trebling, new independent report reveals

1.3 Social care

Social care is another crisis reaching breaking point for many councils and is one that is particularly vulnerable to current and projected demographic changes. Since 2015/16, requests from older people for social care support have increased by six percent, whereas requests from working-age adults have increased by 22 percent²³. Meanwhile, overall public health funding per person is 27 percent lower in real terms in 2024/25 than in 2015/16 – with the largest cuts to funding often hitting most deprived areas, which tend to receive less funding relative to need.

The pandemic has had a large, adverse impact on the capacity of the system to provide for demand. The workforce gap, already extensive, has reached 150,000 unfilled social care posts in England²⁴, and tightening regulations on international recruitment are predicted to lead to further constraints – although plans to mandate higher pay for social care staff may prove attractive to potential employees²⁵. The increase of the National Living Wage as outlined by the Budget may prove positive for workers in the sector, however, combined with the higher National Insurance Employer Contribution and limited additional funding may prove to further constrain local government capacity. Financial pressures in social care service provision have numerous negative consequences. These include higher care costs for individuals; difficulties attracting and retaining staff; delays in accessing support and instability in some care markets – often, but not solely, due to councils spending as little as possible on fees – a situation leading to uncertainty among providers and foisting charges onto self-funders.

Costs are huge: the Health Foundation has estimated that an additional £8.3bn will be needed per year by 2032/33 to keep up with growing demand²⁶. In 2022/23, local authorities in England spent £20.5bn on adult social care,²⁷ and only two-thirds of councils are confident in their ability to delivery statutory adult social care by 2025/26²⁸. Increases to the national living wage from April 2023 have resulted in additional direct and indirect costs to councils related to adult social care, while longstanding underinvestment in the sector is clashing with the demographic changes and widening health inequalities putting pressure on care

²³ The King's Fund (2024) – Social Care 360: access

²⁴ The Guardian (2024) – From social care to homelessness, what are the cost pressures facing English councils?

²⁵ The King's Fund (2024) – Skills for Care figures show there are still huge workforce gaps in adult social care

²⁶ House of Commons Library (2024) – Funding for adult social care in England

House of Commons Library (2024) – Funding for adult social care in England

²⁸ Room151 (2024) - Councils struggle to meet social care costs as funding cuts expected

13 BITING THE BULLET

providers²⁹. Additional grant for social care of around £2bn featured in the local government finance settlement for 2023/24, but the cost to local authorities of purchasing care has risen faster than inflation in recent years and concerns abound for the ability of the sector to meet the rising demands of the population³⁰.

Compared to a decade ago, local authorities spend over £200 per person more on children's services and adult social care, accounting together for more than two-thirds of the average local authority budget³¹. When this pressure is looked at alongside the equal crises of SEND and TA, the question must be asked whether there might be a better system for managing revenue intake and expenditure for local authorities – a reformed system that would relieve some of the pressure particularly of those demographic challenges that will continue to require massive spending figures year after year.

²⁹ The Health Foundation (2023) - Nine major challenges facing health and care in England

³⁰ The King's Fund (2024) - Lack of government action leaves social care struggling

³¹ County Councils Network (2024) – Councils call for 'honest discussion' on what they should be expected to deliver as new data reveals local authorities spend two-thirds of their budgets on care services

CHAPTER TWO

Options for reform

Meeting the immense financial pressures of place will require change to a fractured system. The following section outlines some potential paths to transformation, noting where devolution could effect greater change, what the possibilities for the reform of current tax-raising powers for local government are, and the more radical forms of system overhaul that some suggest could hold the key to place-based financial resilience. Particular attention is given to where, and what types of authority, would see the greatest negative or positive impacts in terms of the potential for fiscal transformation, with the view to aligning the current political context of the new Labour government with the opportunity, or harm, that could occur in terms of local political impact under the assumption of bold and ambitious fiscal change.

2.1 Restructured grant funding

Grants from central government are expected to finance half of revenue expenditure by local authorities, for 2024/25. With council tax accounting for 32 percent and the remainder covered by business rates retention³². The reliance on national level decision-making is typical of the centralised system of governance in the UK, but overwhelming criticism points to the fragmented and uncertain nature of grant funding, wherein the distribution of grants fails to account for the spending needs of local authorities, and the inefficiency of the competitive system of bidding for pots of funding. Grants to local authorities are diverse in the mechanisms used to distribute their amounts and calls to simplify the system and get rid of bidding pots are matched with equal fervour by calls to review the current allocation of the funding based on valuation of needs across the country. The current system of grant funding is immensely complex, and increasingly piecemeal. A summary of the sources of central grant funding can be found in the report appendix.

2.1.1 Fair funding review

The idea of reviewing the formula by which grants are allocated to local government has been in stasis for almost a decade. In 2016, the government committed to a Fair Funding Review for local government, to address how funding is allocated and redistributed between local authorities³³. Yet eight years later, this has still not taken place. The Institute for Fiscal Studies (IFS) has said that "at some stage, an understandable desire for stability becomes damaging inertia" and called on the government to "get a move on with completing the review" ³⁴.

In announcing the intention to hold a Fair Funding Review in 2016 and in publishing a first consultation in 2017, the government noted then that methodology had not been updated since 2013/14³⁵. The reforms were initially set to be implemented in 2020/21, then were pushed back a year and then postponed due to the Covid-19 pandemic.

After the first two delays, the Housing, Communities and Local Government Committee in 2021 recommended that the government implement the Fair Funding Review "as soon as possible" to "partly restore the link between funding and

³² DLUHC (2024) - Local authority revenue expenditure and financing: 2024-25 budget, England

³³ The Rt Hon Greg Clark MP (2016) - HCDeb, Vol. 604, c.1642

³⁴ Levelling Up, Housing and Communities Committee (2023) – Oral Evidence: Financial distress in local authorities by David Phillips, Associate Director, Institute for Fiscal Studies

³⁵ Ministry for Housing, Communities and Local Government (2017) – <u>Fair Funding Review: a review of</u> relative needs and resources

need³⁶". However, in December 2023, the government confirmed that the Funding Review would not be implemented in the 2019-24 Parliament³⁷.

The impact of the delay is that funding is now uncoupled with perceived needs. Analysis by the Institute for Fiscal Studies has shown that "while more-deprived areas receive more funding, for local government...they do not receive as high a share of the national funding pot as the formulae used in official spending needs assessments suggest they should³⁸". This suggests the necessity for updating the needs indicators that delegate where funds should go.

Following the 2024 General Election, the government has committed to finally implement a Fair Funding Review. Jim McMahon, Minister for Local Government and English Devolution has said that "any fair funding formula of course has to address the range of challenges that local authorities face, whether that is their local tax base, and how much they can realistically generate from their local communities and businesses, or the cost of service delivery and the demand within a local community. We will ensure that the fair funding formula, of which multi-year settlements are a part, is done with that rigour³⁹."

Past attempts to reform local government finance through reform of the funding methodology have been beleaguered by politics, since any proposed reform is likely to result in "winners" and "losers". In the past, sectoral bodies representing different local authority governance models and geographies have also taken different stances on proposed reforms, largely centred around the relative weighting attached to deprivation and rurality in any calculation. For example, London Councils⁴⁰ has advocated for stronger weightings for deprivation and the County Councils Network (CCN)⁴¹ has emphasised the importance of accounting for rurality.

With reforms having drifted for over eight years and the methodology now over a decade old, there is now a sector-wide recognition of the need for reform as funding distribution models no longer match resources to need. The Local Government

³⁶ Housing, Communities and Local Government Committee (2021) – <u>Local authority financial sustainability</u> and the section 114 regime

³⁷ Levelling Up, Housing and Communities Committee (2023) – <u>Oral Evidence: Financial distress in local</u> authorities

³⁸ Institute for Fiscal Studies (2023) – How much public spending does each area receive? Local authority level estimates of health, police, school and local government spending (ifs.org.uk)

³⁹ Jim McMahon (2024) – HCDeb, Vol.753, Col 5

⁴⁰ The Guardian (2019) – Plan to redirect inner-city funds to Tory shires 'a stitch-up' | Local government | The Guardian

⁴¹ Government Business (2020) - County councils welcome fairer funding promise

Association (LGA) has called for a Fair Funding Review that lifts the overall funding pot across the sector, ensuring no council loses income⁴², London Councils has said reform must be a "top priority⁴³" and the County Councils Network has said that formula reform is now "inevitable," and the government must "focus on importance of lifting the overall funding pot⁴⁴". With this sector-wide consensus on the need for reform, the Fair Funding Review looks likely to now finally be taken out of the "too difficult" Ministerial box.

2.2 Devolution of revenue raising powers

Looking past the 2024 Autumn Budget and ahead towards the Spending Review early next year, the rhetoric of devolution has very much formed a part of Labour's commitment, amongst its other missions, to economic growth. As such, it might be expected, especially in light of the forthcoming English Devolution Bill, that changes to the relative autonomy of local government across England might bring about further opportunities to raise and retain revenue. At present, only 23 percent of spending decisions are made locally, and only 5.1 percent of total government tax revenue is raised by local government⁴⁵.

2.2.1 Context for devolution

There are a number of ways for fiscal devolution – that is, greater revenue collection and spending powers for local authorities – to open up greater opportunities and capacity for local government to provide services and meet escalating pressures of demand. Among options to broaden the suite of possible local taxes, there exist arguments that larger scales of governance can act as the most efficient instrument for the fair collection and distribution of resources, albeit with the caveat that decision-makers at the more local level often have a better knowledge of the needs of place. The question of devolution is one, therefore, of balancing efficient resource distribution with place-based knowledge.

Labour has persevered with the previous government's pursuit of extending mayoral combined authorities to all corners of the country. Some concerns lie in the potential for regions in 'devolution deserts' without mayors to be overlooked by central decision-makers – concerns potentially amplified by the launch of the Mayoral Council by the Deputy PM, a council notably steeped in Labour representation –

⁴² Local Government Association (2024) - Autumn Budget and Spending Review Submission 2024

⁴³ London Councils (2024) – Update on London Councils' finance pressures

⁴⁴ Room 151 (2024) - CCN: councils face 'unpalatable trade-off between reducing services and 'insolvency'

⁴⁵ Centre for Progressive Policy (2023) – Funding fair growth: Can fiscal devolution help?

and there remain, and will remain for some time, details to iron out surrounding the efficacy of the spatial and demographic reach of the combined authorities, and whether the government will force the expansion of the mayoral system.

However, such large and collaborative sub-regional bodies may interact well with further transformations to the fiscal status quo. Presently, for instance, the instigation of the first wave of single settlements for the trailblazer combined authorities in Greater Manchester and the West Midlands – both under Labour control – emphasises the potential to not only simplify the funding environment across larger organisational networks, but also to emphasise how allowing local government discretion in spending can precipitate better value for money and sustainable outcomes.

2.2.2 Local fees, charges and levies

Another option for 'growing the pot' is the extension of local fees, charges and levies. Local authorities already have some decision-making powers over the setting of fees for certain services, including parking and leisure centres, with which revenue must be spent within the same service areas. However, these are small sources of income hypothecated for specific services and will not be extended to bolstering wider local government revenue pooling. Additionally, the use of one-off hypothecated tax in response to the wider demographic challenges for local government is unlikely to be a long-term solution, ⁴⁶ although this avenue has received support from government sources in the past in the specific context of funding the NHS and social care.

Completely new forms of local taxation levied at the local level could, in theory, become additional to the existing fiscal powers of local government, although are unlikely to provide anything more than marginal revenue support. In the Netherlands, for example, partnerships between municipalities enable the coordination of service provision in the context of freedom to choose what taxes and how much tax to levy, and how much to distribute, at the municipality level⁴⁷. Options with smaller revenue yields of this kind include the introduction of a tourist tax, which is a mechanism that has extensive international precedent and is popular due to the fact that it would not raise the tax burden of local residents. For the Dutch system, options for local taxation range widely across a real estate tax, refuse tax, pollution levy, and taxation on the use of municipal land.

While heaping various, but fairly constrained, options for local taxation on more fiscally autonomous local authorities may present only a drop in the ocean when

⁴⁶ Institute for Government (2018) – Hypothecated tax is no long-term solution for funding health and social care

⁴⁷ Localis (2020) – Fiscal Devolution: Adopting an international approach

compared with the immensity of local government financial crises, learnings can be drawn from countries that choose to offer local government more fiscal freedom than the UK. The Dutch example, for instance, proves that there is benefit to be drawn from cross-organisational collaboration to choose how to levy taxes, as Inter-Municipal Cooperations are the primary mechanism through which municipalities can coordinate on service provision, while tax collaborations form the brunt of decision-making concerning the levying of taxes. Additionally, there is always a case to be made for diversifying the mechanisms and sources from which tax might be levied at the local level, to entrench a more extensive financial resilience at place level.

2.3 Uniform reform of current powers

As the two main taxes currently collected by councils, business rates and council tax are often signalled out as obvious targets for reform. This is particularly true for the latter, which remains rooted in property valuations from more than three decades ago. Perhaps unsurprisingly, given the potential for council tax reform to radically transform the bills of households in some parts of the country, business rates has received the most focus from central government. Arising from the Budget, the government has instigated a review of business rates, but have left council tax untouched so far. Considering the practicalities of both, however, will be necessary for any root-and-branch examination of local government finances.

2.3.1 Business rates

The "bricks and mortar" approach of levying taxation from businesses based solely on the rateable value of their spatial footprint incites criticism. Although taxes levied on properties are inherently easy to collect, there are questions of fairness raised in the context of the changing high street, especially in the years following the pandemic, during which business rates relief brought support to the retail, hospitality, and leisure sectors. Labour, in the Budget 2024, proposed a change to business rates that would include a higher multiplier on the most valuable of business properties, which should, to some extent, address the pressures on smaller and high street businesses relative to larger corporations. However, there is still a way to go before perceived parity is reached between the immensity of some businesses that function predominantly online, with little physical footprint, and smaller businesses. Any future and further transformation to business rates would need to balance local government financial needs with the ability for businesses to pay the tax.

For local authorities, concerns lie with the extent and mechanism of the system of retention. Since 2013, business rates retention has been frozen at 50 percent

remaining with local authorities, while the other half gets funnelled back to central government. Additional revenue raised by the local authority can be retained, which acts as an incentive for local authorities to proactively encourage local economic growth. The question of redistribution makes the system more complex: some authorities receive a 'top-up' to their retained revenue, while some receive a tariff, based on central government valuation of need based on the allocation of the revenue support grant, itself calculated with the Relative Needs Formula.

The levels of redistribution under the current retention scheme have not been recalculated since its launch in 2013, and although higher rates of retention have been proposed and committed to by consecutive governments, the commitments to additional revenue retention of up to 100 percent for local government have remained unenacted. However, pilot schemes in Greater Manchester, Liverpool City Region, the West of England, Cornwall, and the West Midlands have all operated with 100 percent retention rates since 2016⁴⁸, and will continue to do so, following the Budget, for the 2025/26 period. It should be noted that these councils do not receive any funding through the Revenue Support Grant.

Possible alternative mechanisms would have to take on the assumption that a fairer taxation on businesses would be contingent on business turnover or profits – which could also, in theory, incentivise local authorities to drive forward economic growth and support local businesses. Yet there are a number of challenges inherent to introducing extensive transformation to or replacement of business rates, including identifying who and what to tax, issues collection and administration of valuation and collection, and the variation of income to local government compared to the present norm. Completely new taxation in place of business rates, on the other hand, could take the form of local corporation tax retained by local government, without necessarily completely abolishing business property taxation⁴⁹.

Although large businesses of more than 250 employees only account for 0.1 percent of businesses in the UK, they account for almost half of all turnover in the country, while the micro-businesses that make up 95 percent of businesses account for only 21 percent of turnover⁵⁰. Additionally, almost one in five businesses in the UK are located in London, with another 15 percent in the South East while the North West and East make up another 20 percent between them: the disparities in location of businesses is, naturally, already nominally mitigated by the 'top-

⁴⁸ House of Commons Library (2024) - Reviewing and reforming local government finance

⁴⁹ Kevin Muldoon-Smith and Mark Sandford (2024) - Doing business rates differently

⁵⁰ House of Commons Library (2024) - Business statistics

up/tariff' system of business rates retention and the Revenue Support Grant. But any new mechanism for locally raised and retained business taxation must invariably tackle the question of distribution particularly when business turnover is so localised to only a few businesses and must not dampen the incentivisation of local growth.

In the past, national government has vetoed the instigation of an online sales tax in order to redistribute the tax burden away from high street businesses. This leaves only so many available options for renewal, but it is likely that any change or devolution of responsibilities over business rates to local government would require the support of a more diversified revenue-raising environment for local authorities.

2.3.2 Council tax

Some of the financial burden suffered by local government in the context of dwindling central government funding has been historically mitigated by increases to council tax bills.

Council Tax values are based on the grouping of domestic properties into bands based on the price that they would have sold for on the open market in 1991. There are eight bands in England, listed from A to H, and every property within a tax band pays the same charge according to the rate set by the administering authority. The administering authority will collect a total yield equal to the number of properties in each band multiplied by the rate, with a reduced yield according to the number of properties benefitting from tax discounts or exemptions.

The following section considers a variety of changes that could be made to the council tax system, each would have different effects on tax yield based on their effect on either bands or rates. Revaluation of the bands, for example, could just shift the number of properties in each band for each authority, without impacting rates. For some authorities, particularly those in areas with higher number of properties with values that have increased disproportionately more than those in other areas since 1991, this would lead to significant increase in the tax burden on some residents.

Similarly, the addition of new, higher rated bands would potentially lead to a good deal of pushback, unless rates were levelled out in order to maintain a more balanced impact that would mitigate the concerns of residents in higher-value properties.

Notably, council tax liabilities are not proportional to even 1991 property values. The IFS has argued for a revaluation that improves proportionality by ensuring that the rates in each band are calculated based on the median price of properties in each band – this could be done in a revenue-neutral fashion, but could also ensure

that any overall rate increases would be fully progressive.⁵¹

Ultimately, council tax reform should be divided into two considerations: a) revaluation to ensure that the tax is no longer regressive, based on property values that are thirty years old and ultimately disproportionately harming those in more deprived areas, and b) devolution of powers concerning council tax to administering authorities, including fully devolved rate-setting powers and the equalisation of funding for local authorities based on the redistribution of grant funding based on, in an ideal scenario, the revaluation of bands and rates. Each of these considerations has significant political implications.

Since the 2012/13 financial year, a system of local referendums for rises above three percent has, however, been in place to prevent excessive increases to council tax, which, since 2016/17, has allowed local authorities with social care responsibilities – counties and unitaries – to make use of a five percent threshold for council tax increase without recourse to public vote. In the long-term, however, it is unlikely that gradual increases to the yield that local authorities receive from council tax will meet the immense revenue challenges faced by local government.

The literature on council tax reform and the necessity of revaluation is extensive, and is primarily concerned with the regressive state of property valuation, unchanged since 1991, with half of all households estimated to be in the incorrect band⁵².

The practicalities of revaluation

Under the assumption of revaluation, whether only in the form of pure revaluation, including additional tax bands or other transformation such as the removal of the single-person discount, there would be fundamental 'winners and losers' across the country, dependant on how much property values have changed relative to other regions. Charges in London rose more than twice as much than those in the North East from 1995 to 2020, and disparities in tax bills would be exacerbated under the assumption of continuous onward revaluation of properties⁵³.

Different approaches to valuation create disparities at different levels. As highlighted by research from the IFS, central government funding would need to respond to the changes in tax bases that council tax reform would introduce, in order that higher rates of taxation in London and the South East, where property

⁵¹ IFS (2020) - Revaluation and reform: bringing council tax in England into the 21st century

⁵² IFS (2020) - Revaluation and reform: bringing council tax in England into the 21st century

⁵³ Ibid.

23 BITING THE BULLET

values are the highest, would not translate to greater disparities in service provision between those regions and the rest of the country⁵⁴. The Centre for Cities has also proposed the devolution of rate-setting powers to local and combined authorities⁵⁵. However, council tax rises through increases to rates should not be relied upon to solve local government financial crises without wider change to the system in order that the tax burden does not become insurmountable for individuals.

While updating the cap on council tax referendums would, in theory, allow local authorities to better match their revenue collection to the needs of place, under the assumption that large rate increases would be fiscally neutral, and so match revenue requirements, the capacity for increasing council tax diminishes in the face of political reality. It is unlikely that the party controlling a given council would be re-elected if council tax were to be hiked to unsustainable levels in order to meet the absolute necessities of service provision – particularly without a fair revaluation of the regressive system. Almost all county councils are currently under Conservative control, meaning that hikes to council tax to meet the demographic demands of places with debilitating social care bills would disproportionately impact Conservative control at the place level.

Granting rate-setting responsibility for council tax without wider fiscal control and other forms of revenue-raising possibilities leaves councils between a rock and a hard place, while removing accountability from central government in ensuring that local government has the resources it requires to meet the needs of place without exacerbating existing cost pressures on local populations.

On the other hand, as recently as earlier this year the then-Conservative government announced that it had no plans to carry out revaluation, citing the expense of executing a new programme and the potential for penalising low-income groups, who may be asset-rich but cash-poor, such as pensioners, who may be unable to pay for an increase in council tax on homes that they have inhabited for years⁵⁶.

Overall, however, as with business rates retention, despite the change in *who* pays the tax, the intake of revenue across local government might not shift that much under the sole revaluation of council tax, without a potential reform to council tax rate increase rules. Furthermore, fair reform to property taxation will be reliant on the Fair Funding Review, or potentially further review to needs-based

⁵⁴ Ibid

⁵⁵ Centre for Cities (2024) – <u>Devolution Solution: How fixing English local government will improve</u> economic growth

⁵⁶ DLUHC (2024) - Financial distress in local authorities: government response to the Select Committee report

metrics for equalisation. Without council tax reform, changes to grant funding that rely on council tax increases would exacerbate issues in redistribution for areas of high deprivation⁵⁷.

Ultimately, the question for next year's Spending Review and ongoing revenue concerns for local government will, and must, concern the fairness of local property-based taxation and the capacity for transformation across the system. In both the cases of council tax and business rates, questions of reform are likely to have most negative political impacts for either Conservative-led counties or London's predominantly Labour-controlled boroughs.

The politics of revaluation

In the former case, it may be that local perception turns in favour of the opposition. In the latter, it is perhaps unlikely that those who would be most affected by, for example, increases to rates or changes in council tax band would make a significant-enough difference to the overall London weighting in favour of the Labour government. In the London mayoral elections, 2024, Labour received 40 percent of both the constituency and London-wide list votes, 58 while 59 of 75 London seats went to Labour in the 2024 general election, implying a strong Labour hold over the city. As such, it could be that the current government, at this early stage of the political cycle, are ideally placed to introduce reforms that would a) require a long-term programme of implementation and b) have the greatest negative impact on areas that may not produce unpalatable political ramifications. Questions of resourcing transformation should, regardless, be met by the argument that transformation is necessitated by the failures of the current system.

The actual relative impact of revaluation on the 'losers' relative to other regions, and the consequent political backlash, would rely primarily on both the rates chosen by local authorities and the magnitude of change to the equalisation formula, which would need significant renovation in the case of council tax becoming less regressive. Many councils would see their overall yields from council tax take a plunge as more of their properties will have seen limited value increases in the past 30 years. It is already the case that the instrument for equalisation has its critics, particularly in the context of boroughs with high numbers of businesses paying high business rates with limited local retention.

25 BITING THE BULLET

But equalisation is necessary if local taxes are to benefit local communities across the country, and so the political repercussions of council tax revaluation will be partly defined by the extent of change to equalisation - and how far the system of equalisation accurately accounts for the disparities of needs across local authorities.

Using IFS analysis of a fiscally neutral revaluation of council tax mapped across local authority political control, ⁵⁹ it becomes evident both that revaluation would hit London boroughs the hardest, and also that as an overall proportion of Labour-controlled parliamentary seats – although there would be a tight margin – more Labour seats would see average decreases to individual tax burdens than increases. Political repercussions would therefore mostly be defined by how likely voters in London boroughs, as well as certain other Labour-controlled urban areas such as Brighton and Hove and Cambridge, would be to change their voting habits. The most hard-hit boroughs, where average council tax would see more than 20 percent increase, are all comprised of seats that have been safely Labour mostly since the 1990s or since their own creation, with the exception of Islington North, Jeremy Corbyn's constituency, and the relatively high Liberal Democrat vote in Bermondsey and Old Southwark. It might be assumed, therefore, that council tax revaluation could be relatively undamaging to Labour's overall majority.

Revaluation by LA by political control: >10% impact on council tax					
Billing authority	Control (15 October 2024)	Revaluation – impact on council tax			
Hackney	Labour	36.74%			
Waltham Forest	Labour	25.36%			
Lambeth	Labour	24.29%			
Lewisham	Labour	22.83%			
Islington	Labour	22.76%			
Southwark	Labour	22.76%			
Haringey	Labour	21.32%			
Camden	Labour	19.23%			
Newham	Labour	17.06%			
Brighton and Hove	Labour	16.68%			
City of London	IND	16.26%			
Hammersmith and Fulham	Labour	16.04%			
Merton	Labour	15.81%			
Brent	Labour	15.32%			
Wandsworth	Labour	14.30%			
Tower Hamlets	IND	13.78%			
Greenwich	Labour	13.71%			
Cambridge	Labour	13.28%			
Bristol, City of	NOC	12.46%			
Richmond upon Thames	Liberal Democrat	12.29%			
Oxford	Labour (minority)	11.21%			
Kensington and Chelsea	Conservative	10.27%			
Westminster	Labour	10.13%			

Source: Institute for Fiscal Studies

Likewise, under the scenario not of complete revaluation, but the instigation of a 0.5 percent flat-rate property tax, the relative "losers" would again primarily be those Labour-led London constituencies. In this scenario, it would also be the case that the largest "winners" would be overwhelmingly Labour constituencies – primarily in the North West, North East, and the East Midlands. Additionally, in this scenario, only 23 percent of Labour-led boroughs would see an average increase in tax on property, compared to almost 40 percent of Labour boroughs under a council tax revaluation scenario.

Annual estimate of a 0.5% property tax based on median property values relative to Band D average council tax by LA: >20% difference in property tax

Billing authority	Control (15 October 2024)	% difference with property tax
Westminster	Labour	395%
Kensington and Chelsea	Conservative	344%
Wandsworth	Labour	254%
City of London	IND	224%
Hammersmith and Fulham	Labour	178%
Camden	Labour	91%
Isles of Scilly	IND	81%
Islington	Labour	71%
Richmond upon Thames	Liberal Democrat	66%
Hackney	Labour	60%
Barnet	Labour	58%
Southwark	Labour	53%
Windsor and Maidenhead	Liberal Democrat	53%
Tower Hamlets	IND	49%
Lambeth	Labour	47%

St Albans	Liberal Democrat	44%
Elmbridge	IND+LDM	42%
Merton	Labour	41%
Ealing	Labour	41%
Haringey	Labour	39%
Brent	Labour	39%
Bromley	Conservative	35%
Three Rivers	Liberal Democrat (minority)	32%
Hillingdon	Conservative	31%
Hertsmere	NOC	30%
Wokingham	NOC	28%
Mole Valley	Liberal Democrat	26%
Newham	Labour	26%
Harrow	Labour	24%
Hounslow	Labour	23%
Epsom and Ewell	IND	22%
Greenwich	Labour	22%
Epping Forest	Conservative	22%
Waltham Forest	Labour	21%
Kingston upon Thames	Liberal Democrat	20%
Redbridge	Labour	20%

Source: ONS, Median house prices for administrative geographies; ⁶⁰ DLUHC/MHCLG, Council Tax levels ⁶¹

⁶⁰ ONS (2023) – Median house prices for administrative geographies: HPSSA dataset 9

⁶¹ DLUHC (2024) – Council Tax levels set by local authorities in England 2024 to 2025

Consequently, if large-scale transformation to property taxation were undertaken in order to establish a more progressive method of taxation, devolved or otherwise, it has the potential to be a fairly politically neutral choice to make for a Labour government. Although many of the most senior members of the Labour party hold London seats, and may be politically averse to sweeping changes to the tax burden on their constituents, it is also the case that the Labour government enjoys a lead that is geographically spread across areas of differing levels of property value, with some of its safest constituencies in those places that would see the highest increase to their tax burden.

2.4 Reforming national taxes

The use of funding formulae to allocate grants to local government means that, until the calculation of needs and potentially the indicators of needs for communities are reassessed, it is likely that the system is unfit, and will remain unfit, for the wider goal of encouraging economic growth across all of the country's regions. The unfair allocation of taxation will remain predominantly a political choice until government reforms the process.

Under a future in which extensive fiscal devolution has occurred, in which local authorities have a suite of taxes to choose to levy and can set their own rates, central government grants would, however, be only one small part of a much more stable system. On the other hand, some suggest that even instigating a reform of current powers would be unlikely to fully meet the challenges presented particularly by those three crises of local government: social care, Special Educational Needs and Disability (SEND) education, and temporary accommodation (TA). As such, complete overhaul or more radical reform to national taxation and allocation are worth consideration.

2.4.1 Distribution of income tax

One prominent, radical fiscal measure would be the distribution of income tax. There are multiple international precedents for the assignation of a share of personal income tax and VAT to local government. Germany, for example, has a complex 'payout' system of allocating income tax revenues to its municipalities, 62 while in Italy local authorities have the power to set a supplementary rate on income tax. The UK, in 2021, was the country with the highest proportion of tax revenue collected by central government in the Organisation for Economic Co-operation and Development (OECD),

whereas some countries such as Korea and Sweden see local government collect a much larger proportion of revenue: 35.9 percent and 35.0 percent respectively⁶³.

The centralised grant system in the UK naturally limits the discretion of local authorities to meet the needs of place in comparison to other countries. A devolved share of income tax, or even also of other large national taxes such as VAT or corporation tax, might provide a more stable and predictable source of revenue, and could also add to a diversified suite of taxes that would make local finances more resilient and less dependent on property taxation as a sole source of revenue income.

However, it is also the case that a form of localised income tax might prove inefficient and, fundamentally, would rely on a strong system for re-allocation based on fit-for-purpose needs-based calculations. So, again, the system will need to await revaluation in order to produce a suitable formula for distribution. At the moment, if income tax were to be distributed based solely on where it is raised, this would benefit services in the South East and London disproportionately. It could be that a new distribution formula would include economic incentives, with some similarity to the current system of business rates revenue increase retention, whereby local authorities could keep a percentage of any increase in income tax revenue.

2.4.2 Land value tax

Conversely, the idea of a land value tax (LVT) to reform the system of property taxation has had its proponents since, at the very least, the late 19th century. Replacing council tax and business rates with an annual tax based on the recent market value of the land, and potentially split-rate in conjunction between the land and the recent value of the property itself, could better utilise private wealth for social benefit. Much of the argument for an LVT traditionally surrounds the idea any value added to land is passive income for landowners and that any value gained from improvement to the land should therefore be transferred to public benefit.

The UK operates under a discretionary planning system, which undermines the willingness and capacity of developers to provide affordable housing, as it emphasises the potential profitability of new homes rather than allocation of housing based on assessed needs. The problem is particularly rife in rural areas, which are beset by an insufficient supply of affordable homes and wide-ranging speculative investment in land that fails to associate social value with best use⁶⁴.

⁶³ OECD ilibrary (2024) - Revenues by level of local government

⁶⁴ Phoebe Stirling et al. (2024) – <u>Land, landowners, and the delivery of affordable homes on rural exception</u> sites in England

In order to avoid rampant speculation, therefore, any LVT would have to be rolled out under the basis of ongoing revaluation ⁶⁵. It is, however, generally agreed that an LVT may be able to depress speculative 'hope values' on land, if estimated hope value is included within the valuation of land for taxation, ⁶⁶ and deter land banking. However, this is not a guarantee: these conclusions work under the assumption that large developers would be unwilling to lose cash on an ongoing tax expenditure ⁶⁷.

On average, in the UK, over 70 percent of the value of homes is represented by the value of the land, ⁶⁸ suggesting that the LVT could tap into an underutilised asset that would, by its very nature, engender a greater stability for the economy – as land is finite and tends not to depreciate over time to the same extent as property, it presents a more stable value against which to levy taxes.

A split-rate LVT, combining property and land taxation, could also present the opportunity to levy higher rates on second homes, as is the case in some areas that have higher council tax rates for second homes, and on international investment. A better system of taxation of owned land assets could also make room for lower transaction taxes, which would incentivise greater mobility in the population. This would be of benefit to one particular group, who are often brought up in arguments against the LVT: cash-poor, land-rich households, such as pensioners, who might be disproportionately impacted by the implementation of an LVT. There is precedent, notably in some states in the US, of a system of deferring payments of LVT until the property is sold or transferred. The positive in this case would be the incentivisation of downsizing, which can help to energise the housing market in the round.

It has already been suggested that the system of land value capture, making use of value uplifts from planning permissions or new infrastructure, currently benefits only landowners in the UK, as they retain a large portion of any uplift. Despite existing mechanisms such as Section 106 planning obligations for affordable housing and the Community Infrastructure Levy, there is nothing in place currently designed specifically to capture land value uplift,⁶⁹ demonstrating again the case for an LVT.

⁶⁵ John Muellbauer (2024) - Why we need a green land value tax and how to design it

⁶⁶ Ibid

⁶⁷ Nick Gallent et al. (2024) – Reflections on 'land value recovery' for UK rural areas, and its implications for housing affordability, wealth-building, rural land use, and community wellbeing

⁶⁸ John Muellbauer (2024) – Why we need a green land value tax and how to design it

⁶⁹ Housing, Communities and Local Government Committee (2018) - Land Value Capture

On the other hand, there is some suggestion that land value capture in particular would not produce transformative amounts of revenue for local government, and therefore would underserve the emergencies of funding that beset local authorities. Again, within a wider range of local taxation options and under the assumption that local authorities could have the power to decide what rates would be appropriate to levy to make best use of their local tax base, and with the support of a renewed formula for redistribution, it may be that an LVT could form part of a much more resilient, devolved fiscal context.

It has also been suggested that introducing an LVT in the form of a split-rate tax, with a continued rate levied on property values, might induce a sufficiently high stream of income to meet revenue pressures⁷⁰. Furthermore, a good system of redistribution would limit the disparity between the "winners" and "losers" from large-scale implementation and drastic tax overhaul. However, opposition abounds from landowning interests, particularly as land in the UK is unevenly distributed, meaning that a very small number of powerful and wealthy people would be disproportionately impacted by the introduction of an LVT. The opinion of vested interests would likely, therefore, continue to block potential reform in this case.

Furthermore, critics do emphasise that an LVT would be stymied by complexities in terms of how land value is calculated, which itself would require resourcing that is unlikely to be popular among politicians – note the above section on council tax revaluation, and the political disinterest in a programme of revaluation based on expense. Even supporters of land value capture must grapple with the question of how to measure an increase in land values, as this requires inference of the underlying land value from the value of what is built on the land?

However, in a current political context that has encompassed its rhetoric on growth with a drive towards a rejuvenated national housebuilding programme, it should be noted that LVT is best placed to capture and incentivise uplift through the "best use" of land – which is, often, residential. The government's £500m top-up to the Affordable Homes Programme suggests also an attempt to meet the crisis of under-supply in affordable housing, which may prove to mitigate some of local government's temporary accommodation crisis.

O Richard F. Dye and Richard W. England (2010) – Assessing the Theory and Practice of Land Value Taxation

⁷¹ Transport for London (2017) - Land value capture

Affordable housing is unpopular with developers, particularly as it can depreciate the speculative value of land. However, the introduction of LVT might, in reducing speculative behaviour, encourage private development, with the assumption that developers would be less likely to sit on undeveloped land, and also mitigate land costs and therefore enable local authorities to make cheaper purchases of land for social housing. The Levelling Up and Regeneration Act 2023 has allowed local authorities to undercut the hope value of land through the process of enacting a compulsory purchase order, where doing so is in the public interest. However, extending the mitigation of hope value for all potential development would likely facilitate a boost to housing supply - whether through changes to taxation or not. It may be that transformation by Labour to the planning system will include efforts to depress the impact of hope value on land costs, but this remains to be seen. As it is, land cost reduction would potentially make an LVT more popular in areas in greatest need of housing supply: coastal and highly touristed towns, London, and the South Fast.

However, the introduction of a Land Value Tax would require upheaval to the system and is without certain guarantee of the widespread success that is needed to tackle the immense pressures on local government. It should very much not be considered a silver bullet in terms of the immediate alleviation of fiscal pressures, overlooking the existing structures and the reforms needed in each case. As such, the focus of policymakers may be better spent on ensuring that instruments for land value capture are able to perform well and ensure the best possible outcomes for communities across the UK, thus incentivising local growth and capitalising on every possibility to add to the social and environmental value of the built environment.

CHAPTER THREE

Prospects for this Parliament

The national renewal agenda of the new government depends on well functioning public services at the local level. This section examines how the Autumn budget, which set the tramlines for the next spending review, responds to the crisis points for local government laid out in section one. Beyond this, potential for the spending review and a wider policy agenda to build on some of the options for reform detailed in section two is also assessed.

3.1 The Autumn budget

The Autumn Budget 2024 notably hit the core points of crises for local authorities in the form of a suite of extensions to grant funding: £1bn uplift to special needs education and alternative provision, and a £1.3bn grant to local government for public service provision, including £600m for social care and £233m towards homelessness and rough sleeping services⁷².

To put the additional grant funding into the context of previous budgets and central government grant spending, the Homelessness Prevention Grant offered councils £315.8m in 2022 to 2023, with a top-up of £109m in 2023 to 2024, and a further top-up of £109m announced in early 2024;⁷³ a £2.6bn funding package was introduced for the years 2022 and 2025 for investment into Special Educational Needs and Disability (SEND) services, translating to £850m in 2024 for local authorities; and the autumn statement of 2022 announced £400m for 2023/24 ringfenced for adult social care and £680m in 2024/25⁷⁴.

What this budget presents, then, is a modest but reasonable upgrade to the sticking-plaster approach of the previous government. But to again refer back to the ongoing costs of these crises: £1bn for SEND in the context of a £3.2bn cumulative SEND deficit for councils is not going to go very far; neither will £600m for social care when an additional £8.3bn per year might be needed in ten years' time to meet spiralling demand; £233m towards homelessness and rough sleeping prevention is very positive, and somewhat matches annual increases in homelessness service spend since 2010/11, but costs may still prove overwhelming for those authorities at the brink bankruptcy because of their duties to provide temporary accommodation.

Overall, the new Budget has led to an increase in core spending power of 3.2 percent for local authorities, primarily through the £1.3bn of grant funding for services and some changes to council tax flexibilities for combined authorities and locally retained business rates⁷⁵. This is about equivalent to the average real-terms increase in spending power for local government since 2019/20, amounting to 3.1 percent. As such, the actual quantity of spend has not changed significantly, although the devotion to meeting the most pressing issues faced by local authorities

⁷² HM Treasury (2024) – Autumn Budget 2024

⁷³ MHCLG and DLUHC (2024) - Homelessness Prevention Grant: 2023 to 2025

⁷⁴ House of Commons Library (2024) – Funding for adult social care in England

⁷⁵ Local Government Chronicle (2024) – Councils set to get 3.2% increase in spending power

has been welcomed by some in the sector⁷⁶. Additionally, there are concerns that the change to employer's National Insurance and rises to minimum wage will negatively impact local government funding, with the Office for Budget Responsibility forecasting that local authority spending will fall to 4.8 percent of GDP by 2029/30 from 7.4 percent in 2010/11 and five percent in 2023/24⁷⁷.

Looking to future costs facing local authorities, the Local Government Association (LGA) has estimated that councils are going to face a funding gap of £6.2bn in the next two years⁷⁸. It is clear that, with the limited fiscal space for central government to increase spending on public services following this budget,⁷⁹ wider reform will have to be the answer to preventing further collapse of public service provision. Heightened public investment at this stage is positive for the long-term outlook for funding public services, but in the face of such immense pressures and the fairly inelastic premise of the Autumn Budget, any ongoing sanguinity across local government stakeholders concerning the state of public services will stem from opportunities presented at the periphery of the immediate cash injections in the Budget.

Namely, most of the optimism surrounding the Budget comes from "Phase Two", which represents the latter half of the Chancellor's bold plans for "change" and was cited no less than 47 times in the Budget paper. Evidently, this was a Budget that was forward-looking, or less charitably, a placeholder to plug an immediate gap – necessary, but only half-realised. Such is the hopeful view of the Chancellor's plan of action.

3.2 Spending Review 2025: Prospects for reform

Phase two is the conclusion of the Spending Review that will come early next year alongside a number of significant policy papers and plans for intervention: the infrastructure strategy, the establishment of Skills England, planning reform, and a white paper on work, with a long-awaited white paper on English devolution expected before the end of the year alongside a local government finance policy statement that will conclude the details of the coming multi-year settlement for local authorities.

⁷⁶ Room 151 (2024) – <u>Budget reaction</u>: additional funding falls 'far short' but local government anticipates 'lots more to come'

⁷⁷ The MJ (2024) - Budget: LGR confirmed in high tax, high spend Budget

⁷⁸ LGA (2024) - Autumn Budget and Spending Review Submission 2024

⁷⁹ Resolution Foundation (2024) – <u>Autumn Budget delivers short-term living standards pain in the hope of long-term growth-based gains</u>

37 BITING THE BULLET

Phase two will have to function within the bounds of the spending envelope already fixed by the Budget, and there are already concerns that those bounds are far too limiting in the face of vast spending need. As such, the appetite for reform will have to be one that isn't cash hungry, especially given the Budget's expectations for very limited rises to day-to-day public service spending down the line⁸⁰

3.2.1 Governance and local growth

A closer reading of the Budget does point to some budding enthusiasm for reform that goes beyond the baseline set by the previous government. On English devolution, the Budget promises local government reorganisation towards "simpler structures", combining the thread of combined authority enthusiasm that has gripped the country since Greater Manchester was established in 2011 with a much longer-standing trend for the creation of large unitary authorities from two-tier areas. Support for the mayoral combined authorities (MCA), in the form of integrated settlements for Greater Manchester and the West Midlands, and flexible single pot funding for the MCA's, is, firstly, positive: it represents a turn towards more resilient financial environment for local government that will grant greater autonomy in spending choices, and promote an enhanced capacity for better strategic, long-term purview due to the assurance of a multi-year settlement.

Reorganisation should, however, be approached carefully, as evidence on the short-term savings is not especially convincing⁸¹. The consideration must be whether or not a reorganised unitary authority can be more sustainable over the long-term, given the economic and political costs of the process. However, expectations for significant efficiency gains due to council reorganisation can, and should, be questioned – and, ultimately, should not be solely relied upon to produce savings in the long-term. England has some of the largest local government units by population size in Europe, highlighting that just expanding the geographic reach of regional structures is not necessarily the answer to poor regional equality. Simply reorganising the structure of local government does not, on its own, respond directly to the enormity of the local government financial emergency.

An indication of wider reform that may support the agenda for local growth is the restructuring of business rates to the assurance of permanently lesser business rates for retail, leisure and hospitality businesses paid for by a higher multiplier

80

on the rating of the most valuable business properties, with the fall from a 75 percent rates discount to 40 percent in order to avoid a cliff-edge drop in support for indispensable businesses. It remains that many businesses are likely to see their rates nearly double, 82 and there are further concerns that costs affected by the Budget will be passed downwards to customers, but in terms of providing for public services, it is positive to see that there will be efforts to ensure that local government income is unaffected by policy changes to business rates. Furthermore, the assurance of compensation to local government for administration costs mitigates some of the potential risk to local financial resilience that reform can instigate.

The implication for the time being seems to be that combined authorities – as well as Cornwall, which benefits from an existing rates retention structure – will continue to be the beneficiaries of business rates retention. Like most potential for restructuring of the local fiscal environment that goes beyond a rejuvenated grant system, it appears that the government are intent on a mayor-first approach, although the devolution white paper may reveal changes to the status quo in the respect of fiscal autonomy for non-mayoral structures – this seems unlikely, however.

3.2.2 Fair and efficient funding

From a funding perspective, simplifying the landscape through a proposed cancellation of unfunded Levelling Up projects alongside a transitional continuation of the Shared Prosperity Fund, until the promise of "wider funding reforms", inspires hope that both the English Devolution Bill and the Spending Review will begin to shape the structure of central support for local government in a manner that is actually supportive, rather than paternalistic. The promise to move away from competitive bidding for funding in phase two is also a very positive sign, and the effectiveness of Local Growth Plans remains to be seen, although the new environment of local growth funding reforms suggests some support across the board. The coming local government finance policy statement might pave the way for a period of fiscal transition.

However, following a Budget that seems to be staunchly pushing a mayor-forward future, it is vital that current asymmetries in growth are not deepened by the asymmetries in local government structures, and that the worth of the 'local' in 'local government' is not undermined by a blinkered push towards simplification and rationalisation. As this report has stressed, a fundamental prerequisite for ensuring regional equality will be the reform of the system of distribution.

Neither allowing local authorities to raise more council tax to cover statutory duties, nor ongoing extension of 100 percent business rates relief to certain combined authorities, will be sufficient to address the financial needs of *all* places, and any kind of wider reform to local fiscal responsibilities will need to be underscored by a fair funding review to ensure the more equitable distribution of revenue from fiscal transformation, a functional system of local audit, and a building of trust between central government and local government. The Budget, and the coming policy interventions concerning English devolution, at least insinuate something of the latter.

Overall, the crises outlined in this paper need drastic action: Phase one has hinted at the potential for reform, but the extent and effectiveness of transformative policy intervention remains to be seen. The stability of local finances will rely on the capacity for local government to make fiscal decisions that support local place, and to extend to a range of revenue sources that are more resilient to risk when combined in aggregate. Hopefully, the Spending Review and Devolution Bill will, moving forward in time and extent from the baseline of the Budget, consider the potential for local government to draw investment from locally informed decision-making and to balance its very demanding obligations against a fair system of revenue collection – with the absolute requirement of a functioning and fair process of distribution to ensure that existing deprivation is not further compounded by a lack of due regard – given to the country's asymmetric system of local governance.

3.3 Steps to genuine reform

Potential reforms that could be introduced for the 2025-27 period, that could be instigated as part of the considerations at hand in the coming Spending Review, therefore need to take account of the system as it is, not what it could be under the widespread and potentially disruptive instigation of full unitarization for all areas, in order to counter the financial crises.

3.3.1 Grant funding and local levies

Firstly, fair funding is paramount to any fiscal transformation, under the prerogative that any assessment of current and ongoing, actual need will have to result in an overall uplift to the funding pot in order to make sure those needs are met across the country. While the reformulation and simplification of grant funding in the Budget is a welcome effort, the system of top-down distribution must continue to meet the needs of place with a considerable injection of funding in the short-term to allow further transformation in the future, bolstering the financial environment for local public service delivery in alignment with Reeves' plan to "fix the foundations of the economy".

Consideration should be given to extending the decision-making power for local authorities to levy less significant additions to the current suite of local taxation, such as supporting local efforts to trial and establish tourist taxes, as part of an effort to diversify local revenue sources and support greater fiscal freedom in local government. Precedent and best practice should be taken from international examples.

Ultimately, however, greater fiscal powers, and trust, should be extended to local government regardless of overarching structure – because there are areas in need of massive uplifts to funding to meet the needs of communities that cannot be overlooked. Although the Budget has suggested reducing the funding for the functions previously delivered by Local Enterprise Partnerships and Business Boards, as well as pan-regional structures, there must be recognition that collaboration between authorities and across organisations can go a long way towards improving service delivery, even when such collaboration is formed organically without top down policy intervention. It remains to be seen whether Local Growth Plans will deliver in this respect.

3.3.2 Local property taxes

A renewal of the system of domestic property tax to ensure that it is at the very least up-to-date, is vital: council tax revaluation, or replacement, will go some way to ensuring that regional disparities are addressed provided that it follows a sufficient system of redistribution to councils with smaller tax bases under the new system.

Although there will be winners and losers in the case of any significant upheaval to the current system, the distribution of support for Labour at local and national level does suggest that immediate change will not necessarily result in significant political sacrifices.

Alternatively, it could well be that the best instrument for fair and well-distributed revenue collection to meet public service provision needs would be based on land valuation, rather than property. As such, efforts to better understand and overcome the issues of land valuation and introducing more efficient mechanisms for land value capture would support better national decision-making that responds to the most pressing questions of revenue collection and distribution.

It is unlikely, following the changes of this Budget, that there is appetite for further reform to business rates taxation. However, there remains much potential for more radical business rate reform to produce better outcomes across the board, with mechanisms based on business turnover more likely to produce a progressive system that would rely on the businesses with the most ability to pay higher rates

while supporting the local businesses that define England's high streets and places. A new business rates system would further incentivise local growth if revenue uplift, or even 100 percent of rates, could be retained by local government under the assumption of an up-to-date and fit-for-purpose calculation of redistribution of funds.

It is, finally, also unlikely that the current Parliament will see an immense overhaul of the country's taxation systems, but given the immensity and plurality of the crises facing local government and public services more widely, it may be time for government to extend consideration to reforming the way that national taxes are allocated and distributed. Again, international precedent for the devolution of a share of income tax could support knowledge building in efforts to decentralise revenue collection in the UK.



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