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EQUALITY AND EMPOWERMENT

A PROGRESSIVE PROPOSAL FOR FISCAL DEVOLUTION AND ECONOMIC DEVELOPMENT IN ENGLAND

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Like all publications of the Fabian Society, this report represents not the collective views of the society, but only the views of the individual writer. The responsibility of the society is limited to approving its publications as worthy of consideration within the Labour movement.

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An increasing consensus about the need for reform

England is generally agreed to be the most centralised nation of its size in the developed world, with central government involved in almost all aspects of how local authorities operate. Despite the extensive control exercised by Whitehall, ministers find this does not translate into effective action on the ground, while local leaders are frustrated by excessive bureaucracy and limitations on how they can drive economic development locally and regionally.

There is an increasing consensus across the political spectrum that the regional and local government system is not functioning effectively and should be reformed. We are therefore pleased to work with the Fabian Society on how fiscal devolution could be implemented in England.

In this pamphlet, the Fabian Society sets out to make a progressive case for devolving public spending, raising important questions about how public money can be used more effectively to deliver policy objectives. In doing so, it has arguably made a financial management case as well, seeking to reform poorly designed and unstable funding arrangements, excessive bureaucracy, and overcentralised decision-making processes.

One of the benefits of these proposals is that they do not attempt to propose a radical redesign of the tax system for local government and hence they do not depend on overcoming the challenges that come with wholesale tax reform. That also means that these proposals should not stand in the way of much needed reform of business rates, as called for by ICAEW.

Governance and accountability

Public confidence will be critical to the success of fiscal devolution, especially in the light of recent government failures in certain English local authorities. More control over spending must be accompanied by stronger governance and accountability. Greater transparency, easier-to-understand financial reports, high-quality timely local audits, and more investment in finance teams, processes, systems and financial controls will all be essential, not just for the public but also to bring policy makers on board.

There must be confidence in regional and local decision-makers to make the best use of public money, and that will mean strengthening governance arrangements by having independent members on audit committees, accountability events on financial *performance and on accounts, systems and controls, training, information and support to enable councillors to hold leaders and officers to account, performance management that encompasses the balance sheet and financial risks, and transparency around decision-making and outcomes.*

While it could be argued that even more radical reform is required, the Fabian Society has put forward an innovative proposal to improve local and regional government in England through greater fiscal devolution of spending powers, at the same time as freeing up central government to focus on national priorities.

We are pleased to be able to support the Fabian Society in exploring options for strengthening the ability of local and regional government to contribute to improving economic outcomes and reducing inequality.

After all, micromanagement is an ineffective way to run any organisation, let alone a nation the size of England.

Alison Ring OBE FCA
Director Public Sector and Taxation, ICAEW

About ICAEW:

*The Institute of Chartered Accountants in England & Wales (*ICAEW*) was founded in 1880, four years before the establishment of the Fabian Society in 1884. Our mission is to promote high-quality financial information and professional expertise to enable effective financial management and governance.*

We support 200,000 chartered accountants and students in the UK and worldwide. Our members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour, as well as to apply the highest professional, technical and ethical standards.

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SUMMARY

Concentrating fiscal power in central government has a real effect on people's quality of life. It affects their daily commute, the quality of their town centre, and the jobs they can get to. It bears a large share of blame for the unnecessary decline of many towns, and the underperformance of our cities.

Many of these problems can be traced back to the fact that just 5 per cent of tax is controlled at a sub-national level in the UK, compared to 13 per cent in France and 31 per cent in Germany. This holds back both central government and local government. It means local government cannot invest in economic development projects, like new bus, tram or train connections, or new social housing developments. And it means low growth in many areas, while others overheat – and local government is powerless to address the poverty and poor living standards that result.

England needs an English solution to fiscal centralisation – one which prioritises equality and empowerment. Fiscal devolution should be linked to local economic development, while the funding of other local services should be determined separately. We can learn from the devolved nations and similar countries, but while improving our own dysfunctional system, we must be aware of others' shortcomings – and try to avoid the inefficiency, legalistic logjam and unfairness that can result.

English fiscal devolution must make redistribution the foundation, not an afterthought. It should ramp up investment urgently in the places and for the people who need it most. And it should account for high regional inequality and beleaguered local government.

We therefore recommend that between 2025 and 2035 the government:

1. **Devolve an economic development budget for England.** Combined authorities and councils should receive a large, stable economic development funding stream, transferred from central government, settled in legislation, under local control with robust local accountability.
2. **Enable targeted levies and charges to unlock development**. Combined authorities and councils should get the powers and capacity to introduce new levies and charges, such as workplace parking levies, visitor levies and land value capture, so that they

can fund new projects, like housing developments and tram lines, independently of central government.

These reforms also require complementary measures. These should include devolution of real economic development powers, long-term local plans which focus on living standards and poverty, an increase in local capacity, and robust local checks and balances.

This model avoids the concerns progressives often raise about fiscal devolution. Under this model fears of 'postcode lotteries' would not materialise; local spending would be better protected from devolved austerity; central government would be able to focus on what it does best; spending inequality would be tackled; there would be no 'tax competition' or 'race to the bottom'; and households wouldn't have to pay more during a cost-of-living crisis. Finally, our recommendations sit alongside the wider reforms of local government taxation and redistribution that are needed in the long term.

1. INTRODUCTION

Fiscal devolution is often misunderstood. To some, it means a radical form of tax competition and differentiation, whereby places cut taxes in a 'race to the bottom' to attract private investment, undermining the tax base as they go. To others, it means councils creating a whole raft of new taxes, burdening and confusing businesses and citizens. Many fear that it means rich places getting richer, and poor places getting poorer.

However, another form of fiscal devolution is common in other countries, as well as being practical and progressive. It prioritises local empowerment, stability and diversity of funding based on tax revenue set aside for this purpose. It provides the funding necessary for transport and housing projects – something the UK sorely needs. Significant local tax variation is not allowed, so there is no 'race to the bottom' of lower tax, nor is there a 'race to the top' of higher tax. And transfers from richer to poorer areas are absolutely integral. This is the form of fiscal devolution that operates in highly decentralised countries, notably Germany.

British progressives should be champions of this form of fiscal devolution, and it should be far more prominent in progressive thinking than it is.[1] When we step back and survey the UK's many problems, it becomes clear that fiscal centralisation is a major contributor. 95p in every pound of tax goes to the Treasury, which then treats the money raised as central government money, to be doled out grudgingly, rather than as the public's money raised for the benefit of us all. The country, especially the capital, is treated like one big tax-generating machine, not a place where people live.

And in 2023 – after 13 years of especially poor *centralised* fiscal mismanagement and underinvestment – the case for decentralisation is stronger now than it ever has been. Centralisation has enabled both underinvestment in infrastructure and housing and then wasteful overspending on projects that do go ahead. It has allowed central government to devolve public spending cuts, undermining local democracy, while shirking accountability for the consequences. As a result, inequality is greater between both places and people.

We can see 'what might have been' on the streets and in the city centres of France, Germany, and the Netherlands. We may not realise it, but they are a visible testament to the value of fiscal devolution. Regional and local spending decisions have brought these places to life, funding tram networks, housing developments, cycle lanes, and public realm of a quality that shames our once proud towns and cities here in the UK.

This paper sets out a specifically progressive proposal for fiscal devolution and economic development in England. We focus on economic development, not service spending, because service spending has a far weaker relationship with local revenue income. And services which are already local (such as social care) are under such high pressure that they should be set aside from the fiscal devolution discussion. We look at existing fiscal devolution to the other nations of the UK and in other countries, before sketching out how fiscal devolution should look in England and addressing genuine and misplaced concerns regarding fiscal devolution.[2] This paper complements the work of the Fabian Society's Commission on Poverty and Regional Inequality, whose final report was published earlier in 2023.[3]

2. FISCAL DEVOLUTION IN ENGLAND, THE UK AND BEYOND

This section discusses how fiscal devolution works in other countries – first within the UK, and then in France and Germany. Then we discuss England in this context.

1. Fiscal devolution and the devolved nations

The devolved nations have a substantially greater level of fiscal devolution than regional and local authorities in England.

- **Scotland** has a population and economy similar in size to that of Yorkshire but has a significant autonomy over both spending and tax. The Scottish government receives a large block grant and has been allocated a portion of the tax base, with significant flexibility in how it can choose to spend those funds. It has powers to vary income tax rates and thresholds above the personal allowance; and half of VAT receipts will be 'assigned' to Scotland once a methodology is agreed with the UK government.[4,5] It also has devolved powers over taxing land and building transactions, and air passenger duty, although the latter has run into legal/state aid difficulties. Council tax and business rates are devolved and Holyrood has made minor alterations to both. Scotland can create additional local taxes to fund council spending, which they have used to enable councils to raise workplace parking levies and have recently consulted on a visitor levy (similar to a tourism or 'hotel bed' levy).[6] The Scottish government is permitted to borrow, within strict rules, to fund capital expenditure and to smooth revenue shortfalls that result from fiscal devolution or unforeseen social security overspends.
- **Wales** has a population and economy similar in size to that of Greater Manchester or the West Midlands conurbation, but now has

some fiscal devolution, albeit less than in Scotland. The Welsh government has significant flexibility over how it chooses to spend its budget and has recently taken on partial income tax devolution, with the Senedd able to control a 10p slice of each income tax band.[7] Wales also has control over some taxes which raise a relatively small amount of revenue, like land transaction tax (formerly stamp duty land tax) and landfill disposals tax (formerly land tax), and it has full control over its own business rates and council tax policies.[8,9] Wales has reformed council tax, raised an additional council tax rate for second homeowners, and has recently consulted on a visitor levy too.[10] Wales is also permitted to borrow, again within strict rules and again to primarily fund capital expenditure or smooth revenue shortfalls.

- **Northern Ireland** has a population and economy similar in size to Kent, with a Northern Ireland Executive that, when in operation, has budgetary control over a proportionately greater block grant than available in other parts of the UK. The executive has powers over council rates and business rates, as well as delegated authority over corporation tax. A recent commission explicitly rejected full fiscal devolution and tax assignment, although it recommended gradually taking control of income tax, in a similar way to Wales or Scotland.[11]

The devolved nations' fiscal devolution settlements reflect very different circumstances from those in England. Their wider devolution arrangements involve very large grants, calculated via the brute simplicity of the Barnett formula, to fund high-cost public services such as health and education. This wider settlement in turn has the foundations of strong, politically coherent, national identity, which is not found in any English region.[12] And the journey to this point has also been challenging, to say the least – with a long history of unsuccessful referenda on devolution, Scottish threats to leave the UK, and the 'troubles' in Northern Ireland.

But the devolved nations do provide a very useful example in other ways. They demonstrate that breaking the UK Treasury's grasp over tax and spending is possible, if only we have the will to try. They demonstrate that there is an accepted need to pool risk across the UK, and to have safeguards and backstops to prevent areas from spiralling into a low-tax-revenue, low-public-spending spiral. Finally, perhaps most importantly, they highlight the importance of *transfers* to underpin fiscal devolution and resolve some of the accountability challenges associated with doing so.

2. Fiscal devolution in other countries

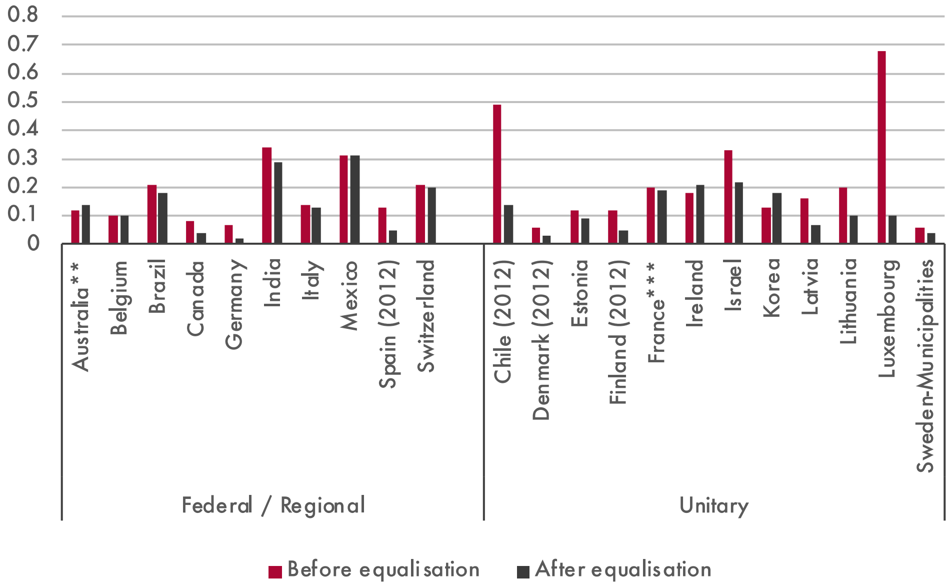
Outside of the UK, fiscal devolution is a standard, well-established feature of national governance. This is the case in countries with both federal and unitary constitutions. Germany and France are useful comparators:

- **Germany** is a federal country, governed by a constitution (basic law) which both sets out the universal standard of 'equivalent living conditions' and establishes that the 16 regional states (Länder) primarily exercise the functions of government, with significant power over how they choose to spend their budgets.[13] Some tax rates are within the remit of each state, but these are usually decided by them nationally, collectively, to avoid divergence. Municipalities collect business tax, local tax and property tax, but they cannot create new taxes. States and municipalities can change the multiplier of certain taxes to self-fund projects. Transfers are a major feature, both between states (horizontal) and increasingly between the federal government and the states (vertical). Income tax revenue and corporation tax are shared equally between the federal government and the Länder, and 75 per cent of VAT revenues are redistributed across the states to ensure a uniform standard of living across the country. Länder are responsible for the finances of their constituent municipalities and often transfer grants to them.
- **France** is a unitary (non-federal) state like the UK. But it has a degree of fiscal devolution set out in the constitution, most recently revised to favour of further devolution in 2004. France established a regional tier of government in 1986, complementing its existing system of departments (counties) and municipalities. French sub-national authorities have a fairly high level of discretion over tax rates and reliefs. The four main local taxes with rates set by the municipalities are: business tax, residents' tax, property tax on non-built land and standard property tax. Departments also raise money through the latter.[14] Additionally, property tax rates are set by departments and municipalities. Versement mobilité is an important local employer tax, based on the size of the wage bill, hypothecated to fund local transport – which has been a great success in Paris and other cities. Fiscal redistribution primarily takes place between central government and the municipalities (ie 'vertically') rather than between places ('horizontally) and is governed by the Finance Law. Places expected to receive less than the equivalent of the average tax rate qualify for the equalisation fund. Some 'horizontal' transfers – ie inter-municipality – now occur, as of 2012.

Most medium-sized advanced nations have significant levels of fiscal devolution, either through federal constitutions that grant a degree of fiscal sovereignty to states or provinces (for example Australia, Switzerland and Canada), or decentralised unitary states that devolve spending decisions and some tax-raising powers to regional and local government (eg Spain, Italy, Japan and the Netherlands). As figure 1 below shows, most high income countries have significant equalisation measures alongside fiscal decentralisation.

FIGURE 1: FISCAL EQUALISATION MEASURES ARE COMMON IN MOST HIGH-INCOME COUNTRIES

Inter-jurisdictional Gini coefficients of per capita revenue, 2016-18*



Source: OECD, Fiscal Equalisation Questionnaire 2019 and 2013, in OECD, Fiscal Federalism in 2022: Making Decentralisation Work, 2022
*Most recent year available is 2016-17 for Federal countries, except Mexico, and is 2018-19 for unitary countries except Israel.
**For Australia, the Gini coefficient calculated on the basis of fiscal relativities after equalisation equals zero. The Gini coefficient calculated on the basis of post-equalisation revenue receipts illustrates an increase relative to pre-equalisation receipts due to the gap-filling nature of the system.
***For France, Gini coefficients are computed based on the disparity of mean tax revenues received by communes within 11 tranches clustered by population size.

3. Fiscal centralisation in England

England is a major outlier: it is, by far, the most fiscally centralised country of its size in the developed world, as illustrated by Tale 1 below. Only 5 per cent of tax is raised at a sub-national level in the UK (which mostly reflects England), compared to 13 per cent in France and 31 per cent in Germany.

There is also much less spending discretion at regional and local levels in England than in comparable countries. Outside of London, there is no tier of government at the larger regional scale (whether across the whole north of

England, or just the north west, for example), and a large swathe of England lacks even a sub-regional combined authority. Even places with a combined authority have relatively small economic development and transport budgets, have little capacity and are highly dependent on the centre.

TABLE 1: THE UK IS MORE CENTRALISED THAN ANY COMPARABLE COUNTRY

Various measures of centralisation across the OECD

	Sub-national tax as a per cent of total tax	Sub-national spending as a per cent of total	Sub-national economic affairs spending as a per cent of GDP	Regional Autonomy
United Kingdom	4.9	24.8	1.0	9.6
France	13.2	20.0	2.2	21.8
Germany	30.9	39.7	2.5	37.7
Netherlands	3.7	30.9	2.0	17.5
Belgium	11.7	40.4	4.3	33.9
Ireland	2.8	8.4	0.5	11.0
Switzerland	39.7	58.1	2.7	26.5
Finland	23.3	40.1	1.6	7.1
Norway	14.2	33.2	1.6	12.1
Sweden	36.4	48.5	1.5	12.0
Denmark	26.4	62.0	1.3	7.3
Italy	16.1	28.2	1.9	26.0
Portugal	7.1	12.3	1.1	9.5
Spain	24.6	42.7	2.5	35.6
United States	34.2	47.8	2.6	29.6

Source: OECD, Fiscal Decentralisation Database, 2023; Hooghe, L, and Marks, G, Regional Authority Index (RAI) – Country, 2021.
* Regional autonomy is derived from an index which synthesises a range of self-rule and shared-rule measures (from ability to borrow, to policy scope for example)

Fiscal centralisation in England has several key features:

Grants, council tax and business rates

- Central government collects 95 per cent of tax revenue and determines how funding is distributed to local authorities in England via the annual local government finance settlement. This redistributes business rates and manages the system of retention, allocates specific grants for specific purposes and provides the non-ringfenced revenue support grant using complex formulas (except in places with full business rate retention). The funding formula is determined by central government at its discretion, supplemented by time-limited funding programmes ('pots') that local authorities can bid for.

- The formula was last changed in 2013 to shift the weighting away from poverty and towards age, alongside significant cuts to council grant funding. This appeared to be partisan as Conservative-led councils with older, more affluent populations avoided the severe austerity that faced Labour-run councils with younger and poorer demographics. But it also reveals that such decisions can be capricious, subjecting essential budgets to the whims of central government, which cannot be challenged or appealed. The funding formula is supposed to be revised on a regular basis, but the Fair Funding Review has been repeatedly postponed since 2016, and it will have been more than 10 years since the baseline for funding has been reset, during which time significant social and demographic changes have occurred.
- Councils' principal local source of funding is council tax, but they are required to adopt nationally determined bands, and in most cases they cannot increase it each year by more than a nationally determined percentage, without calling a referendum – a de facto cap. Council tax precepts are also used to fund police forces, fire and rescue services, the Greater London Authority, combined authorities (where they exist), as well as sub-local town, village and parish councils (mostly in rural areas).
- Councils collect business rates, but most of the money collected is pooled and redistributed nationally, either as part of the funding formula or through a complex system of redistribution adjustments (tariffs and top-ups). This redistribution addresses some of the inequalities between areas, but in doing so has effectively turned business rates into a national tax. In recent years, the government has sought to permit councils to retain a greater proportion of the business rates they collect, supposedly to 'reward growth', but in practice there is a limited relationship between economic growth and higher local rates income, as box 1 below discusses.
- The majority of council spending goes to meet statutory obligations, including high cost-pressure services where there is growing demand, especially adult and children's social care, which account for a large share of spending, despite serving only a small proportion of the local population.[15] This leaves most councils with relatively small amounts of discretionary spending power.

Other income streams

- There are other income streams available but these are relatively small. They include section 106 contributions and community infrastructure levies from housing and commercial developers. These have been used innovatively – Leeds City Council used section 106 agreements to implement a ‘roof tax’ of £15,000 on future houses across 32 sites to fund a new ring road, for example. Councils do have the power to implement workplace parking levies, road user charges and landlord licensing schemes, but these must be directed toward a specific purpose. They can usually be interfered with or even blocked by central government, and they require capacity that has been reduced by austerity.[16] Some local authorities have been permitted to charge business rate supplements, or supplements to contribute to infrastructure projects (such as the Elizabeth line in London) or to fund business improvement districts (including one which includes a hotel bed charge, as recently developed in Manchester). Notably, West Yorkshire’s devolution deal included provision for a strategic infrastructure tariff, which was to be subjected to a referendum, but which the government then rescinded.[17]
- Unitary, borough and district councils also generate rents and service charges from social housing tenants, but social housing revenue is ringfenced and surpluses cannot be used for other purposes.
- Councils also generate commercial income from a range of sources – from airports to car parks, and from genomics firms to street markets. This can form a major revenue stream – Manchester City Council has received as much as £13m in revenue per year in dividends from its 36 per cent share in Manchester Airports Group.[18] However, there are risks involved – for example, Covid-19 hit airport passenger numbers, so Manchester does not expect to receive a dividend until 2027. Elsewhere, some councils have run into financial difficulty because of poor investment decisions, in some cases contributing to section 114 ‘bankruptcy’ notices, to constrain spending and, in some cases, interventions by central government.

Economic development

- Central government departments deliver almost all policy related to economic development – from transport and digital infrastructure, through to skills and innovation – but only with the Treasury’s permission. Councils have an important role in planning, which can be transformative, when they proactively assemble packages of land to attract housing or businesses. Some places directly deliver services related to economic development, such as adult education services, local housing companies or municipally owned bus companies, for example. But outside of London, local government's role tends to be more informal – convening, and encouraging, rather than funding or delivering directly.

- Central government runs spending competitions for economic development cash, such as the levelling up fund, transforming cities fund and the shared prosperity fund. These funds often relate to areas that are already within the council's remit – such as high street regeneration – but which have been hampered by austerity. Before Brexit, EU structural funds provided an important boost, particularly to some of the more deprived areas. But these have now been replaced by one of the centralised, competitive funding pots - the shared prosperity fund.
- Mayoral combined authorities have taken on some powers over economic development, notably adult skills. New 'trailblazer' deals for Greater Manchester and West Midlands aim to provide a single funding settlement in place of multiple funding streams from across Whitehall. These and other 'devolution deals' such as to Cornwall (a unitary authority), simplify the funding arrangements for the authorities concerned but represent a relatively small increment in fiscal devolution given that the government remains in control of the purse strings. The trailblazer deals raise an important consideration for England-wide economic development funding – if they become the standard, then we will need a way to distribute funding that does not involve every combined authority having a separate negotiation with government.
- London has a unique arrangement. Most of the Greater London Authority's funding relates to transport and passes to Transport for London. This includes congestion charges, LEZ and ULEZ revenues, and fare revenue from TfL services. Business rates retention has changed in recent years: Greater London operated a 75 per cent pilot in 2019-20 and a 100 per cent pilot in 2018-19. Currently, London's boroughs and the GLA together retain 67 per cent of business rate revenue generated in the capital, with 30 per cent retained by boroughs, and 37 per cent retained by the GLA (most English councils now retain 50 per cent of business rates). This is in place of some grant funding, and London therefore contributes less to the national business rates pool. There is also a supplementary business

rate, a community infrastructure levy, a council tax precept, and a small 'lane rental' scheme.[19]

- Local authorities are permitted to borrow, within certain restrictions. They cannot borrow to finance day to day spending, only capital. And they have to do so 'prudently' – they must be able to service that debt. The main source of borrowing is the Public Works Loans Board (PWLB). The National Infrastructure Bank has recently been set up to further support local authority borrowing but is currently underutilised.[20]

England is clearly doing something very differently from other countries. Fiscal and economic development powers are highly centralised, with only very marginal powers exercised by councils or sub-regional combined authorities.

In practice, councils lack discretionary funding to fulfil even the limited role that remains outside central government's remit. Both core funding formulae and competitive funding bids are politicised and inefficient. This configuration is out of line with most other countries, including within the UK. There is a broad consensus across the political spectrum and in all regions of the country that this is not working.[21]

4. The consequences of fiscal centralisation

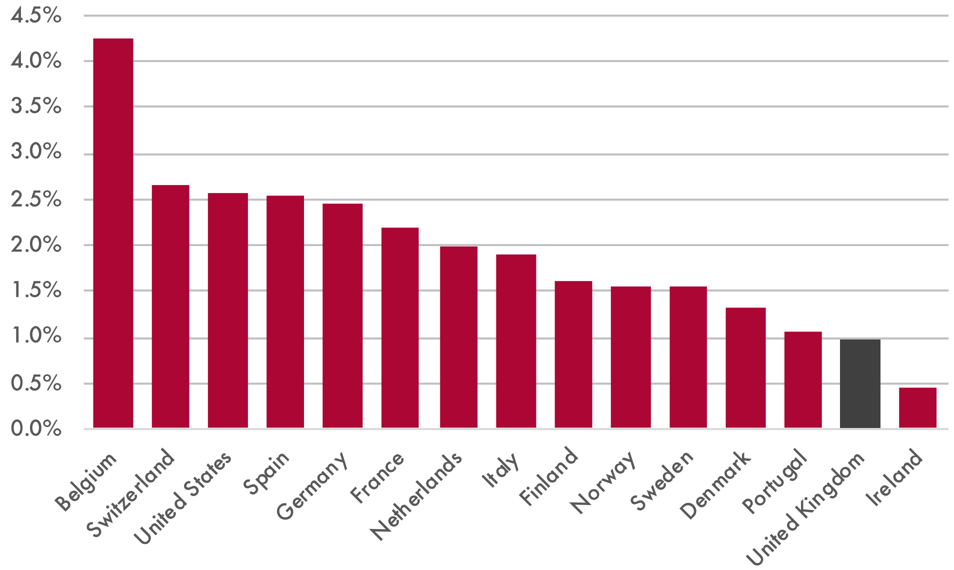
Fiscal centralisation is holding England back. Across OECD countries there is a pattern: provided local governance and institutions are strong, fiscal devolution empowers and incentivises sub-national government to develop their economies, by spending on areas like transport and regeneration – and also on education, which has longer term economic benefits. It can unleash progressive economic development as places strive to become better places to live.[22]

The evidence indicates that regional disparities can reduce in countries where more local spending is financed by local taxes or shared national taxes, because subcentral governments are more inclined to spend on economic development.[23] As a result, countries with fiscal devolution tend to be more regionally *equal* – contrary to many expectations. As we should expect, the relationship between fiscal devolution and these positive outcomes is contingent and not always clear. This is inevitably the case when trying to disentangle the many causes behind such general outcomes. And it is also inherent in devolution: it enables a variety of possible decisions, even if it tends to incentivise better ones.

In the UK, fiscal centralisation means local government cannot do economic development properly. And central government economic development investment is lower, less efficient, and less equal than in other countries**.** The rate of local economic affairs spending is twice as high in Germany and France than in the UK, as figure 2 below shows. And spending on key 'drivers of growth' is inefficiently distributed: for example, R&D funding is concentrated on 'basic' research in the 'golden triangle' around London, Oxford and Cambridge, instead of the high-return 'applied' research that tends to be more evenly distributed.[24] This, combined with wider centralisation, is also likely to be a major factor in lower private sector investment too: private funding tends to be 'leveraged in' by economic development spending, both as formal partners in specific development projects, and more generally, by investing in areas that get greater public investment.[25]

FIGURE 2: THE UK'S LOCAL SPENDING ON ECONOMIC AFFAIRS IS LESS THAN HALF THAT OF FRANCE AND GERMANY, AND LOWER THAN ALL OTHER HIGH-INCOME COUNTRIES, EXCEPT IRELAND

Sub-national economic affairs spending as a per cent of GDP



Source: OECD, Consolidated expenditure by government function, 2023

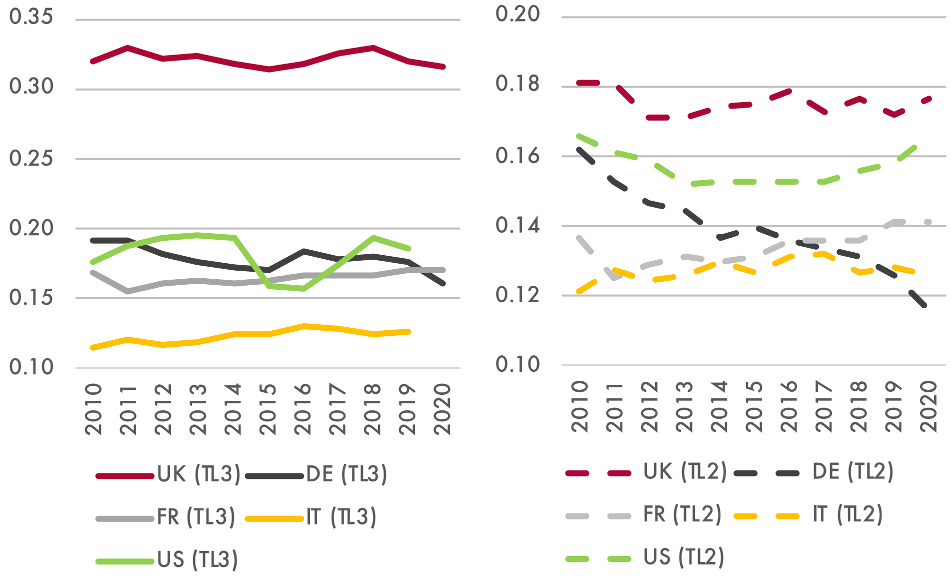
It should be no surprise, therefore, that the UK is so geographically unequal. The UK remains the most regionally unequal developed economy, and this has persisted during a time when other countries' regions have converged, as figure 3 below shows. This inequality is widely attributed to centralisation, and especially fiscal centralisation.[26]

This regional inequality in turn translates into fiscal inequalities between regions. London receives more public spending, and the tax take from

London and the South East is also higher – although it should be clear that this is simply because it has more high-income people, more company headquarters and higher wealth, rather than people in the region paying higher rates of tax. Figure 4 below shows the balance between public spending and tax by region. All countries have regions with different net positions with regard to public spending and tax revenue. But the UK is unique in having such an extreme imbalance. There is clearly redistribution in the system, and recent research from the IFS showed that places that need most may receive the most funding, but that this still does not match their needs.[27]

FIGURE 3: REGIONAL INEQUALITY IN PRODUCTIVITY HAS REMAINED HIGH IN THE UK, WHILE IT HAS DECREASED IN OTHER COUNTRIES

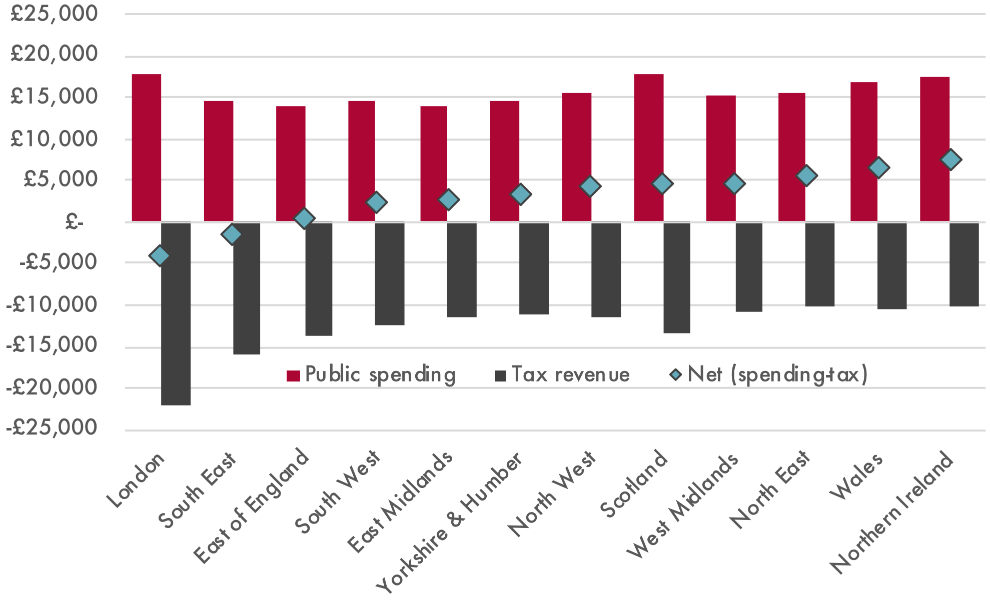
Coefficient of variation in regional GVA per worker, TL3 geographies (small sub-regions, e.g. Darlington) and TL2 geographies (large regions, e.g. north east)



Source: Analysis of OECD, Regional GVA per worker, 2023. Excludes extra territorial regions

FIGURE 4: LONDON HAS THE HIGHEST PUBLIC SPENDING AND TAX TAKE PER PERSON

Public spending and public revenue per capita, 2021-2022



Source: ONS Country and regional public sector finances, UK: financial year ending 2022, 2023

3. OUTLINE PROPOSAL

England has been left behind. But what could an English solution look like in practice?

This section outlines principles for fiscal devolution in the English context that should underpin any reform before going on to set out a more detailed proposal.

The limits of 'rewarding growth'

Fiscal devolution requires careful thought if it is to be effective, especially in the context of a complex structure of regional and local government in England, the reform of which is outside of the scope of this paper and which is also likely to be a challenging, long-term endeavour with costs that may well outweigh the benefits.

Fiscal devolution inevitably has one key challenge, which other countries also encounter and tackle: richer areas tend to have higher tax bases and lower needs, while poorer areas have lower tax bases and higher needs.

But recent attempts in England to devolve fiscal responsibilities over taxation have been limited primarily to a simplistic principle, which comes into conflict with this reality. This principle is that places should be rewarded for the economic growth they generate. This applies in practice to business rate retention, discussed in box 1 below.[28]

Linking funding to economic growth raises immediate and obvious challenges:

- Places do not currently have the powers to grow their economies.
- Global and national events can affect local growth rates dramatically
- The additionality of local projects cannot be proven accurately enough to trigger funding awards.[29,30]
- Economic growth, on its own, is not always good for living standards.
- Local tax bases reflect existing patterns of inequality, so devolving significant tax raising powers would inevitably favour more prosperous areas over more deprived localities.

This 'rewarding growth' principle as currently adopted is also only intended to be a marginal element of council funding, with equalisation implicitly ruled out. This makes it an unsuitable basis for more extensive fiscal devolution.

Fiscal devolution principles: Toward a new framework

Instead, we propose a more comprehensive framework of principles that should guide fiscal devolution in England, illustrated below.

A fiscal devolution settlement for England must be:

1. **Effective at improving living standards.** The ultimate purpose of fiscal devolution should be to raise and equalise living standards between places, and between people. To that end, fiscal devolution should unlock more economic development investment, including housing in overheating areas, and ensure that policies are effective 'on the ground' in communities across the country. It should incentivise broad-based, 'inclusive' economic development. It should not mean new punitive taxes on middle- or lower-income taxpayers – particularly during a cost-of-living crisis. Finally, it should support better public services, and should not result in a smaller tax base to fund those services.

2. **Equal and empowering.** Equality and local empowerment are not zero-sum: greater local empowerment tends to mean greater equality between places in the long run. But the model of fiscal devolution needs to ensure that, in empowering places, we are not embedding or creating inequality between them. Germany is a good example of how this is possible.

3. **Fair – in all its forms.** 'Fairness' is often in the eye of the beholder, setting the stage for intense disagreement when places feel like a settlement is unfair. There are many legitimate interpretations of what is 'fair' that need to be reconciled or traded off with one another. For example, these are just some of the types of 'fairness' that need to be considered:

    - 'Fair' – places or people that need most resources get most resources.
    - 'Fair' – good, long-term decision making is rewarded, not poor or short-term decision-making.

- 'Fair' – places shouldn't be disproportionately punished for negative factors outside of their control, such as recessions, longstanding economic stagnation, or a historic low tax base.
- 'Fair' – places shouldn't be disproportionately rewarded for positive factors outside of their control, such as UK-wide growth, historic high growth, or a historic high tax base.
- 'Fair' – citizens should not be punished for leaders' poor decisions, without being given an effective way to influence these decisions and to hold leaders accountable, including between elections.
- 'Fair' – any reforms to taxes, or new charges, must themselves in totality be progressive across the income or wealth distribution.

4. **Pragmatic.** Fiscal devolution must:

    - Work with the institutions and governance options we already have – and tolerate imperfection. The UK must deal with the inheritance of institutions, boundaries, and organisations that we have – we cannot start from scratch or copy and paste another country's system. Disruption is a major obstacle to effective policy making, particularly in economic development, which takes decades to deliver results. Further, the pursuit of perfection in any area of public policy is counterproductive and is often ends up blocking change. That means working with existing councils and combined authority structures (in places that already have them or rolling these out further to places that do not currently have them). It also means having a pragmatic tolerance of some asymmetry in powers, and imperfect governance boundaries, when there is a need or good reason for it. Again, other countries tolerate such imperfections as a matter of course.
    - Be politically viable and engage with public opinion. Fiscal devolution can provoke challenging opposition, when it involves new levies and charges, council tax revaluation, scrapping business rates, and

redistributing funding. This is a vital consideration. But it is not a roadblock: opposition is often founded on misunderstanding, and there are ways through, as many places in the UK and abroad have found.[31]

5. **Accountable – in its many forms**. Accountability is often raised as an issue with devolution, usually by central government as a reason to not give power away. This often rests on the (flawed) assumptions that things start from the Treasury being accountable for all public spending and taxation, and that existing systems of centralised accountability function well. Accountability, again, has many legitimate forms and all of these need to be considered:

   - Democratic accountability (direct and indirect elections) – through elections of mayors and councillors, and indirectly through the election of council leaders and cabinets.
   - Democratic accountability (checks and balances) – through scrutiny, consultation and citizen involvement between elections, transparency, and engagement.
   - Financial/fiscal accountability – ensuring money is not spent recklessly or improperly.
   - Financial/fiscal accountability – ensuring money is used in the best reasonable way to achieve a stated objective.
   - Accountability to UK parliament for delivering UK priorities on their behalf.
   - Combined authority accountability to constituent councils and members.

Fiscal devolution debates often focus on business rate retention, which actually exemplifies some of the worst aspects of fiscal devolution, violating many of the principles above. This is discussed in box 1 below.

Box 1: Business rate retention in England

The limited fiscal devolution embodied in business rate retention in England has been the focus of most discussion in recent years, but it is a step in the wrong direction.

In particular, it is wrong to have a simplistic focus on 'rewards for growth'. This term has framed the fiscal devolution that remains in place now, many years after George Osborne first pushed earnback and gain share through city deals.

Business rate retention exemplifies 'rewards for growth'. It means that all councils now retain a share of the total amount of business rates collected locally, as well as a share of the increase in business rates revenue. For most councils, this amounts to 50 per cent of both the total amount raised, and the increase. But there have been both 75 per cent and 100 per cent pilots in recent years and, as noted above, London's boroughs and the GLA retain 67 per cent of business rates. To make this work in practice, there is then a complex process of topping up places where this retention does not meet local needs, and safeguards to ensure there is not a sudden drop in income. Enterprise zones and the new investment zones also aim to incentivise growth by allowing councils to retain business rates raised within a smaller area.

Both business rate retention, and its 'rewards for growth' framing are highly problematic.

First, a great deal of evidence shows that business rates are a poor tax with an uncertain future. ICAEW highlighted that business rates are considered to be 'unfair, disproportionate and unproductive', while the Labour party has proposed replacing them altogether.[32]

Further, business rates devolution:

- Does not reward growth, least of all inclusive growth. There is very little link between marginal increases in rateable value and economic growth, and councils may gain more in rates by supporting a new shopping centre than new high-tech manufacturing, which has the potential to deliver more growth for an area over the long term.
- Disincentivises SME support. The design of business rates also provides councils with a disincentive from supporting small and medium-sized businesses (which do not pay business rates or pay lower amounts) that form the backbone of local economies in most developed countries.

- Is not accompanied by powers that could feasibly 'drive' growth. Even if business rates responded to growth, local areas don't have sufficient powers, even under devolution, to actively 'drive' that growth.
- Conceals what are, in effect, grant funding arrangements from proper scrutiny. A complex system of safeguards and backstops mean there is very little or no downside risk for places, and they can only essentially gain income if their business rates tax base happens to grow. This essentially substitutes explicit grant funding for de facto grant funding, with an additional bonus for places where business rates happen to go up for reasons likely unrelated to their actions.
- Enables more funding in areas that happen to have increases in business rate revenue. If growth in business rates is kept within an area, this actually deprives the pre-existing system of business rate redistribution of that increase. And that gap can be substantial: the IFS projected that London gained to the tune of £431m in 2018/19 alone – money which would otherwise have been redistributed to other councils to spend on essential services.[33]

This indicates that the current business rate retention experiment should be ended and the fiscal devolution conversation should move on to more fruitful avenues.

An outline proposal for fiscal devolution in England

Fiscal devolution in England must address the specific context and challenges which England faces. As discussed, England's problem is specifically that the centralisation of economic development funding in the Treasury has created severe regional inequality and poverty in *all* regions – even those which are highly productive, notably London.

It follows that fiscal devolution must prioritise flexibility, stability and equality of economic development funding. It should be heavily redistributive – so much so that the poorer regions should be able to spend more per capita on 'drivers of growth' than richer regions – but it should also unlock housing developments in high-growth regions, to improve quality of life there too.

To be clear, the value of fiscal devolution in England is *not* in attracting or encouraging investment by cutting taxes; nor in inventing new taxes that will burden businesses and taxpayers. Its value is in giving local areas control over economic development, an incentive to spend it wisely, and the ability to unlock new projects using local levies or charges.

We propose a system which has two components:

1. An **economic development budget for England** under the control of local and regional government collectively. An Act of Parliament would set aside economic development funding for local government in each spending review – before departmental settlements are negotiated. The amount of spending would be proposed by an independent Productivity Commission. And long-term spending plans could also be 'frontloaded' during downturns, to stimulate a return to growth. This will be essential to spread new arrangements agreed for Greater Manchester and the West Midlands to more places, to avoid a chaotic process of negotiating a settlement with every combined authority in England every spending review. To recognise and reward the local government contribution to broad-based growth, this funding could increase when national revenues for income tax and VAT revenue rise.
   Local government should be given the opportunity to divide the economic budget up fairly. Each place would be guaranteed a minimum floor of spending per person, and equal per capita spending, and poverty rates, should be starting point. UK-wide spending levels would be set across the country by broad theme (transport, or housing). However, the weighting of different factors should be subject to discussion and agreement among local government at the national level. If local government fails to come to an agreement, then the Treasury should step in and allocate using a transparent, fair formula.
   Additional central government funding, such as the shared prosperity fund, should be allocated to combined authorities, routed through the mayoral investment fund processes of assurance and 'gateway review', and available to all places with a Level 2 (non-mayoral) devolution deal. This reflects the fact that central government will have its own economic development priorities, but these would be best delivered locally or jointly.
2. **Targeted levies and charges to unlock development**. We believe that with the foundation of a redistributive economic

> development budget, there should be scope for both combined authorities and councils to raise more revenue locally, primarily through land value capture, workplace parking levies and visitor levies to fund new transport and housing projects that are directly associated with economic development. While this would of course benefit places with higher land values or economic activity more than other areas, it would provide all communities with incremental funding to invest in developing their local economies. Poorer areas might gain less but they would have a larger per capita allocation of the nationwide economic development budget. Some of our proposed measures are already theoretically possible, and occasionally implemented, but they are obstructed by central government. Others require new legislation. This is discussed further below.

These are practical proposals but they arguably fall short of the long-term rewiring required.[34]

We do not recommend the assignment of national taxation to local areas at this point. Others have suggested that income tax or national insurance could be assigned or retained within an area, in order to incentivise local government toward broad-based improvements in living standards. However, in practice, it is unlikely to be a strong enough incentive to counteract the incentive of council tax and business rates. For example, councils have far more power to enable or deliver new homes, which pay council tax, than they do to raise resident incomes, and gain more income tax. And a system incorporating assignment would require substantial redistribution and safeguards to be viable and fair.

Our proposals are also not dependant on more general, wide-ranging tax reform and public service reorganisation, though these reforms are arguably necessary and should incorporate fiscal decentralisation.[35] This is because the task of rebalancing is urgent and we cannot 'let the perfect be the enemy of the good'. For England, the top priority must be to establish substantial, long-term economic development funding, while unlocking projects with targeted levies and charges, as we propose.

This proposal is the opposite of what many fear. It would not involve taxing households already struggling with the cost of living. It is not the sort of fiscal devolution that leads to tax competition or variation, nor would it allow wealthier places to keep significantly more funding overall and entrench inequality. Such an approach would also not attract state aid or subsidy control concerns.

It may not look like fiscal devolution, as some would like to see or might imagine. But it is an English solution to an English problem. And its impact would be similar to the transfer-intensive arrangements in other countries.

4. ADDRESSING CONCERNS

The case for this particular form of fiscal devolution is strong and many of the common objections to fiscal devolution are therefore either wide of the mark, or even moot. Below we discuss each of these in turn.

1. Postcode lotteries already exist – fiscal devolution can address them.

Some people are concerned that fiscal devolution will mean people are treated differently based on where they live. This seems unfair and contrary to the principles of equal rights and a national welfare state. This concern is held both about devolution generally, and about fiscal devolution, as it could mean different levels of resource for different areas.

But we currently have severe postcode lotteries – in some ways, the most severe in the developed world. Centralisation has just hidden these from view, because we are treated unequally by the same government. Our postcode lottery comes in two broad forms:

- First, we have a socio-economic 'postcode lottery'. We have the highest regional inequality in disposable incomes, productivity, health and job creation of any comparable high-income country.[36]
- Second, we already have postcode lotteries for public services in England, just ones which are unclear and unaccountable. In order to function, central government delegates decisions to its local branches, but without the accountability, effectiveness and integration that devolution would bring.[37]

The proposed model of fiscal devolution primarily addresses the first, socio-economic postcode lottery, by tackling the centralisation that has held all of England's regions back. The second postcode lottery would improve indirectly – as public services from health to early years and education often mop up the consequences of industrial decline and inequality. But there is a further case for devolving some public services powers, beyond the scope of this paper.

More generally, concerns for postcode lotteries should be alleviated by a more precise discussion of what is being devolved versus what remains centralised. In short, UK-wide rights, entitlements and public service standards can set out '*what*' services people should have a right to; councils and mayors can tackle *'how'* to meet people's rights to those services, and they are usually better able to do so than central government. Enhanced rights could even underpin and complement devolution if the job of putting these rights into effect were devolved – this is the German model of 'administrative federalism'. Devolution could deliver, in practice, proposals for universal basic infrastructure.[38]

2. Fiscal devolution could protect services and infrastructure from unaccountable austerity

Some believe that fiscal *centralisation* is the way to protect the public sector from austerity. This is perhaps because only the central state has the reassuring economy of scale and power to protect its citizens.

However, centralised control over local government funding has resulted in councils delivering austerity on behalf of central government over the last 13 years. More recent steps to devolve budgets have been accompanied by cuts to other funding streams, mitigating the benefits of such deals (for example with council tax benefit, and the early intervention and public health grants).

Locally driven economic development has essentially been wiped out in most of the country by the current model of local government funding. What funding there is often requires a complex process of bidding and negotiation between central and local government, which delays action on the ground and wastes time and money at all levels.

This outcome largely highlights the problems of centralisation as opposed to devolution, and so the model of fiscal devolution proposed keeps intact those elements of the central state that require economies of scale or national consistency, at the same time as providing dedicated funding for economic development at a local level.

The proposed approach would separate decisions made by central government in how it manages the national budget, from how councils operate locally – at least with regard to economic development. In the model we propose, huge cuts would not be possible, as local government in England would collectively have a legal right to economic development funding.

3. Fiscal devolution would help central government be much more effective

The current centralised approach of micromanaging local government funding in England is a major distraction for central government. It does not just hold back the responsible department (DLUHC) but hinders policy right across Whitehall, and especially in the Treasury. A significant amount of time and effort is spent organising and re-organising the deck chairs of local policy objectives instead of delivering on national priorities. Not only does making councils bid for central pots of money waste councils' time, it is also very inefficient for central government too. The direct involvement by central government in the approval and funding of, for example, public toilets in small towns, inevitably reduces the bandwidth it has available to focus on the bigger picture.[39]

Just as Labour's reforms to the Bank of England led to governments no longer obsessively micromanaging interest rates, fiscal devolution presents an opportunity for central government to deliver on national priorities and let local government get on with investing in local economies and improving the public realm.

4. Spending inequality is already a problem – a good programme of fiscal devolution should *reduce* this inequality

Some highlight the spending inequality that could result from fiscal devolution, especially if not accompanied by redistribution. Richer places would get richer, and poorer places would get poorer. In the UK, this would exacerbate our regional inequality even further.

This misunderstands three things:

- First, UK centralised economic development funding is already regionally unequal, lower than in other countries, and inefficiently distributed.
- Second, transfers and equalisation underpin fiscal devolution in other countries – and would do so in England too.
- Third, devolution is not being proposed for major public services under this model – therefore large-scale spending inequalities on services are not possible.

The fiscal devolution model proposed should result in more equal economic development spending. The model eschews retention of major tax within particular areas within England, and instead redistributes taxes from across England as a whole.

5. A 'race to the bottom' in tax rates is not possible under any serious set of proposals

Some fear that fiscal devolution will enable a 'race to the bottom', whereby places compete for investment by cutting tax rates. People sometimes assume that the purpose of fiscal devolution is to encourage investment in this way. Recent governments have adopted policies and rhetoric that support this worldview – it was the Truss government's short-lived approach, but it is also a view shared by the current prime minister Rishi Sunak (as his thoughts on free ports demonstrate). It is also a small component of current economic development policy – proposed investment zones major on tax incentives, as do corporation tax reliefs and free ports. If the opportunity for tax cuts were a major feature of fiscal devolution, this would be highly problematic, undermining the tax base, and creating a mess of different tax rates for businesses that straddle local boundaries.

But tax rate divergence is not a feature of fiscal devolution as proposed under this model – and does not play a major part in most highly devolved countries outside of the USA. In general, no country wants to facilitate tax competition or regulatory divergence within its borders that undermines smooth business operation and undercuts their tax base. The value of fiscal devolution for England is not in attracting or encouraging investment by competitively cutting taxes. The consequence of doing so would be to displace economic activity from one place to another, resulting in a net loss rather than sustainable growth. Instead, the value is in allowing places to invest more, and more flexibly, in economic development, generating a better overall outcome.

6. Fiscal devolution means greater control of tax revenue and targeted levies, not higher taxes

Some fear that fiscal devolution will lead to a raft of new taxes as local authorities seek to avail themselves of all options to raise more money. Tax rises are understandably unpopular, not least during a cost-of-living crisis.

This concern erupted recently when the Scottish government proposed allowing councils to implement workplace parking levies. This is a relatively modest proposal to charge larger companies, based on how many parking spaces they provide employees, to both deter car use and raise revenue for public transport. The measure was opposed vociferously when implemented in Nottingham in 2012, but in 2023, the fuss is long gone and Nottingham has a new, highly successful tram line. Leeds, meanwhile, is still waiting on central government to provide investment in new public transport infrastructure.

In practice, we need to be more comfortable with real local decisions and real local trade-offs. Implementing a scheme such as a workplace parking levy is a decision which has risks and consequences. But so is *not* implementing a scheme. These decisions are part and parcel of grown-up local democracy in other countries, and already feature in small corners of England.

Our proposals are a sensible, incremental step toward more grown-up attitudes toward local decision-making, which do not raise households' tax contributions. The economic development budget for England would be the primary mechanism for empowerment, and it does not involve any change in the rates of tax people pay. The proposed powers for levies and charges are limited in scope and targeted to ensure clear benefits for those involved. Taking three of these in turn:

- Workplace parking levies – fund transport networks that businesses subject to such levies will benefit from, while businesses can also reduce their parking spaces to reduce the amount they pay.
- Visitor levies (or tourism levies and hotel bed taxes) – are minimal, paid only by visitors, and contribute to the public realm people will enjoy while visiting a place.
- Land value capture – provides a fair deal for landowners, which allows councils to invest in better economic and social infrastructure that should enhance local communities and the public realm, resulting in benefits to landowners and developers, for land that would otherwise not be developed and sharing the gain to land value that investment has brought about.

5. THE PROPOSAL IN DETAIL

Fiscal centralisation has a real effect on people's quality of life. It holds back both central government and local government.

Fiscal devolution, done well, would help address regional inequality, and deliver a step change in that quality of life.

This paper has discussed the progressive case for a specific form of fiscal devolution. Our solution for England focuses on enabling places to invest economic development in a sustainable and accountable way. We learn from other countries, and from the devolved nations, but our solution must be appropriate for England. The proposed model deals with the doubts and challenges that are often aimed at fiscal devolution. Our proposal avoids the inequality and unfairness many fear and prioritises equality and empowerment instead.

Below we develop this proposal in greater detail. This proposal closely mirrors that of the Fabian Society's Commission on Poverty and Regional Inequality.[40]

We propose two phases for economic and fiscal devolution.

Phase 1: 2025-2030 – Setting the foundations and freeing local government

1. Focus central government economic development funds on poverty and living standards

From 2025 onward, additional economic development funding from central government should be structured to have maximum impact on poverty and living standards. The equivalents of the levelling up fund and shared prosperity fund should not be distributed by competitive bidding; but nor should they be distributed by formula alone. The aim is to ensure economic development spending not only goes to areas where it is needed, but that it is actually put to good use. Neither bidding nor formulas alone achieve that. Therefore, we propose adapting the existing mayoral investment funds framework:

- Councils, combined authorities and the mayor of London should produce statutory economic plans which have a focus on poverty and living standards, to be a 'landing point' for central government funds, a basis for accountability for those funds, and to connect and integrate activity at all levels.
- Places should be awarded funding from a new, 30-year investment fund which incorporates the shared prosperity fund, levelling up fund, and their successor funds. Their allocation should be based primarily on places' population level and poverty rate and they should be index linked (unlike mayoral investment funds).[41]
- Accountability should be on a similar basis as existing mayoral investment funds. Every five years there should be an independent gateway review, where they must prove to an independent commission how places have invested that 30-year investment fund pot towards addressing the problems identified in those plans – with a focus on poverty and living standards.

This would mean, for example, London would have to prove this funding had been spent primarily on social housing, as housing is such a major cause of poverty in the capital. We could expect city regions like Greater Manchester to focus on new bus connectivity or job creation activities.

Existing mayoral investment funds would be unaffected and places which already have full business rate retention should not be disadvantaged by this arrangement, but the revenue would be replaced by this funding stream. This investment fund should be open to all places with 'level 2' devolution – ie they would not require a mayor.

2. Build local capacity

The government should partner with councils to ramp up economic development capacity and political leadership in local government. Capacity is a recurring concern in devolution discussions: combined authorities are often underfunded and, after 13 years of cuts, many councils do not have the people, skills or resources to prioritise economic development, even though it often makes financial sense to do so.[42] For at least a five-year period, the government should work closely with the Local Government Association to develop a programme of recruitment and training of economic development professionals, and transfer and retrain personnel from central to local government. Councils could choose to combine these resources at combined authority level, either formally (as combined authority staff) or informally (as networks, or with secondments).[43]

They should particularly ensure that this increase in capacity translates into an increase in funds available to the authority, from a wide range of sources. They should build capacity to implement new levies and charges, in order to fund economic development and engage with the UK infrastructure bank, as many places could benefit from its support. They could learn from Wales and Scotland's drives to increase capacity.[44] Independent panels should determine the remuneration of councillors, council leaders and council mayors who take on additional responsibilities.

3. Strengthen local accountability

Accountability problems must be resolved, but the current government's proposal for direct parliamentary oversight is ill-advised. The evidence indicates that good governance is essential for devolution to have a benefit. But mayoral combined authorities should not be treated like government departments, with mayors required to attend select committees, and engaging in department-style spending review settlements.

There is already a well-established model for local government accountability for non-ringfenced funding transfers from central government, which currently governs councils and combined authorities, and which is very different from departmental oversight – for good reason. Crucially, this resolves accountability in a system where councils are elected to make decisions, can raise taxes and must balance budgets, but also receive a large transfer of non-ringfenced funding from central government.[45]

Mayoral investment funds also have a form of accountability, whereby they receive a 30-year funding stream, but must prove it has been spent well every five years. Either of these provides a basis for accountability under a single funding pot. Treating mayoral combined authorities like government departments, as currently proposed, is not likely to be fruitful.

As combined authorities take on more powers, there should be a review of **local** accountability. This must ensure that combined authorities have the right scrutiny, and checks and balances to do their job well. This should include discussion of remuneration and role of local council leaders and councillors. There are also questions of assurance and audit which should be clarified and resolved – for example with place-based audit and a national organisation to audit local government.[46] Again, the solution is likely to be adapting the well-established mechanisms for council accountability, rather than attempting to fit mayors into a Whitehall-department-shaped process.

4. Enable and support councils to unlock economic development with new levies and charges

Councils should have the power and capacity to unlock funding for economic development – from high streets and the public realm to housing and transport projects – without any interference or permission from ministers or parliament. To do this they should be in a position to implement a limited range of local revenue raising measures such as visitor levies; higher council tax on second and empty homes; workplace parking levies; road user pricing; congestion charges; business rate supplements; and land value capture schemes.

Some of these are already possible, but they rarely go ahead. This is often because they are blocked, obstructed or discouraged by central government; or because places lack the political will, capacity and incentive to use their powers. This applies to interventions such as workplace parking levies, road user charges, business rate supplements, and strategic infrastructure tariffs. None of these should require referendums, or secretary of state sign-off. Local elections provide the necessary mandate and accountability.

The other measures will require new legislation but are already being progressed in the devolved nations and are under discussion in England. This includes visitor levies, higher council tax on second homes, and land value capture schemes.[47] These remain relatively modest reforms, particularly by international standards.

But these changes would be significant, even if not transformative. Such measures would provide councils with greater flexibility to fund investments that would benefit their areas, and to be accountable to their local electorates in so doing, without distorting the national tax landscape or introducing significant tax competition between localities. They can be combined, used to leverage in more funding from central government, or used to finance borrowing.

5. Lay the foundations for post-2030 devolution

A new Act of Parliament should enable devolved economic development in England. Previous primary legislation enables the transfer of powers from departments or councils to combined authorities, but long-term funding needs to be resolved, and specific powers need further legislation. The government currently has a 'Levelling Up Bill' before parliament, but this doesn't go far enough, meanwhile the opposition has proposed a 'Take Back Control Act', with details currently unclear.

This legislation should create a ring-fenced UK economic development budget, with the majority of this devolved. The act should set a duty on government to meet a defined minimum level of spending on each of the key economic development areas – transport, innovation, skills, employment support and housing. It should also require that this is mostly devolved in England before the spending review process of setting departmental spending is started (other UK nations would receive the Barnett consequentials). The operation of this budget is discussed under phase 2 below.

Phase 2: 2030-2035: An England-wide devolved economic development budget

6. Set an England-wide economic development budget

An England-wide, devolved economic development budget is supported by three arguments:

1. England's local government needs long-term, devolved economic development budgets to tackle low growth, overheating and the poverty that results.
2. The 'trailblazer' deals, writ-large, suggest a natural evolution to an England-wide economic development budget – because, as discussed above, involving several mayoral combined authorities (often from different political parties) in spending reviews is impractical.
3. Fiscal devolution must reconcile local empowerment with equality between places. The best role for fiscal devolution is to enable better economic development spending, by having larger, more stable, more diverse funding streams. An England-wide economic development budget would be a good, fair, efficient and simple way of doing this – at least as a stepping stone to a more complex system. And if national tax take were to increase, there is a case for recognising and rewarding local government's role in that.

These arguments all point to the logical solution of an England-wide, devolved economic development budget. This would include almost all government spending on transport, housing, innovation (including applied, but not basic R&D), skills, employment support and business support. Additional central government funds, such as levelling up and shared prosperity funds, would continue to operate– so there would be two different funding settlements: one, which reflects the 'core' functions of devolved economic development; and another, 30-year investment fund, as described above, geared primarily toward addressing poverty. This would enable central government still to have a role in local economic development.

Spending levels should be proposed by a new productivity commission and decided by a new industrial and regional strategy cabinet committee.48 The productivity commission would recommend a level of spending across each of the broad economic development themes (such as housing, or transport). This would draw lessons from international comparators' spending levels, but would be tailored to the UK. The productivity commission would be supported in this by the National Infrastructure Commission and the Climate Change Committee.

Spending should be stable but responsive to downturns and reward local government collectively for inclusive growth. A minimum floor should be established for as long as possible – 10 years, at least. This timeframe has a precedent – Transport for London has had a 10-year budget settlement, for example. During recessions, additional funding should be rapidly deployed or frontloaded, to stimulate a return to growth in the most effective way possible to avoid long-term damage to regional economies and public finances. Furthermore, to incentivise inclusive regional development and collaboration, if national receipts for taxes like income tax, VAT and national insurance rise more than expected, then a share of this could be devolved. This would replace the current approach to fiscal devolution, which supposedly 'rewards growth' but does nothing of the sort, as discussed above.

7. Devolve economic development spending permanently

Most of this funding would then be devolved to local government in England, with departmental budget settlements resolved via spending reviews afterwards. For example, the Department for Education's adult education budget would not include any provider funding, because in future this will all have been devolved. Departments' capital budgets would, between 2025 and 2035, mostly transfer to local government – or regional combined authorities, in the case of pan-regional transport projects, like Northern Powerhouse Rail. There would need to be national frameworks, strategies and safeguards, and agencies like the Education and Skills Funding Agency, Highways England and Network Rail would have a coordinating or regulatory role. An England-wide project like the (now truncated) HS2 scheme would also remain under the Department for Transport. There would remain significant scope for policy to be set at the England and UK level, even with devolved delivery – this is similar to highly decentralised countries such as Germany. In practice, good economic development means working as partners between different tiers of government, with each tier undertaking a role to which they are best suited.[49]

This funding should be distributed on the basis of a formula specified by local government collectively. Central government should set out a set of broad priorities or 'missions': reducing poverty would be one of these, alongside decarbonisation and productivity growth. They should also specify a minimum floor of spending for every council area and provide indicative allocations to each thematic area of policy, such as 'housing' or 'transport'.

Local and regional government should determine the weighting of different factors in each thematic allocation, such as population, sustainability, housing need, transport connectivity and poverty rates. This is likely to be a challenging negotiation but is preferable to the current system. It also has the potential to be more sustainable once settled. There is some precedent for local government coming together to negotiate challenging settlements – such as in the specification for northern rail services and investment as part of Rail North and Transport for the North. There is also precedent for this in other countries – for example Germany's primary economic development fund (GRW) which has lasted 50 years. If local government fails to come to an agreement, then central government should decide based on transparent criteria. This process should be repeated every 10 years.

Accountability for central government funds would be maintained in a better balance with the empowerment needed to deliver economic policies. Almost all economic development funding would be devolved, funded from general taxation and with some regions gaining more than others. That requires a level of accountability to central government, to ensure it matches the spending levels and priorities decided nationally. Each combined authority or the Greater London Authority would receive a long-term settlement with indicative allocations by policy theme. Places would be barred from deviating too far from the thematic allocations. These would also be subject to five-yearly gateway reviews to maintain accountability to national taxpayers.

These thematic allocations will also help move beyond zero-sum competitions between places – for example, in simple terms we would expect London and parts of the south to get far more funding for housing, but the north and midlands to receive far more for transport. In practice, good investment projects will cross themes, and this should be encouraged, not prevented.

Endnotes

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2 This paper is focused on England – Wales, Scotland and Northern Ireland are beyond scope. In one sense, the devolved nations do set a precedent – Scotland especially has a relatively high degree of fiscal devolution, and it serves to show what is possible if only we have the will to try. But this isn't a happy precedent to set in many other respects. The settlement across the UK is incoherent and lacking clear purpose, having been arrived at often through extreme brinksmanship and stilted, adversarial negotiation. It is underpinned by the Barnett formula, which has many flaws – the worst of which is the seeming impossibility of ever getting rid of it. Further, the nature of wider devolution in these nations – ie of large, high-cost public services such as health and education, and the reserved powers model, is not a precedent for England, where the focus is on economic devolution – which in turn has major consequences for the type of fiscal devolution being proposed.

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