STRONGER GROWTH, BETTER SERVICES, FISCALLY SUSTAINABLE:

CORE CITIES' RESPONSE TO THE METRODYNAMICS REPORT ON FISCAL REFORM

CORE CITIES

CORE CITIES DRIVING GROWTH, PRODUCTIVITY AND PUBLIC SERVICE REFORM

The Cabinet of Core Cities UK welcomes the recent report by Metro Dynamics, building on previous contributions like that of the London Finance Commission, setting out the heavily centralised nature of public finances in our current system, and how change can deliver increased productivity, more jobs and better public services.

For the ten Core Cities this is particularly important because they deliver 25% of the UK's economy; when Core Cities do better the UK does better. This has been clearly recognised in the devolution policy of this and previous Governments and business leaders support the thrust of our proposals.

Devolution is happening, and has been welcomed, yet the productivity of Core Cities is still low by international standards and we need to go further, devolving more to cities across the UK's borders to unlock their potential. The UK is missing out on at least an extra £66 billion GVA a year which could be achieved if all Core Cities performed at the UK average. Compared to their combined average, in Munich productivity is 88% higher; 80.7% higher in Frankfurt; 42.8% in Rotterdam and 26.7% in Barcelona.

Despite austerity, the total spent across the public sector is not reducing in Core Cities. Instead it is shifting from preventative services to those that deal with crisis, mainly health and welfare. That is contributing to a gap between total taxes raised across our cities and total public spending. Through a different approach Core Cities could close a public finance gap of £53 billion a year.

These two issues are linked. The dividing lines between social and economic policy need to be redrawn. Connecting more people to growth, bringing them out of dependency and into the labour market doesn't just save the taxpayer money, it boosts the productivity of city regions. 'Social' policy is not something we should look to once we have growth, it is a driver of growth and productivity.

Yet the way in which the total public resources are deployed across our cities is in most cases still too disjointed. There is a fundamental systemic failure where one bit of the system unwittingly undermines the efforts of another, meaning local and national aims are not achieved.

The single most important factor in boosting the productivity of the UK's cities is taking a 'place-based' approach. Improved performance relies on understanding the interaction of a complex set of 'place-based' factors and then asking "how can the total available public resources be best deployed to address these issues?" By building-in service alignment from the outset, this approach is much more likely to succeed.

Although elements of the Government's Productivity Plan 'Fixing the Foundations' and the Spending Review were welcomed by cities, so far this fundamental issue of unlocking place-based productivity remains unaddressed. Cities are left trying to bend inflexible out-dated systems to meet complex modern challenges, instead of building in alignment from the outset. Without change, the national programme for increased productivity and economic rebalancing is at risk.

REBALANCING RESPONSIBILITY: THE IMPORTANCE OF PLACE IN CREATING A PRODUCTIVE UK

Establishing a rebalanced, city-led economic model for the UK is critical to the long-term sustainability of the national economy. As the main economic and population centres of the UK, the Core Cities have the potential and ambition to be the UK's productivity drivers, making a greater contribution to UK PLC and connecting people with the economic opportunities unlocked by stronger growth to increase economic wellbeing and reduce demand on public services.

But, cities need the power to invest; to capitalise on economic assets and opportunities; and to reshape public services so that deliver efficient services which enable people to be in the best position to be prosperous and productive.

In a recent publication, 'Delivering Place-based Productivity', Core Cities have set out six critical challenges which must be addressed over the coming Parliament if we are to see productivity rise and the need for public spending fall; and if life chances are to improve and the need for some services reduce.[1]

These six challenges are:

1. Improving Land Use and Housing Supply
2. Tailoring Support for Business Growth, Science and Innovation
3. Strengthening Labour Markets to Drive Productivity
4. Increasing Life Chances, Connecting More People to Growth
5. Improved Infrastructure for Better Connected, More Sustainable Cities
6. Stable and Effective Investment

The solution to these challenges does not require more spending; rather, the solution is to empower Core Cities with the ability to direct existing spend differently to maximise impact on local growth and public service outcomes. This means a fundamental shift towards place-based policy and spending, aligning efforts at the right geographic level to create city region economies that are primed to deliver economic growth, higher productivity and fiscal sustainability.

But at present, public services and agencies, and the way they are funded, tasked or incentivised can work not only against the interests of cities and their residents, but also against stated government policy. Be it in housing policy, health and social care, or skills and education, the established model of policy delivery in the UK on place issues fails - not because those policies are focused on the wrong issues - but because there is a fundamental systemic failure where one bit of the system unwittingly undermines the efforts of another and individual departments struggle to address complex, multifaceted challenges.

And this is expensive – fiscally, economically and in terms of impact on people's lives. The difference between total spending on all public services (police, councils, health, welfare etc.) and the total tax raised across all the Core Cities is around £53 billion a year. Despite austerity, our figures show that this level of spending is not reducing in our cities. Instead it is shifting from services that are about prevention to those that deal with crisis, mainly health and welfare.

Whilst not everything is appropriate for local control, attempting to direct the intense complexity of linkages between skills, health services, jobs; infrastructure investment and transport is impossible at the national level. We need to establish a better balance between local and national decision making, empowering places with the powers and resources to take decisions which are shaped by outcomes for a place rather than by the organisation in charge.

1. Core Cities (2016) Delivering Place-based Productivity, http://www.corecities.com/sites/default/files/images/publications/Delivering%20Place%20Based%20Productivity%20v3.docx

FISCAL REFORM TO SUPERCHARGE PLACE-BASED POLICY

The capacity to direct investment and manage locally-raised resources can supercharge growth and reform at the place level. Despite progress in 'functional' devolution through devolution agreements, in respect of city financial autonomy, the UK is still one of the most centralised states in the developed world. Even with the proposed full devolution of business rates from 2020, that amounts to around 9% of the total tax base raised within cities being kept by those cities. In Canada about 50% of taxes are retained at the local or regional level, in Germany 35%, 25% across the OECD on average and a massive 80% in Tokyo.

The recent report by Metro Dynamics into fiscal reform in the UK[2] is an essential and welcome reassessment of why fiscal reform has a critical role to play in creating a sustainable and productive UK economy. The Metro Dynamics demonstrate that fiscal reform is vital because:

- **There is a growing public finance gap in cities –** the gap between public spending and taxes raised in Core Cities is around £53 billion a year and the solutions to this challenge are inherently about stronger place-based integration of investment in growth and public service reform. High quality public services make our cities good places to live and create the conditions for attractive, dynamic environments which attract businesses, investment and talented people.
- **Budget reductions are increasing the public finance gap –** removing capacity for places to invest in prevention has shifted demand towards more high cost, acute services.
- **The UK is an outlier –** the most economically successful OECD economies have a strong network of cities that are empowered both functionally and fiscally to drive growth for the national economy. The UK's economy is being held back as our cities are not punching their weight in a global economy dominated by cities.
- **Rebalancing needs to happen at the level of the functioning economy –** to capitalise on local economic assets and strengths, cities need the financial flexibility, borrowing capacity and multi-year financial confidence to tailor investment towards areas of competitive advantage, capitalise on growth opportunities, facilitate new inward investment and develop a skilled labour market.
- **Solutions to the 'productivity puzzle' vary from place to place –** in short, there is no one national solution to the productivity puzzle and different places need the decision making and fiscal autonomy to unlock the place-level solutions that will deliver higher productivity for the national economy.

2. *MetroDynamics (2016) A call for greater fiscal autonomy for our cities*

There is a strong socioeconomic case for fiscal reform in the UK but Core Cities believe this is a longer-term journey that needs to develop along with further, more wide-ranging functional devolution to the place level.

Our view is that retention of more of the tax base by cities should come before full devolution (where the rate of tax might be varied) and that buy-in of the private sector is a vital component of this. Indeed, Core Cities have long argued for business rate retention and we have specific views on how that should happen to get best value for our economy and, if implemented correctly, see business rate retention as a testing ground for further reform rather than 'job done'. We want to focus first on creating a workable, sustainable system of local government finance.

Business rate localisation represents an important policy shift and a clear statement of intent for further fiscal reform but there is a large amount of work required to create the new business rate system in a way that recognises the needs of cities and other places. This should include addressing the mismatch between the functions that Government is looking to fund from business rates and how business rates are actually generated. For example, areas that generate low amounts of business rates may have high levels of public health and Attendance Allowance expenditure, and vice versa. Without reforms, the system of business rate appeals creates significant volatility and risk and should be reviewed alongside a tightened safety net and risk share mechanisms to facilitate pooling. It should be borne in mind throughout the creation of a new system that business rate retention is meant to incentivise growth.

The changes to the business rate thresholds announced in Budget 2016 will ensure that 600,000 small businesses no longer pay business rates and 250,000 firms pay less have direct implications for the current and long-term financing of places. This announcement serves as an important demonstration of the impact that national policy decisions can have on local finances, despite Government's commitments to fully devolve business rate income. We are keen to work with Government to understand how the threshold changes will be funded in the existing system and the implications for the long-term localised business rates model as such national changes have the potential to restrict the financial capacity of places to invest in local growth and public services.

Further, whilst we accept the necessity of ensuring that the net effect of business rate retention is fiscally neutral, it is important to recognise that the additional responsibilities being considered, particularly public health, will impose significant new costs on local authorities. The switch from RSG to business rates creates additional volatility for local authorities that, without further devolution of powers around borrowing and other sources of revenue, they will struggle to deal with. In principle, greater responsibility sits well with the devolution agenda, but the details of what is being proposed are important to understand. Core Cities need to have a strong voice in the system redesign.

Our view is that the devolution of business rates represents an important opportunity to incentivise and reward growth and unleash local capacity to invest in locally-integrated services. The allocation of additional responsibilities should represent a further opportunity to expedite local growth and reform. We urge Government to apply three clear principles when assessing which additional responsibilities to allocate to places: supporting public sector reform and preventing demand; increasing productivity; and addressing distinctive local needs.

Whilst we welcome recent progress on multi-year, place-based budgeting, the scope of funds contained within multi-year settlements should be widened, and made available across locally defined geographies from all relevant departments, including a proportionate element of departmental administrative costs. Consideration should be given to a broader range of departmental funding streams, based on Devolution Deal components.

STRONGER GROWTH, BETTER SERVICES, FISCALLY SUSTAINABLE: A ROADMAP FOR FISCAL REFORM

Fiscal reform has a vital role to play in establishing a rebalanced, city-led economy in the UK where places have the capacity and are incentivised to invest in local growth and deliver efficient, locally integrated public services. But, Core Cities recognise that fiscal reform is complex and is should be seen as part of a longer-term journey to empower the UK's cities. This journey will need clear, incremental steps over the short to medium term, enhancing the fiscal responsibilities of cities and building confidence in more fiscally decentralised UK.

However, incremental short-term steps need to be seen in the context of a longer-term vision for fiscal reform; an agreed perspective, shared aspirations and sense of direction between cities and Government which articulate what we intend to achieve with clear milestones for how we will get there.

Below is a roadmap for fiscal reform which defines, in two clear packages the steps that Core Cities believe need to be taken in the coming years to deliver the fiscal reforms needed to support city-led growth and public service reform.

Pre-2020: driving growth and reform by establishing the foundations of fiscal reform

Before the next election, Core Cities will work with Government on creating the foundations for more comprehensive fiscal reform in the UK by empowering cities with relatively simple additional fiscal flexibilities.

COUNCILS IN FULL CONTROL OF THEIR FINANCES

There are a number of comparatively simple but important steps that should be taken before the next election which would empower places with the capacity to drive growth and reform. Set against the timescale of full business rate localisation, Government should look to empower councils with full local control over the finances that resource local government. Alongside business rate localisation and the introduction of multi-year council budgets, full local control of council resources would act as a platform for more comprehensive place-budgeting and wider fiscal reform.

Government have argued that business rate localisation will 'set local government free' from Whitehall control but this fails to recognise that councils remain constrained in a number of areas of local government finance. Business rate localisation alone does not complete the job of local fiscal reform and, as argued by Metro Dynamics, business rate localisation only serves to further the case for wider fiscal reform, empowering places with broader range of revenue streams to balance out any volatility in the business rate base.

Rather than looking at more complex and radical fiscal reform, with full local control of the finances that resource local government. This would build upon work by Metro Dynamics and research from elsewhere (eg. London Finance Commission; Independent Commission on Local Government Finance) to focus the agenda on immediate steps that could be taken increase the financial responsibility of places.

A) BUSINESS RATE LOCALISATION

The most immediate focus for Government and Core Cities must be on business rate localisation as, if implemented correctly, represents a significant opportunity to empower places with incentives, rewards and financial capacity to support growth and reform.

There are several critical areas of work which need to be undertaken:

- **Addressing the legacy of the current system –** as articulated in detail by MetroDynamics, there are a number of legacy issues with the current business rates system which must be addressed in order to create a stable platform for full localisation post-2020. In particular, this needs to consider the responsibility for and the volume of appeals which is significantly undermining the local finances.

- **Transition –** the move from the current grant regime to full business rate localisation will undoubtedly create uncertainty and significant risk for local financing and Core Cities are keen to work with Government to ensure that places do not suffer a 'cliff-edge' effect between 2019 and 2020 which could have major implications for local services and local investments.

- **Co-design of fully localised model –** the development of the post-2020 model of business rates will be critical to the long-term fiscal position of places. The new model needs to strike a balance between robust equalisation and redistribution aligned to local service needs and ensuring that places are incentivised and appropriately rewarded for investing and growing their economies. Through the Core Cities network and those Core City regions that are piloting full localisation over the coming years, it is vital that we consider:
  - ***Redistribution –*** developing the top-up and tariff arrangement to ensure places have the necessary funding to deliver vital services.
  - ***Reward –*** ensuring that places are rewarded for success and are able to reinvest the proceeds of growth in local priorities and public service reform.
  - ***Resets –*** in line with the above, ensuring that any reset periods under the new regime provide sufficient local certainty to enable investment in longer-term projects which take time to delivery financial return.
  - ***Revaluation –*** establishing a revaluation system that reflects the reality of growing economic conditions in cities.
  - ***National decisions –*** the impact of national policy changes (eg. reliefs, tax thresholds, academisation) on local business rate bases and how such nationally defined changes would be compensated under a fully localised system. Similarly, this should entail considering how the new system will take account of nationally significant premises which could be subject to policy change (eg. power stations).
  - ***Comprehensive modelling –*** we are keen to support and work with Government on modelling and testing different scenarios, assessing the range of factors above and looking at the financial impact and opportunities for cities and the wider local government sector.

- **Additional responsibilities –** additional responsibilities represent an important opportunity to empower cities with levers to drive growth and reduce high cost demand local services. Further, rather than simply identifying functions to devolve to places, we urge Government to take a more strategic, outcome-focused view; creating the opportunity for localised commissioning arrangements for place-based services rather than simply shifting administrative responsibility from central to local. Core Cities' view is that the additional responsibilities should be devolved based on the following three principles:
  - ***Productivity:*** spend that tackles productivity and prosperity challenges, e.g. skills, employment pathways (e.g. for the vulnerable) and apprenticeships, business support.
  - ***Reform:*** spend that can be used to prevent service demand, e.g. early years, social care or public health.
  - ***Addressing distinctive local need:*** the ability to vary local offers and entitlements, according to local need, decision making processes and accountability

B) WIDER LOCAL GOVERNMENT RESOURCE BASE

The localisation of business rates is a fiscally significant step for place financing and ensures that councils are almost entirely funded through locally raised resources.

However, this leaves some anomalies which should be addressed and would ensure that councils can harness their full resource base and brings greater coherence to local democratic accountability.

By 2020, Government should look to enable councils to have full local control of their resources, establishing a platform for further place-based financing, unlocking local investment potential and enhancing stronger local accountability for decision making. This should include:

- **Council Tax setting, banding and discounts –** complete local management of Council Tax base including the ability to manage discounts, set banding values, add/remove bands and set Council Tax levels.
- **Multi-year budgets –** building on DCLG's announcement of four year budgets to secure multi-year budgets for local government aligned to the Spending Review periods
- **Multi-year budgets for key partners –** building on the recommendations of the Independent Review of Local Government Finance,[3] multi-year settlements could be developed for key local partners (eg. CCGs, Police) as a developmental step towards multi-year place budgets in the longer term.
- **Local determination of fees and charges –** as an initial step, this could mean retaining the principle of cost recovery but enabling local authorities to have flexibility about how revenue from local fees and charges is used as part of mature local budget management (eg. parking fines no longer having to be only reinvested in parking).

Post-2020: mature place financing for high growth, productive cities

The second part of our approach to fiscal reform would be the development of a longer-term perspective on place-level fiscal reform in the UK for implementation post-2020. This would need to be developed in parallel with phase one (outlined above) and be based on the assumption that local government will fully control resources that are aligned to it by 2020.

Working with Government and capitalising on our strong relationship with London, Core Cities will develop a robust, evidence-based vision for place-based financing post-2020 with the intention of establishing a clear plan for fiscal reform in the UK. This will include specific milestones to achieve up to and beyond the 2020 election and recognising the ambition of such a proposal, we will seek cross-party political support for their implementation.

3. CIPFA (2015) Financing English Devolution: final report of the Independent Commission on Local Government Finance, http://www.localfinancecommission.org/documents/iclgf-final-report

The core areas of work would involve:

- A Core Cities vision for place-level fiscal reform post-2020 – utilising the more radical elements of the MetroDynamics report and additional modelling to set out a post-2020 vision for the fiscal powers, levers and flexibilities which would enable cities to fully compete on a global stage with the decision-making capacity to invest in growth, reform and drive productivity.
- A co-designed programme of fiscal reform – Core Cities working with Government to agree a timetable of clear milestones for the implementation of further fiscal devolution for the next decade (potentially linked to Spending Review periods). This would be developed with the current Government and could lead to a Green and White Paper (as suggested by Metro Dynamics) and we would look to secure cross-party support for the programme of reform.

The post-2020 vision need not be a public statement if Cabinet are wary of the political and public interpretation of more radical fiscal reform proposals but this vision would act as the basis for joint working with Government.

As part of the Core Cities vision and for discussion with Government, initial areas we may want to consider could include:

- **Whole-place multi-year budgets –** drive growth and reform at the place level with integrated, multi-year place budgets
- **Retention of wider set of property taxes –** build the case and develop models for the devolution of the remaining property-based taxes including Stamp Duty Land Tax; Annual Tax on Enveloped Dwellings and Capital Gains Property Development Tax
- **Right taxes at the right level –** consider the wider hierarchy of taxation in line with the MetroDynamics report, looking at local fees and charges (including Hotel Levy); alcohol and tobacco duties; Air Passenger Duty; VAT; Income Taxes; Corporation Taxes and Capital Taxes. It is unlikely to be the case that all of these taxes will be appropriate at the local level but they should be considered as part of a comprehensive assessment of taxation in the UK
- **Assessing the fiscal reform scenarios –** considering how places may access fiscal reform in differing ways depending on local priorities and circumstances, for example:
  - ***Geographic –*** eg. city/city region place budgeting.
  - ***Functional –*** eg. fiscal reforms aligned to specific place outcomes such as health and social care or employment support.
  - ***Flexible investment –*** eg. local fiscal flexibilities, levy varying and borrowing to enable investment in economic growth.
- **Governance and accountability –** as part of this development, we will need to consider local governance arrangements to support greater fiscally devolved arrangements, including enhanced scrutiny functions (eg. Local Public Accounts Committees) and executive officer accountability arrangements (eg. revisiting the proposed Joint Accountability models we have proposed previously).