

LYONS INQUIRY

into Local Government



Place-shaping: a shared ambition for the
future of local government

Executive Summary

March 2007

Sir Michael Lyons

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Preface

From the beginning of this Inquiry in the autumn of 2004, I have taken the view that questions about local government taxation and the funding of local services are not simply matters for technical analysis, but need instead to be considered in a wider context. They must be part of a broader debate about the type of country we want to live in: the balance we strike between citizen, community and government in terms of both power and voice, and how we manage the inevitable tensions between diversity, choice and a desire for common standards. In this respect, I follow firmly in the footsteps of Sir Frank Layfield, who reached similar conclusions in the 1976 report of the Committee of Inquiry into Local Government Finance.



Sir Michael Lyons

The extension of my remit in 2005, when ministers asked me to consider the future role and function of local government in this country, as well as its funding, reflects this concern to consider the wider context. I have interpreted even that remit generously, looking to describe how we can develop a new, stronger relationship between central and local government, founded on a shared interest in the prosperity and well-being of this country and its citizens. I have sought to explore whether a strong, national framework, together with greater local flexibility and choice, and improved engagement with the individual, might better enable us to tackle the complex challenges that we face as a nation. These ‘wicked issues’ include: the need to build a cohesive society in which everyone feels they have a stake; to improve our own competitiveness and meet the growing challenge of the emerging economies; to respond to climate change; and to strike a balance between immediate improvements to public services and the longer-term investments in infrastructure, skills and research that will underpin our future prosperity.

In order to strengthen the connections between the individual and government, and contribute to our wider national objectives, I believe that we must rebalance the relationship between centre and locality. My second interim report *National prosperity, local choice and civic engagement*, published in May 2006, outlined the steps that need to be taken to create the space for local government to take on its full ‘place-shaping’ role, as well as the measures that councils would themselves have to adopt to be ready for that challenge. I warmly welcome the Government’s subsequent White Paper, *Strong and Prosperous Communities*, published in October 2006, and the promise it holds for greater devolution.

No one should underestimate the sustained effort which will be required to achieve a real shift in the balance of influence between centre and locality. The history of the last 30 years is marked by a series of well-intentioned devolution initiatives, which have often evolved into subtle instruments of control. But it is an effort worth making.

This report seeks to develop my arguments further and includes my recommendations on how the future funding of local government could contribute to this rebalancing. However, I am clear that neither funding, nor powers, nor structures, are by themselves the key to the revitalisation of local government, and the improved self-confidence of local communities. I stress instead the

importance of changed behaviours in all tiers of government, of local flexibility, and the pressing need to inspire a sense of powerfulness in local government. This is not a simple argument in favour of the local, and I stress throughout the importance of improving our 'single system of government' through clarity of responsibility, alignment of purpose, and lean and efficient working practices.

We now have a real opportunity – with clear evidence of improvement in local authorities across the country, resurgent and self-assured cities, and an acceptance across the political spectrum of the need once again to empower our communities – to foster a new public confidence in local government, and perhaps in representative government at all levels. To meet this opportunity, central government needs to provide the space, the framework and the incentives that will release the energies of local councils – but they must in turn embrace the wider place-shaping role, further strengthen their engagement with those they serve, and establish themselves as unequivocal champions of value for money.

Just as our present situation is the product of many years, so we must approach this task with the intention, above all, of setting the right direction for the future, building the constructive relationships that will enable better decisions in the future. My proposals for the future funding of local government and the taxation to support it are therefore explicitly developmental. I lay out recommendations for early changes and others that can follow in due course. These should properly be seen as a mosaic of related changes, rather than a menu for separate choice. Together they could improve the fairness and flexibility of current arrangements; introduce greater incentives for local effort; and provide wider choices to future governments.

Many readers will be preoccupied with my conclusions on the future of council tax (the impatient should turn to Chapter 7). I conclude that it has a continuing part to play in the future funding of local government either on its own or alongside other taxes. However, early steps must be taken to reduce the pressures upon it. I also recommend measures to change the definition of, and eligibility for, council tax benefit, and believe these must be addressed as soon as possible in order to improve the perceived fairness of the tax. Concern for fairness has inevitably been raised with me on many occasions. There is no doubt that the perception of fairness in questions of both taxation and public expenditure is essential to the sustainability of the system, but there will always be different views about just what is fair; often dependant on the personal circumstances of the individual, including their income, wealth and age. I have tried to expose those tensions in my report. There remain concerns, however, about the lack of buoyancy of council tax and its continued unpopularity which may mean future governments need and want to consider more radical change in the longer-term.

I have also explored issues of business taxation in some detail. I offer recommendations which are again intended to be evolutionary in nature, but do respond to the strong messages I heard about the need for a closer working relationship between local government and the business community, and the importance of facilitating substantial new investment in infrastructure improvements and related measures to foster local economic prosperity.


We elect governments to make difficult choices on our behalf, but I am clear that ministers can only make changes where they can be confident of public support, or at least tolerance. So my message, the tensions I expose, and my conclusions, are as much a matter for the people of this country as for its current Government. I have become increasingly concerned that our expectations of what government can do for us grow faster than our willingness to meet the costs of those expectations through taxation, and possibly even beyond what can actually be delivered. Helping

citizens to engage in honest debate about our choices, both as a nation and as individual communities, is the big challenge for this and for future governments.

Local government could play a more active part in the management of these pressures, but it needs to have both the space, and the willingness, to work with residents and other parts of the local community to establish clear local priorities, to shape public services to local needs and preferences, and to strike the right balance between what is done for us and what we do for ourselves. We should, I believe, be as interested in how we might develop the distinctiveness of different places and how we leave space for different local choices which improve people's satisfaction, as we are about how we seek to achieve potentially expensive, and frequently elusive, 'consistent' standards.

I, for one, would hope to see debate about postcode lotteries being replaced, over time, by discussion of 'managed difference' – recognising the right and the ability of local communities to make their own choices, confident in their own competence, and in the knowledge of their own preferences.

In closing let me thank, most of all, Sally Burlington and the team that has supported me in this work. Their talent, enthusiasm and unfailing good spirits (even through several extensions to both remit and timetable) have been an inspiration to me. I also want to thank the many people and organisations that have contributed to my research and the wider discussion around it. Special thanks go to the 'critical friends' who have served on my reference group. Finally, let me express my gratitude to the thousands of people who responded to our extensive efforts to engage the public in these knotty questions about taxation and local expenditure. The balance and good humour of the many respondents I met, and their willingness to engage in genuine debate, gives me confidence that we can find a way forward on these highly contested issues. The views expressed in this report, together with its conclusions, are of course my responsibility alone.

A handwritten signature in black ink, appearing to read 'M. D. Healy', with a large, stylized flourish at the end.

Executive summary

LOCAL GOVERNMENT: A CONTINUING DEBATE

1 I was asked to undertake this Inquiry into Local Government by the Chancellor and the Deputy Prime Minister in July 2004 at a time of considerable public and political interest in and concern about the funding of local government, and council tax in particular. My initial terms of reference asked me to make recommendations on the reform of council tax, to consider the case for shifting the balance of funding, and to conduct analysis of other options for local taxation, including local income tax, non-domestic (business) rates and other local taxes and charges.

2 During the course of my work on funding, I came to the conclusion that changes to the finance system could not proceed effectively without the role of local government being more clearly established. In September 2005 ministers asked me to extend my work to consider the strategic role of local government, devolution and decentralisation, and how pressures on local services could better be managed. The full terms of reference are set out at the end of the report.

3 The final stage of my work has been the consideration of the Barker Review of Land Use Planning, the Eddington Transport Study and the Leitch Review of Skills, three independent reviews with significant implications for local government.

4 Much has changed since the beginning of my work, including:

- the transfer of schools funding from unhypothecated local government grant to the ring-fenced Dedicated Schools Grant;
- the Government's decision to postpone the planned revaluation of domestic properties for council tax purposes; and
- the publication of various important contributions to the debate including the Local Government Association's (LGA) *Closer to people and places – a new vision for local government*, and the Government's proposals for the future of local government and local public services in *Strong and Prosperous Communities – the Local Government White Paper* in October 2006.

5 During the Inquiry I have periodically set out my thinking on both funding and function issues. My *Interim Report and Consultation Paper*, published in December 2005, set out some early thinking on both, including the results of extensive analysis on options for revaluation and reform of council tax. My May 2006 report, *National prosperity, local choice and civic engagement: a new partnership between central and local government for the 21st century*, set out my conclusions on the role of local government, emphasising the advantages to be secured from an enhanced level of choice and flexibility at the local level for communities to make their own decisions. I also discussed my views on the strategic role of local government for the future, a role I call 'place-shaping', discussed further in this report. I want to emphasise that in our discussions about the role of local government, we must not become fixated on the service delivery role that has become so important over the last century. There are three, inter-related but identifiable, sets of roles that local government has played in the past, and continues to play: as service provider; as a vehicle for investment in public infrastructure; and as an institution of government – a place for debate,

discussion and collective decision-making. An analysis of the modern role of local government needs to take into account all three of those roles, recognising that the appetite for self-determination is as much a part of local government's background as its role as a service provider.

6 Following my May report, the Government set out its proposals for the future direction of local government in *Strong and Prosperous Communities – the Local Government White Paper*, published in October 2006. The White Paper is intended to devolve more power to the local level and reduce the level of central prescription, while strengthening leadership and expanding the opportunities for local people to influence local decision-making.

7 I welcome the direction set out by the White Paper and subsequent Bill. However, it is clear that it is only the beginning of a process and, as this report will demonstrate, much will depend on how it is implemented, and how both central and local government respond to it. My recommendations are intended to lay out a 'developmental' approach in which steps that should be taken quickly to improve the current situation can provide greater space for local action, helping to build trust and effective behaviours in the future and paving the way for possible further reform.

LOCAL GOVERNMENT IN THE 21ST CENTURY – WHAT IS IT FOR?

8 Government is a device that allows us to frame and enforce rules and laws for behaviour, manage the provision of public services, redistribute resources and manage frameworks for long-term economic, social and environmental sustainability. Local government has an important contribution to make as part of a single system of government, allowing different communities to make choices for themselves, and relating and shaping the actions of government and the public sector to the needs of the locality.

Pursuing the well-being of citizens

9 There are strong and compelling arguments for it as a device for allocating public resources and effort efficiently and effectively to secure the well-being of citizens. While individual and quasi-market approaches are important, there remains a set of issues which are resolutely collective. This includes decisions about the best use of public money and the management of public good and other publicly subsidised services in particular places. That does not necessarily mean that those services need to be publicly owned and directly provided, but it does mean that there must be the capacity for collective action and choices about the use of public revenues.

Place remains relevant

10 Though some economic and sociological analyses have challenged the importance of place and the importance of the local in modern society and economics, place remains relevant. As our understanding of the multi-faceted nature of social and economic problems grows, and as our aspirations to solve them and to govern uncertainty and diversity increase, the arguments for a local role in determining the actions of government and the provision of public services are becoming stronger. In addition, economic analysis continues to identify local factors and institutions as important influences on economic change and growth.

Necessity of local choice

11 Accepting these arguments means accepting some degree of variation and difference between different parts of the country in their decisions and their use of resources. Some would not agree with that view, but it is a point of fundamental importance. The argument that this will lead to an unfair 'postcode lottery' over-simplifies some complex issues. If the people of one area collectively choose to use the public resources at their disposal in a different way to the people of another area, it is hard to argue that is unfair.

12 There are therefore strong arguments in favour of a degree of local choice. In practice there is a desire to see both national standards and local variation. The research I commissioned suggests that people want an assurance that key services will be delivered to similar (generally minimum) standards across the country, but also that they want the ability to influence the shape and delivery

of services and take decisions locally. There is clearly a balance to be struck between an appropriate set of national or minimum service standards, and the variety of choices that different communities can make, and which in my view are a positive part of a healthy and sophisticated system of governance. My conception of the modern role for local government is therefore of a system which can deliver this ‘managed difference’.

Importance of engagement 13 However, all of these advantages of local government as a way of pursuing the well-being of communities depend on it being able to understand and respond to the needs and concerns of its citizens. This is an area in which it has been criticised, but one where I believe it has a great deal to offer. Ensuring that local government is fully and transparently accountable to local people for the decisions it takes in the pursuit of their interests and the use of their resources is critical to an effective system of local government.

Place-shaping 14 Throughout my work, I have promoted a wider, strategic role for local government, which I have termed ‘place-shaping’ – the creative use of powers and influence to promote the general well-being of a community and its citizens. It includes the following components:

- building and shaping local identity;
- representing the community;
- regulating harmful and disruptive behaviours;
- maintaining the cohesiveness of the community and supporting debate within it, ensuring smaller voices are heard;
- helping to resolve disagreements;
- working to make the local economy more successful while being sensitive to pressures on the environment;
- understanding local needs and preferences and making sure that the right services are provided to local people; and
- working with other bodies to response to complex challenges such as natural disasters and other emergencies.

Services 15 Local authorities are responsible for a wide range of services. However, debate too often focuses on which services local government is responsible for, as if this is the true measure of the importance and worth of local representative government. A new conception of the role for local government needs to go further, to reflect the well-being and place-shaping agenda. Whatever the legal and constitutional arrangements for the provision of a service or function, if it has impacts on local people, then the local authority should have a role in representing the community interest and influencing that service. That requires not just the joining-up of resources and activities, but also a leadership and influencing role to ensure that the efforts of all agencies are focused on the outcomes of greatest importance to local people. Local government is well-placed to play this convening role.

16 Local authorities also have the potential to use their purchasing power and long-term perspective to shape markets, and to use their ability to engage with citizens and service users in the design and delivery of services. This would allow them to take advantage of the potential of co-production to deliver better outcomes and greater efficiency.

Key challenges for local government

17 There are four areas where I think local government has a significant role to play in delivering important outcomes that arise from the manifold opportunities and challenges we face. Those are first, in providing safe and secure places to live, where communities are cohesive and integrated; second, in helping to foster the greater prosperity which benefits individuals and allows us to fund public services, including engaging with the challenges and opportunities posed by globalisation; and third, in addressing the impact we are having on the environment by taking steps to make our lifestyles more sustainable through engagement with citizens and through the performance of its statutory functions.

Satisfaction and trust in government 18 The final challenge that I believe exists for government, as a whole, is to address levels of trust and satisfaction among the public. Trust in government and elected representatives in the UK is low, and so is participation in political activity through the most obvious route – voting in elections. This seems to be a long-term problem, rather than an immediate crisis.

19 Local government also has a particular problem with fairness, linked both to concerns about ‘postcode lotteries’, and to concerns about the council tax. But fairness can often be an ill-defined and highly contested concept, meaning different things to different people at different times, and consensus on what is fair is almost certainly impossible.

20 Addressing these problems will be a complex and lengthy task in which local and central government have a joint interest, as I believe that what undermines trust in one part of government is likely to colour people’s opinions of the wider system of government. Improving trust is also essential if other reform is to succeed. When concerns about council tax dominate discussions about local government to the extent that they do now, it can become very difficult to take a wider view of what sort of governance we want in this country, and what reforms might take us there.

21 Local government can help to strengthen the relationship between the individual citizen and the state through measures to build trust, honest taxation and a recognition that people do want to be able to influence government and public choice decisions. There is a risk that if local government has too little flexibility then this can result in a more passive, less connected citizenry.

WHAT IS LIMITING MODERN LOCAL GOVERNMENT?

22 Local government’s ability fully to perform its place-shaping role, and respond fully to local needs and preferences is currently limited, and it also has limited flexibility to manage pressures on local budgets and spread the burden of local taxation. There are many different reasons for this – some are systemic, some are behavioural, and some are based on assumptions about public attitudes to choice and difference.

High degree of central control 23 Over the 1980s and 1990s there has been increasing centralisation across a range of local public services, driven by concerns to control public sector expenditure and to improve public services. In recent years this has been driven through new systems of performance management and targets, greater emphasis on delivery and central government’s willingness to take greater responsibility for specific issues. This has helped to improve performance, but it has also inhibited the ability of local government to respond to local needs and preferences, and to manage financial pressures.

24 While the extent and impact of formal controls has been recognised in the recent Local Government White Paper, there has been less attention to informal, ‘soft’ controls, which include guidance, central encouragements and conditions on grant. These soft controls are more indirect and more difficult to assess than direct targets and indicators, but their impact can be profound.

25 The weight of central controls – both formal and informal – can lead to local choices being crowded out. That can mean that resources are not focused on the top local priorities, potentially reducing levels of satisfaction, and limiting the ability of authorities to manage pressures effectively. It can also crowd out place-shaping, reducing the role of local government to a set of silo-based service activities. Finally, it can stifle innovation and experiment, both of which are promoted by decentralisation.

Lack of flexibility over existing resources 26 A large proportion of local government funds come from specific grants, which are often tightly tied to government requirements and expectations either formally through ring-fencing, or informally through expectations over what resources will be used for, and the monitoring of expenditure.

27 The introduction of Dedicated Schools Grant, reflecting the importance of education to the Government, has radically changed how local government receives its resources, substantially increasing the proportion of resources provided through hypothecated grants, and in the process greatly reducing the scope of local authorities to prioritise and manage pressures between services.

Limited flexibility to raise additional resources 28 English local government is highly dependent on central funding and relies on a single locally variable tax. In other western countries such as the United States, France and Germany, local authorities have significantly greater access to locally raised taxes. This means that the local tax burden can be spread across a range of taxpayers and that marginal increases in local authority budgets are not affected by the ‘gearing’ effect which magnifies the impact on council tax increases.

29 Capping is the other main restriction within our system of local government finance. Capping cuts across local accountability and carries simplistic connotations about local inefficiency. At an individual authority level it can also produce perverse results. It does not allow the underlying pressures on local government to be understood and better managed, and fails to recognise the Government’s own role in creating pressures. There is also evidence that such central controls run counter to public attitudes, with survey work showing that the public support local authorities – rather than central government – bearing the responsibility for the setting of council tax levels.

Pressures on services 30 There is considerable debate about the causes of these pressures at the national level and at individual authority level, and a wide range of predictions about how significant future pressures on local budgets will be. The importance of managing pressures effectively is likely to increase in the next few years, as the money available for public spending will grow less quickly than over the past decade. Analysis of pressures raises important questions about the adequacy of national funding, and the degree to which local government can achieve efficiency savings.

Confused accountability 31 Clear lines of accountability are a precondition for an effective relationship between central and local government and are essential to allow people and communities to engage with, understand and challenge the decisions which affect their lives. Without such clarity local communities cannot know who to hold responsible for taxation and spending decisions.

32 A lack of public understanding of how the system works contributes to this confused accountability, and enables both local and central government to blame the other for problems. There is also a very poor understanding of the costs of services that can only lead the public to be dissatisfied with both local and central government, as they have unrealistic expectations of what can be delivered for the level of tax they pay.

- Improved governance needed for economic prosperity** 33 Recent work comparing the UK with the USA and Europe has concluded that the lack of devolution and local discretion in the UK is a constraint on economic performance, particularly in the cities. There are important questions about what is the best level of governance to drive economic prosperity, but the fact that functional economic boundaries are not precisely defined, are different for different kinds of activity, and change over time, means that we should avoid simplistic solutions to what are complex problems.
- Attitudes to local government and choice** 34 My research suggests that public views about local government are more nuanced than is generally suggested and that there would be support for ‘managed difference’ between areas as long as there was sufficient influence and voice for local people. There is the scope to move away from a simplistic division between total standardisation and total local flexibility, towards the idea of minimum national standards, with communities able to make different choices about the level of service they receive beyond that, based on their own preferences and priorities.
- Lack of trust in the system of government** 35 Building trust is a complex activity, as trust is based on both rational and emotional responses. However, it is a necessary aspect of dealing with the complex problems that face local government. Confused accountability is, I believe, one of the major factors limiting trust at present.
- 36 Public concern about council tax rises and its fairness and associated media coverage also affects attitudes to local government. Central government has a duty, alongside its responsibility for the overall national finance and taxation framework, to maintain a viable tax for local government. The problems with council tax are not solely local problems – many of the pressures and unfairnesses associated with the tax are likely to require national action. Another factor that affects public trust is the fall-out from the adversarial relationship between central and local government, which creates a climate of criticism and a competition for legitimacy, rather than a shared agenda for meeting the needs of citizens.
- 37 It may also be that one of the reasons people do not engage with local government as much as they might, is because local councillors are perceived as having only limited powers. There is some evidence that the local government sector has become disempowered, with a lack of confidence in its ability to make change happen.
- Need for effective engagement** 38 Local government needs to engage with local communities to understand their preferences for services and other aspects of local government activities. However, at present this is limited by central and local government frameworks which focus solely on service improvement against formal targets at the expense of overall satisfaction and a wider understanding of community needs and preferences. It is also undermined by too great a focus on the centre, not the local community, in terms of performance reporting and target setting.
- Poor incentives in the distribution of national resources** 39 Even accounting for some specific initiatives, local authorities have a limited share in the general growth of housing or business tax bases. Neither growth in council tax, nor business rates in England results in any systematic increase in local resources because the grant system automatically takes into account any growth in tax base. Housing growth does have some benefit for the local community in that it allows council tax increases to be spread across a larger tax base, but the new residents’ use of services imposes costs as well. On business rates, local authorities only see a very long run benefit from growth in business tax base in the form of more resources for central government to allocate at the national level.
- 40 This question of incentives is particularly important when considering the role of local authorities in fostering economic prosperity and housing supply in their area, and the views of local communities. These are important aspects of their place-shaping role and so a link between the

health of the economy and the size of local tax base would be a key motivation for local communities to take growth seriously.

Conclusions 41 I have concluded from this analysis that what is required is:

- **clearer accountability** over who is responsible for what;
- **greater flexibility**, both over finances and to enable local government to manage local services in response to local needs;
- **better incentives** on local government to own and grow their tax bases and on both central and local government to develop a more productive relationship over time;
- **tackling perceived unfairness**, in order to improve satisfaction and trust in the system of local government as a whole; and
- **continued improvements in efficiency** to help relieve pressures on council tax under the current system. In doing so, it is also essential that public expenditure is allocated to best meet the needs and preferences of the community – delivering the right priorities rather than just doing them as cheaply as possible. Both of these objectives require greater scope for local choice.

CENTRAL GOVERNMENT'S CONTRIBUTION TO REFORM

42 Central government has a responsibility for the overall framework within which local government operates, and can enable local government to take on its place-shaping role more fully by making changes to that framework. The proposals in the Local Government White Paper, and the subsequent Local Government and Public Involvement in Health Bill, represent a significant step forward, though there are some risks and challenges which will need to be addressed if the potential benefits of the White Paper are to be realised.

Improving accountability

43 A key priority is to improve accountability throughout our system of local government, so that each tier of government has every reason to improve their own contribution to the well-being of citizens and communities, and to support others in doing so. This requires improvements across a range of issues:

- greater clarity about the respective roles of central and local government. This means being clearer about where central and local government can each add most value, and delivering on the commitment to pursue a much smaller number of nationally set central priorities, in order to leave real space for local choice;
- ensuring the new regulatory regime for local government is focused on the right issues, and allows enough space for local choice and priorities to be taken forward, while minimising burdens across the sector;
- improving the framework for local governance to promote effective local leadership and engagement, to better inform local choices which help manage public expectations and service pressures; and
- seeking to clarify how local services are funded to provide greater transparency over what local services cost, and how decisions on spending and resources have been made.

Clarifying responsibility 44 The most obvious way to clarify accountability would be to make a definite distinction between which services are national and which are local responsibilities, but such a formal separation is not possible. Modern public services are complex, both in terms of what they do, and how they aim to do it. Most services have some elements which are appropriately centrally determined, and some which should be locally determined, and some have regional or sub-regional aspects, which suggests decision-making should take place at different levels. In some areas central government will want to set standards which it wants to see everywhere, or to define a ‘national promise’ for citizens across the country.

45 In order to clarify the responsibilities of local and central government a number of changes are therefore necessary. First, both central and local government need to acknowledge the contribution that the other can make to their shared agenda for improving the well-being of our communities. This means recognising that central government should not expect to do the things which local government is better equipped to do, and vice versa. For example, local government by virtue of its closer connection with citizens, is better placed to engage with them about what they want, to manage expectations about what is possible, and to work with service users to improve the effectiveness of local public services.

46 Second, central government should be much clearer about those areas in which responsibility should be firmly local, and resist calls to intervene in those areas. This requires an acceptance that variability between areas is not only inevitable, but also desirable if pressures are to be managed.

47 Third, central government needs to take a more consistent and corporate approach so that local government is clear about what is expected of it, particularly in negotiations on Local Area Agreements. Government departments may need to change their behaviours and approach, and there may also be room for Government Offices to play a part in helping to develop a stronger corporate style in central government by reflecting back to departments the challenges that their own behaviours (however well-intentioned) can create at the local level.

Streamlining the performance framework 48 I welcome the objectives set out in the White Paper to streamline the performance framework. If implemented fully they will mark a real step-change, providing a much more streamlined system of regulation which will provide greater space for local flexibility and choice.¹

49 In particular, I strongly support the principle that local people should be the ultimate judges of the performance of their local authorities in place-shaping, delivering services and convening the work of other public services. The performance framework should support this, but it should not prescribe arrangements. Local authorities should have the primary responsibility for their own performance, and for designing transparent and effective mechanisms for engaging with their citizens.

50 Given the challenges in implementing the ambitions for the new performance framework, it will be important to monitor how well the new system is achieving its objectives, to check whether it, as well as the performance frameworks of partner bodies, is supporting joint working adequately, and whether it leaves sufficient space for place-shaping. An independent assessment should be published two years after the introduction of the new arrangements.

¹ By this I mean the wide range of activities undertaken by central government and inspectorates to regulate the behaviour and performance of local authorities. The performance framework incorporates regulation but also a much wider range of activities such as peer review and support, and other mechanisms included in the Local Government White Paper.

Improving the framework for local governance

51 Improving local accountability and governance rely to a large degree on local government changing its behaviours. Central government needs to design a framework which encourages and enables local authorities to take responsibility for how their communities are governed, and to design, and demonstrate the value of governance structures which work for their locality. No single model will work everywhere and too much central prescription could result in inappropriate local solutions and reduced innovation.

52 The Government has emphasised the role of strong and clear local leadership in providing accountability, in particular by placing an emphasis on elected mayors and the role of the council leader. I agree that leadership is important, but in setting the national frameworks we must acknowledge that effective leadership is not a simple concept and should not be reduced to a simple prescription.

53 Too strong a focus on the leadership of one individual for every area risks losing some of the strengths of the current system in terms of collective leadership and being able to represent diverse interests. Communities are complex and need broadly-based leadership, based on a number of people across a number of institutions. It is therefore important that, if local areas opt for a directly elected mayor or executive under the new governance arrangements provided for in the current Bill, this should not be fixed in stone. Central government should ensure that local communities retain the flexibility to choose models of leadership that best suit their circumstances, and to adapt them as and when they judge appropriate.

54 I also argue that central government should not seek to define any further lead councillor and officer roles and structures and existing prescriptive models should be kept under review.

Funding an accountable system

55 The complexity of the current finance system and its lack of transparency is a barrier to clear accountability. It is, I believe, virtually impossible to come to a definitive view about whether funding is 'adequate' even to fund central government commitments under the current system. This is in part a reflection of the intrinsic difficulty of assessing the spending pressures on such a large and complex system, but it is also a design feature of the current funding system. The move to a new system of distribution in 2006-07, commonly known as the Four Block Model (described in Annex A), ensures that annual changes to grant are now explicitly determined by relative need and resources, rather than by absolute figures.

56 However, while the grant system appears to recognise the practical impossibility and policy costs of central determination of 'correct' levels of spending in individual areas, government announcements and statements still often tend to imply that the public should be able to expect the same high standards of services everywhere – across a wide range of services. The raising of such unrealistic expectations makes it difficult to manage pressures effectively at the local level, and it raises questions about whose 'fault' council tax increases are, which are impossible to answer.

57 It may never be possible to create a system in which anyone can determine precisely whether the total funding available to local authorities is enough to enable them to achieve all of central government's ambitions. I would certainly not wish to promote a relationship between central and local government which simply focuses on inputs and costs rather than outcomes. Nevertheless, it is crucial that if central government makes promises about what local government will deliver, the funding system should provide some certainty that sufficient money will be available to do that, and in a way that helps local people to hold local and central government to account for their respective actions much more clearly.

58 In the short term, the most straightforward way to move towards this goal is to reduce the extent and ambition of the national promises made by central government which have to be met by local government funding.

59 In the medium term, there is a need to improve the transparency of the funding system, its objectives and how well it is achieving them, in a way that improves understanding and the quality of debate. I recommend that central and local government should agree, and formalise in a written agreement, what central government requires of local government, how it should be funded, and the ways in which central government should influence and control other aspects of local government activity (and the limits to that control).

60 In addition, an independent and authoritative voice is needed to provide better information on funding to inform the public and Parliament about the impact of new burdens on local government and the evidence of future pressures. This could build on the Audit Commission's existing role but other options considered should include an independent commission.

61 In order to achieve a more accountable system of local government, the Government should end the use of its capping powers, and then abolish those powers, as part of a wider package of measures to re-establish clear local accountability for local tax and spending decisions. Capping is a sign that central and local government have together failed to make the system work, and represents a short-term response to tax increases which are a symptom of problems elsewhere in the system – namely the pressure on local budgets and hence council tax, combined with a lack of local flexibility and unclear accountability. While it is born out of understandable motives, capping confuses accountability and can have perverse effects.

Protecting flexibility

62 The Local Government White Paper sets a welcome path towards a system with the potential for greater local flexibility, particularly by reducing central targets, with a focus on outcomes rather than outputs and processes and a recognition of the convening role. This responds directly to concerns that I outlined in my May report.

63 The challenge will be to deliver this through the Comprehensive Spending Review, and to maintain this approach over time. It is a substantial change in mindset, not only for central government departments and ministers, but also for citizens, the media and Parliament. It requires a shift towards a situation where ministers respond to issues of local discretion by referring them to the local council, and where central government resists encouragements to meet the particular objectives of lobby groups, professional organisations and representative bodies through central action, and instead encourages such groups to work with local government. In a country so preoccupied by fears of a 'postcode lottery' we should not underestimate the challenge that this poses – though it is one worth taking on.

Soft controls 64 The scale of this challenge means that there is a risk that some of the central controls that have been eliminated will instead 'leak' into either separate mechanisms such as ring-fenced grants, or soft controls which are less transparent and easy to measure. There are measures that can be taken to ensure that soft controls do not take the place of formal targets. I recommend that central government should:

- with the inspectorates, reduce the levels of guidance, reporting requirements and central pronouncements on areas which are of local concern and responsibility;
- develop a code of practice for government departments and agencies which clarifies the limited circumstances under which it is appropriate to place conditions on funding streams for local government, drawing on the work of the Lifting the Burdens task force; and

- set a target to reduce the extent of prescriptive guidance, process and reporting requirements. Progress against the target should be monitored transparently by an independent body such as the Audit Commission.

65 Local Area Agreements (LAA) should be developed in a way which leaves enough space for local priorities. New central government priorities which emerge between negotiations over the LAA should be incorporated into the framework on a strictly 'one in, one out' basis in order to avoid gradual re-growth of central control.

More flexible finance system

66 The inflexibility of the current funding system inhibits local responsiveness. In addition to my detailed analysis and recommendations on local government finance I make recommendations on other ways of improving financial flexibility, by enabling resources to better reflect local priorities and to support partnership working.

67 Central government has been able to influence local government behaviour through ring-fenced or specific grants, which come with specific targets or other conditions attached. These still make up a high proportion of local government spending and reduce the flexibility to respond to local priorities, work closely with partners on joint priorities and place-shape.

68 I therefore recommend that central government should commit to significant further reductions in the amount of conditional, ring fenced and specific grants – to local government and its partner agencies – and set a clear targets and a timetable for doing so. An independent body should report on progress annually. Where conditional and hypothecated funding remains there should be consideration of ways in which reporting arrangements for pooled budgets could be more flexible to support joint working, and a focus on outcomes to enable resources to be used to meet local priorities and circumstances.

69 Greater flexibility in the funding system should also help local partners to work more effectively together on crucial issues such as preventative work, which have tended to be crowded out by short term priorities. Enabling longer term planning through three-year settlements should also help – as preventative work is often the activity which gets squeezed out by short-term budget cuts.

Reorganisation

70 It is argued that reorganising local government, particularly in two-tier shire areas, can provide greater efficiency, and improve accountability. Although it did not form part of my remit, I do want to offer some comment on this debate. The past experience of reorganisation in this country provides a warning about the risks of poorly developed or executed change, and shows that it is by no means a panacea. I therefore put a much stronger emphasis on the responsibility of authorities to develop effective and flexible coalitions which transcend boundaries, and to seek joint solutions to problems where those offer potential advantages.

71 I agree with the Government that improved joint working is also needed in two tier areas, and that authorities in these areas need to aspire to operate as 'virtual' unitaries with greater efficiency through shared back office functions and integrated service delivery mechanisms. Some authorities have already made great progress towards this. There is a need in taking forward such relationships to recognise the roles which each partner is best placed to fulfil – as I have argued with respect to the relationship between central and local government. I include a series of tests for efficient joint working in Chapter 5.

Strengthening the convening role

72 The Local Government White Paper acknowledges the convening role of local authorities in taking responsibility for outcomes across an area even when those outcomes are most directly affected by other agencies. It notes that Local Strategic Partnerships should be co-ordinated by local authorities who should prepare the Sustainable Community Strategy in consultation with others.

The Government's intention is to ensure elected members are fully involved in the Local Strategic Partnership processes, that named partners are under a duty to cooperate with the local authority to agree and have regard to targets in the Local Area Agreement, and local government has enhanced scrutiny and overview arrangements.

73 In taking forward these intentions, I recommend that central government should:

- seek to ensure the suite of targets and national indicators for local government is internally consistent and outcome-focused. Negotiation of Local Area Agreements should make it a priority to allow the local alignment of targets across all local public services;
- acknowledge the role of local authorities in having lead accountability for local outcomes across all local agencies;
- support the convening role in their approach to Local Area Agreements and other activities – particularly in relation to services not provided by local government; and
- ensure that there is sufficient stability in the system to enable local government and its partnership agencies to develop strategies and actions to meet local needs and preferences.

74 Full recognition of the convening role of local government should take account of the complex relationship which local government has with other sectors, including particularly the third sector which is a key partner in service design and delivery.

Efficiency and choice

75 Local authorities need to establish themselves as champions of efficiency and value for money. I distinguish between two different types of efficiency. First, public services need to be delivered in the most cost-effective way possible – which I define as managerial efficiency. Second, the system should enable what economists call allocative efficiency, allowing public expenditure to be allocated in the way that best meets the needs and preferences of each community. There may sometimes be a tension between improving cost effectiveness to find financial savings and prioritising the right activities in each area, but ensuring value for money in the broadest sense is likely to become an even greater necessity as public finances become more constrained in the future.

76 There has been significant improvement by local government, with the support of central government, in driving cost effectiveness in the delivery of local services. This has been achieved through a variety of means including greater service collaboration, exploiting technology, and better procurement and commissioning. Figures released in December 2006 suggest that local authorities will deliver £1.3 billion of efficiencies in 2006–07, in excess of the £1 billion target set by the Government and building on performance in previous years.

77 However, the current level of centralised control still restricts scope to improve cost effectiveness, especially by hindering innovation. Over-emphasis on setting frameworks which have to work in every area can mean that the whole country is forced to go at the pace of the slowest. But, equally, over-experimentation runs the risk that many areas spend time reinventing new approaches and wasting time and resources. The challenge here is to strike the right balance, allowing those communities which are ready to innovate to do so, and ensuring that appropriate support and guidance based on best practice and evaluation evidence is available to support others. This does not mean central government should routinely issue guidance on innovation – rather the family of local government should take more of the responsibility for this, building on work already

ongoing, with organisations such as IDeA and LGA leading on providing information and good practice.

78 The submissions I have received from local authorities and others reflect a sense that managerial efficiency or cost effectiveness is too frequently emphasised in the public sector at the expense of allocative efficiency or broader value for money – we tend to care more about doing things cheaply rather than delivering the right priorities locally; which should be those that have the greatest impact on well-being.

79 I have therefore recommended that the Audit Commission should develop the Use of Resources judgement in the new performance assessment framework to include delivering the ‘right’ priorities to meet the needs and wishes of the local community, as well as doing them more cheaply. Central and local government should together challenge the presumption that difference between areas – the ‘postcode lottery’ – is always a bad thing. And central government should explicitly recognise that for a range of local services the best way to improve well-being is to enable greater local collective choice.

80 In order to enable local government to make the choices which are best for local well-being, the framework also needs to encourage effective public engagement, and provide the flexibility for authorities and particularly local councillors to respond to concerns raised with them.

Powers and powerfulness

81 One of the questions which has arisen persistently in my Inquiry is whether local authorities have sufficient powers to undertake their place-shaping role already. The strong message I received from authorities was that the key problem was not necessarily a lack of powers, but a lack of flexibility to do what was needed locally, as a result of the burden of central controls and performance management described earlier.

82 Local authorities already have wide legal powers, extended significantly by the introduction of the power of well-being in section 2 of the Local Government Act 2000 which enables authorities to do anything which promotes or improves the economic, social and environmental well-being of their area. Moreover, there is still some way to go to ensure that all local authorities are aware of and able to use their existing powers fully.

83 The report discusses a range of areas where local authorities are constrained by the way in which existing powers are drafted or used, and where powers and resources are potentially located at an inappropriate level of government. But it is important to recognise an equally important point, often missed in these discussions. Local government has become dependent on central government not only financially, but in many cases also for guidance, encouragement, and permission to innovate, across a wide range of fields. Confidence and capability must be driven from within the local government community itself, though central government can help to encourage a sense of powerfulness by expecting decisions to be taken locally and by devolving powers.

Economic prosperity

84 The concept of place-shaping underlines the importance of communities taking responsibility for their own economic fortunes, and for striking the right balance between economic, environmental and social objectives and concerns. Patterns of economic activity do not match the administrative boundaries of local authorities, and sub-regional working by groups of local authorities is therefore needed if they are to effectively address economic issues. However, resolving this issue in a way which undermines or cuts across the place-shaping role risks disengaging local government from the economic prosperity agenda.

85 The Government is rightly, in my view, not pursuing a structural reorganisation to address this issue. Nevertheless, it understandably wants to be confident that robust and effective

approaches are in place. I propose that it should establish a framework in which proposals for sub-regional working are determined locally, but tested against a clear set of expectations and tests to ensure that the partnerships have clear objectives, can take a long-term view and are sufficiently strong to support the greater responsibilities that would then be provided. Chapter 4 sets out the tests that I think Government might expect local arrangements to meet.

86 This would be a developmental solution to the challenge, with the capacity for improvement and change as relationships developed. The development of Multi Area Agreements, as signalled in the White Paper, provides a possible model for such an approach. The creation of new institutional structures where these do not currently exist should be avoided unless a consensus exists at local level, or local authorities fail to put in place adequate arrangements through robust collaboration.

What this means for services

87 The analysis for my Inquiry used a range of techniques to assess the problems facing local government and possible solutions. Although my work was never intended to provide an exhaustive analysis of all the services which local government provides or influences, I did examine a range of specific services in order to inform my work using case studies, public engagement and a series of expert seminars. They were selected to cover a range of different issues in terms of pressures, degree of central control and contribution to place-shaping.

Planning 88 Land use planning is an important aspect of place-shaping, perhaps the most immediate tool which authorities can use to influence the physical shape of localities. The Government should pursue devolution and clarification in the planning system as set out by Kate Barker in her Review of Land Use Planning, by reducing the complexity and detail of central control and setting out clearer criteria for the use of call-in powers. In taking forward reforms to the planning process for major infrastructure projects it should ensure that the new arrangements apply only to issues of unambiguously national importance, that local communities have an opportunity to make their views known, and that a clear process for reporting back to local communities is established.

Transport 89 The recommendations I have made for enhanced sub-regional working will be particularly important for transport. There is also one particular area where both local and central government currently have limited capacity to influence activity and provision. That is, as identified in the Eddington Transport Study, bus services, which were deregulated in all areas outside London in 1986. The Government has recently announced plans to enhance and extend the powers and options at the disposal of local authorities and these should be implemented as soon as practicable.

Skills 90 The UK's competitive position is now, and will increasingly in the future be dependent on the level of skills of its workforce, and the Leitch Review of Skills sets out powerful arguments for further investment in skills. The vital contribution that skills can make to economic development makes it essential that local authorities in their place-shaping role, engage with these issues. In taking forward reforms the Government should ensure that provision is appropriately tailored at the local level, that local authorities can play an appropriate role in any future Employment and Skills Boards, and seek to build on existing arrangements between employers and local authorities where possible.

Housing 91 Patterns of housing development and mobility, the availability and condition of housing and the willingness of individuals and developers to invest in it are all important influences on, and reflections of, the health of our communities. That applies to social housing as it does to privately rented and owner-occupied housing. Looking at housing issues in a strategic context is an essential part of the place-shaping role of local authorities. The Government should ensure that local

authorities have appropriate influence over housing issues in that role, including by considering whether to extend the duty to cooperate to housing associations and other social landlords.

Adult social care 92 In relation to social care for older people there is a clear need for reform to enable the system to cope more effectively with future pressures, which raises some profound questions that need to be debated and resolved nationally. Reforming the system of social care to align incentives for efficiency – balancing costs against outcomes and satisfaction – with the ability to control eligibility and pressures as effectively as possible is a huge challenge. In my view it can only be solved by a well-informed and honest debate about the challenges the system faces and the difficult questions they raise.

93 There needs to be a clear, shared agenda between central and local government about how we care for older people. An important outcome from the 2007 Comprehensive Spending Review should therefore be to ensure that the solutions for managing the future of social care effectively are properly debated by central and local government, service users, carers and private and third sector providers.

94 If Government makes a ‘national promise’ about future adult social care, local government must be adequately funded to enable it to deliver that part of the promise for which it is asked to be responsible. As part of this it is important that responsibility for managing pressures lies with those who are able to do so most effectively.

Domestic waste 95 Waste is the other area of significant cost pressures which I examined in my case studies. Rising costs in waste management are a widespread problem, as our dependence on cheap landfill must be reduced in line with European legislation.

96 The Government recently announced its intention to legislate for Joint Waste Authorities in those areas where local councils wished to establish such formal partnership structures. This is a positive step in a context where joint working may make it easier for authorities to procure alternatives to landfill and streamline their dealings with private sector firms. It will, however, be important that there is room for structures to be tailored to, and driven by, local partnerships and not imposed according to a central template.

97 There may also be a case for examining the tools local authorities have to influence not just how waste is disposed of, but the volumes emerging in the first place. Later sections of the report consider the case for giving local authorities greater powers to influence the behaviour of local people through variable charges for the collection and disposal of domestic waste.

Community safety 98 Community safety offers a very good example of a set of concerns and activities which can only be delivered effectively where there is a strong local element – particularly to influence behaviour, working very closely with local communities. It is key to supporting social cohesion, which is one of the most important roles for local government in modern society.

99 One of the clearest messages to emerge from my case studies relates to the need for more stable funding for community safety to enable strategic planning and to encourage partnerships to grow. This problem may have emerged in relation to community safety more strongly than other services, because of the strong reliance on focused, time-limited grants provided through a range of channels. A key role for Local Area Agreements should be to allow the funding and flexibility for those sources of funding to become more streamlined and stable over time.

Health and well-being 100 The protection and improvement of public health is a role which clearly benefits from local determination, arguably to an even greater degree than social care – since the benefits of enhancing health and well-being are likely to accrue to the local community as a whole, and the health needs of each community (and therefore what needs to be done) vary dramatically.

101 Some of the targets which have proved most intractable for the Government relate to health and well-being – particularly in terms of tackling inequalities in health outcomes, for example childhood obesity and life expectancy. It is clear that there are great difficulties in improving the health of some groups, with poor health being strongly linked to deprivation, and determined very strongly by cultures, behaviours and wider environments.

102 Given the importance of health for every other aspect of people's well-being, and its impact on overall public expenditure, I would expect this emphasis on public health to grow over time. In particular, councils need to exploit their advantages in working with communities and individuals to improve outcomes – as they are given greater flexibility to carry out their place-shaping role. I therefore recommend a stronger and more explicit role for local government as convenor in the realm of health and well-being.

Children's services 103 Children's services have been an area of dramatic reform in recent years. The Children Act 2004 introduced a significant reorganisation of children's services, bringing services and partners together with the aim of promoting better outcomes for all children and improving the child protection system. By 2008 every council is expected to lead the creation of a Children's Trust, bringing together strategic oversight of all services for children and young people in an area.

104 Schools provide a national service directly to the community, and therefore provide a potentially vital link between local communities and the local authority, crucial to any place-shaping agenda which focuses on improving the well-being of families. No other service providers, except perhaps GPs, play such a vital role.

105 Schools are excluded from the duty to cooperate which applies to other partners in relation to the Local Area Agreement. They are, however, required to have regard to the Children and Young People's Plan, which informs and is informed by the Sustainable Community Strategy. Nevertheless, I am concerned that this link may be too weak to ensure a high degree of cooperation, and the Government should consider more formal mechanisms to ensure greater collaboration on place-shaping issues.

LOCAL GOVERNMENT'S CONTRIBUTION TO REFORM

106 I have argued that the centralisation of governmental and public service functions has confused accountability and generated a relationship that 'crowds out' local government's role in responding to local needs and priorities. I have made significant recommendations to central government to try to tackle these issues. But responsibility for changing the dynamic of local-central relationships and re-energising the relationship between the citizen and their locality primarily rests with local government itself. I do not want to downplay the progress that many local authorities have made already but, while there is no comprehensive blueprint for success, I am convinced that major changes of approach are needed if councils are to embrace the place-shaping role in all our communities and rise to the challenge that ambition presents. My recommendations concentrate on those changes which are most urgent.

Focusing on the future

107 Place-shaping requires local government to be more consistent in raising its sights beyond the immediate delivery of services, the short-term electoral cycle and the timetables of funding and performance management – and to do this with greater ambition. It needs to focus on developing a vision for an area and its communities, including local businesses.

108 The best authorities are already taking this longer term strategic approach to securing sustainable strategies that address the issues facing their communities. However, despite many strong examples of long-term planning, I have detected a sense that some local authorities have developed a tendency to ‘wait and see’ where central government will go next, rather than setting out their own long-term strategic plans. In some cases this reflects political instability or other obstacles to making difficult decisions, but also insufficient confidence about the long-term budgetary position of the authority. Sometimes this is linked to too narrow a focus on service delivery rather than a wider strategic view of service provision within the locality.

109 In their forward planning, local authorities should look further ahead than even the ten-year time frame of the community strategy; making best use of intelligence and evidence of future trends; engaging local partners, businesses and residents in a debate about the long-term aspirations for the area; and focussing their performance management on outcomes.

Leading communities and places

Political and managerial leadership 110 Visibility of leadership is very important and a key component of accountability. Where people know who is in charge, they know whom to call to account. This is important in terms of public recognition, but also in building the personal networks and relationships with key local partners. If leading councillors, whatever the leadership model being used, adopt an outward-looking approach, communicate and engage local people with energy and enthusiasm and also develop credibility with their partners, they can be excellent place-shapers, even where leadership is not focused on a single individual. A summary of these place-shaping behaviours, which apply as much to small localities as major cities, is set out in Chapter 5.

111 Managerial leadership also remains important but the recent emphasis on this has not always been thought through with the danger of overlapping roles and confused expectations, particularly when there are changes of political leadership. One of the key roles of managerial leadership is to develop the organisation in terms of competencies, behaviours and understanding, including the ability to build coalitions outside the organisation. I am convinced by Jim Collins’s argument that the ‘flywheel’ of public sector achievement is the development of “brand reputation – built upon tangible results and emotional share of heart – so that potential supporters believe not only in your mission, but in your capacity to deliver on that mission.” Again, I feel strongly that facilitating this role of local government is not a matter of legislation or formal frameworks, it is primarily a question of behaviours. Chapter 5 sets out the managerial behaviours which I think best support councils’ place-shaping role.

Convening 112 Local government – at political and managerial levels – also needs to exercise leadership of the whole community, creating a shared agenda that recognises the roles that different partners can play in bringing it to life. Convening requires local government to be able to identify a direction of travel, articulate a sense of the future and enthuse others to be part of a common mission. Significant progress has been made but there is still a long way to go. Local authorities need to ensure that local partnership structures are fit for purpose and have a genuine focus on the needs of the local community. More broadly, local authorities need to adopt a leadership style that engages local partners, builds alliances and secures support for joint priorities. It should facilitate, advocate, arbitrate and influence rather than dominate.

Two-tier working 113 There are many who believe that we should move to a unitary structure of local government across the country. However, two-tier government does have advantages; indeed many urban areas are trying to find ways of getting the balance right between locality and city-wide governance, forming voluntary two-tier arrangements. A key aspect of the convening role is the challenge for those tiers to work productively together. Chapter 5 sets out a range of characteristics of effective two-tier working.

Local government's national voice 114 The leadership challenge in local government is primarily about councils gaining the confidence and sense of power to speak for their local communities, but there is also a need for the local government community to be represented and led nationally. The development of the LGA in 1997 significantly strengthened local government's national voice and there has been important progress in recent years through approaches such as the central–local partnership, to generate a more equal relationship between local and central government. Nonetheless, local government still finds it difficult – particularly in the public's view – to be regarded as having sufficient stature in many debates with central government.

115 I therefore welcome the LGA's review of its role and relationships through the Best Commission. The LGA is likely to have a critical role in reshaping the role of local government and developing the relationship between local and central government. This will particularly depend on its work with partners to provide leadership to the sector and challenge to underperforming councils. Local government will also need to strengthen its performance in contributing to debate on major policy issues of the day, and its key role of communicating with the public about local government's value, its challenges and its successes.

The role of political parties 116 There is also an important role for political parties. In order to improve the calibre and performance of councillors, parties need to refresh their approach to recruiting local councillors, actively seeking out talent and reaching out beyond their traditional activist base. This needs to be accompanied by greater clarity about expectations and time commitment involved in being a councillor. Political parties, mainly at the local level but supported by national parties, should also place stronger performance management pressures on councillors, including provision of information to the public about their activities.

117 Political groups need to reflect on how they are organised and should consider how to achieve the right balance between enforcing the party whip and allowing councillors to represent local issues. Automatic adherence to a party line can undermine councillor credibility with ward constituents. Such a change needs to be accompanied with a focus on developing skills at cross-party working.

Frontline councillors 118 The frontline role of all councillors – both non-executive and executive in their ward role – is one of the keys to effective engagement with the local community and one which receives insufficient attention and support. The White Paper proposals provide an opportunity for all councils to reflect on how members can be more outward facing and how the balance can be shifted towards engagement with their communities. There is a role for the local government family, including IDeA and the LGA to develop new models for frontline councillor working and local government itself should experiment to get the best out of this role.

119 More generally, there is a need for more effective support for local councillors in their frontline role. For example, they should have timely access to the information they need to do their job effectively, and should be clear about how they can influence the council's policy decisions. They should have clear job descriptions and training specifically for their ward member role, and councils should consider the use of individual ward budgets.

Improving local accountability

120 Councils need to go beyond elections to ensure an ongoing mandate to act in the interests of the whole community. Changing expectations about the accountability of government mean that councils need to earn the confidence of local people, to ensure that they are responsive to their views and that they understand their needs and priorities. The White Paper makes clear that central government expects that a shift in powers and flexibility to local authorities must be accompanied by greater local accountability and I support this 'deal'. Local government can go a long way towards improving its accountability to local people even within the current framework and has no need to await further legislation.

Improving public engagement

121 Local government's ability to engage local people lies at the heart of its place shaping role. If local government is to act in the interests of its community, influence its partners and ensure it tailors its work to the most important local priorities, it needs to make a step-change in the quality of its engagement work. Councils need to be selective with their resources with a focus on what matters, avoid allowing statutory requirements for consultation to dictate their approach and to accord higher status to the skills needed by officers and councillors to engage effectively with the public.

Developing scrutiny

122 Scrutiny by non-executive councillors of the executive's decisions, policies and strategies is increasingly playing an important role in the accountability of local government; strengthening public engagement and improving council performance. Scrutiny has a core role to play in place-shaping. Done well, it can provide a focus for community and stakeholder engagement, harness local expertise, challenge current performance and service priorities and secure changes that mean services better meet local needs. There are many examples of effective scrutiny but there is also evidence that in practice the use of scrutiny as a tool for local accountability is mixed. There are also major differences in the extent to which councils prioritise and resource the scrutiny role. There is a need for councils and other participants to resource scrutiny appropriately and to link it to local partnership work.

Innovative, local solutions to public service challenges

123 Councils may be able to provide adequate and even good services without fully embracing their place-shaping role, but real achievements can not be made without local authorities focusing on the sense of place, to enable services to be tailored to the needs of a local area. For services to be provided in this way, innovative local solutions may be necessary which sometimes involve taking carefully judged risks.

Creative use of powers

124 In order to act effectively and innovatively in its place-shaping role, local government needs to make fuller use of the powers at its disposal. It needs to demonstrate that it is ambitious and innovative in the use of existing powers if local government is to be given new ones. The limited use of the well-being power set out in the Local Government Act 2000 is a powerful example of local government not making full use of its powers, with research suggesting that this has been due largely to the need for a more entrepreneurial approach to problem solving.

Local Area Agreements

125 There is a key challenge for local government in making best use of LAAs for the local community as intended in the White Paper. This means negotiating the 'right' 35 targets with central government and partners, and selecting an appropriate set of local targets. These should reflect a proper strategic discussion of priorities for the whole local community with partners, resisting any temptation to rely on a standard list.

Commissioning role 126 The need for innovation also requires local authorities to assess whether they are the optimum provider of services or whether they should adopt a commissioning role, working in partnership with other public service providers, the third sector or the private sector. Such commissioning can have a number of benefits in bringing skills and experience from other sectors, a greater focus on user involvement and users as co-producers. It can also change the dynamic of local government away from being a provider of service, to one of a stronger community advocate taking a strategic view on the needs of the community at times – seeking to help develop community and market responses which reduce the pressure on the public purse.

Improving efficiency 127 Improving efficiency will continue to be a major driver for local government, not least because of the imperative for councils to manage pressures on public expenditure and to secure the trust and confidence of both their local population and central government. Councils role in effective place-shaping will depend on them establishing themselves more clearly as champions for efficiency.

128 Public engagement can help councils to develop innovative solutions which can deliver more effective outcomes. Councils, should consistently involve users in the design and delivery of services, to find ways to enhance user choice and harness the benefits of co-production.

129 Pursuing the broader definition of allocative efficiency – delivering the right local priorities – requires, however, a really clear understanding of local needs and aspirations, together with good levels of engagement to both inform and explain hard choices. Chapter 5 provides examples of approaches which can improve efficiency.

Performing for the community 130 The new performance framework offers opportunities for local government to retain its focus on performance but re-orient its performance management towards greater community and public accountability so that the whole organisation – managerially and politically – knows exactly how it is working for the good of the local community, whether it is achieving its goals and what more it needs to do to meet its own targets.

FUNDING REFORM – INTRODUCTION

131 Reform of the local government finance system should not be seen in isolation, but must be part of the process of empowering the kind of local government that we want. My recommendations on finance are guided by a set of broad objectives for reform, in the context of the wider vision of place-shaping described in this report. These objectives are:

- greater local flexibility and choice;
- stronger national and local accountability based on clearer responsibilities;
- better incentives for local government;
- efficiency in local tax and spending;
- better management of pressures; and
- improved fairness, and perceived fairness in the tax system.

132 Taken together, these objectives shape a package of reforms to ensure the sustainability of the local government finance system, in the immediate term and into the future.

Balances and trade-offs 133 Some commentators have argued that a key objective for reform should be changing the so-called ‘balance of funding’, making local authorities more reliant on locally raised revenues and less dependent on funding from Whitehall. It is suggested that this would help to ensure that local government is more self-reliant and democratically accountable to the local community.

134 I agree that accountability for local decisions, including decisions about tax, is an essential part of meaningful local government. However, it is not obvious that a new or larger local revenue stream would by itself create greater independence from central government. Indeed, greater responsibility for painfully accountable revenue-raising – if it came without greater discretion about the services and outcomes being pursued – might be the worst of all worlds.

135 Equally, it is important that the finance settlement does not put local authorities in a position where local choices about tax rates are continually overridden by external pressures. However, I have some doubts about whether changing the balance of funding or ‘gearing ratio’ would, of itself, solve these problems. Recent changes to schools funding show that altering the headline balance of funding may have little impact on local authorities’ freedom to set locally-appropriate spending plans. In some circumstances it may even reduce their ability to do so.

136 I have not made it an explicit objective of this Inquiry to change the balance of funding. Instead I have aimed to focus on the underlying causes of pressures on local budgets, and to ensure flexibility and accountability in both tax and spending at the local level.

Balances and trade-offs

137 It will be important, in arriving at a series of reforms, to consider how different objectives for reform may pull in different directions. Important judgements include: balancing the interests of different groups of taxpayers, for whom ‘fairness’ may mean different things; judging the appropriate role within the finance system of both taxes and user-charges for services; the appropriate role for equalisation between areas while retaining the scope to introduce financial incentives for authorities; and the trade-off between stability and buoyancy in local revenues.

Principles for good local taxes

138 Tax policy should have regard to a set of general principles for good taxation, and should consider the elements that contribute to a good local tax. These are set out in Chapter 6. Taxes on property (and land) have particular advantages as local sources of revenue, not least in providing a strong connection between the tax people pay and their residence in an area. Taxes on property value reflect residents’ (and owners’) financial stake in a community and its prosperity, and their interest in local services and investment, which themselves impact on the desirability of property in a given area.

Framing a package of reform

139 There is, I believe, a strong and growing case that change is necessary. The ‘no change’ option is itself a painful one: the pressure on local services, on council tax as the only local tax, and hence on council tax payers, will not disappear and may indeed sharpen in some areas as growth in public spending, including central government funding for local services, slows down in the coming years. I believe there is enough evidence to justify action to make the finance system more sustainable into the future.

140 However, although it is true that the status quo is problematic, it is very clear that there are no easy options for change, and no simple ‘golden key’ that will unlock the problems of the finance system. Any change in taxation creates ‘winners’ and ‘losers’, with those who pay more tending to react much more strongly to change than those who benefit. A package of complementary measures will be crucial if we are to balance the impact of change on different groups in an acceptable way.

141 My central proposition is that a mosaic of changes, implemented over time, through a ‘developmental approach’ to reform, is the best way to move forward. I have aimed to shape a package of reforms which both deal with the immediate challenges facing the finance system and pave the way for wider choices in the future. In the report I also consider the implications of my recommendations for Scotland, Wales and Northern Ireland.

HOUSEHOLD TAXATION AND LOCAL CHARGES

Council tax

142 Council tax is a hybrid tax: partly a charge for local services and partly a property tax. Since its inception in 1991, council tax has been the only locally levied tax on households, and the only tax whose rate is decided by local authorities. With a total yield of over £22 billion in 2006–07, council tax makes a significant contribution to the funding of local public services. It is also the most visible and well-known tax in the country, with public awareness of the tax at 99 per cent.

143 Property taxes have a number of things to recommend them, and since council tax incorporates a property tax element, it shares many of these advantages. Council tax is relatively easy to collect and difficult to evade. Since properties do not move, tax bases are stable and revenues relatively predictable, allowing local authorities a degree of certainty in their financial planning. Property taxes are widely used around the world as a source of finance for local government, reflecting the crucial link between residents of an area and the services that are provided there.

144 These factors lead me to the view that council tax remains broadly sound and should be retained as a local tax. It does, however, have some important shortcomings some of which can be mitigated through reform in the short term, and others which may require more radical or longer-term reforms.

145 Concerns about council tax have several dimensions, all of which are exacerbated by the highly visible nature of the tax. A solution to the council tax problem must address:

- the perceived fairness of the way council tax distributes the tax burden, particularly in relation to people on low and fixed incomes, and especially older people;
- the burden of expectation and spending pressures that have been placed on council tax, with consequences for the rate of increase in bills; and
- concerns about the continued reliance on a single local tax which is not naturally buoyant.

Better management of pressures to contain council tax increases

146 Council tax tends to bear the strain of pressures in the whole local government finance system. Making council tax sustainable for the future will depend not just on the design of the tax itself, but on whether service expectations can be managed and met in a way that stops council tax from coming under unsustainable pressure. Local authorities need real flexibility to set spending plans in a way that reflects local choice about service provision and tax rates, even where this means doing less in areas which are not a high priority for local people.

Fairness and reform of council tax

147 During the course of my Inquiry I have been struck by the strength of feeling that property taxes provoke, including resistance to the idea that tax bills should reflect property values. Many people view ability to pay, generally measured by income, as a key criteria for a 'fair' tax. However, fairness is a complex question: other submissions to the Inquiry have also discussed the fairness of council tax in relation to the benefits different households receive from local services. Another definition of fairness would suggest that bills should reflect property values, with the most expensive homes facing the highest bills and vice versa.

148 Nonetheless, the fact that council tax bills may not reflect ability to pay, or income, is the most commonly cited reason for council tax's perceived unfairness. Concerns about people on low or fixed incomes who struggle to pay their council tax bill are widespread and valid, and I have looked at the options to protect these groups.

Options for reform

149 In the short term, reforms should target the most commonly cited source of council tax ‘unfairness’: that related to ability to pay, particularly for the poorest. It is the nature of property markets in England that there is no simple correlation between a household’s income and the value of their home; reforms of council tax as a property-based tax will therefore have only a limited impact on its overall progressiveness to income. The key to adjusting the tax burden on the poorest is therefore likely to be council tax benefit.

150 However, if a short-term solution to income fairness can be found, this might make space for reform in the medium term to the structure of council tax, with a view to strengthening its progressiveness to property value. Doing so could have a number of advantages, including:

- greater fairness as a property tax by ensuring that the most valuable homes are not taxed more lightly than less valuable ones;
- through this, potentially ensuring that council tax could act as a more effective stabiliser of the property market, or at least correct the relatively favourable tax treatment of valuable homes at present; and
- introducing some greater progressiveness to income overall, both to make council tax ‘fairer’ in terms of ability to pay, and to generate potentially significant savings in the council tax benefit bill.

151 The Inquiry has examined a range of options for reform of council tax as a property tax, both in the context of my original remit to consider reform alongside the planned revaluation of properties, and since then as part of a wider look at the scope for council tax reform. Chapter 7 discusses the advantages and disadvantages of those options.

Council tax revaluation

152 The revaluation of domestic properties was postponed in September 2005. While I understand the Government’s reasons for postponing the revaluation exercise, it is my view that there are advantages to revaluing the property base that have not been adequately explained so far. It is worth noting that postponement itself created ‘winners’ and ‘losers’ – 3.7 million households (or 17 per cent of all households in England) that would have been moved down the bands by revaluation are arguably paying too much council tax, subsidising those who would be paying more because their properties had grown in value more quickly.

153 History has shown that it is possible, though not ideal, to keep levying property taxes based on out-of-date valuations. Revaluation would, however, have two significant benefits: it would underpin the credibility of a property tax by maintaining a meaningful relationship between relative property values and bills; and would create an opportunity to make structural changes to council tax. The technology now exists to go ahead with a revaluation relatively cost effectively should the Government choose to do so.

154 There is no doubt that a first revaluation of properties would be a challenging exercise, especially given the long period of time since the original valuations were carried out in 1993. Some form of transitional arrangements might well be appropriate to ensure that any significant changes in liability for individual households – for example upward movements of more than one band – can be implemented in stages.

155 Nonetheless, it is my view that the Government has a responsibility for maintaining the foundations of such an important revenue stream, since an out-of-date tax base will mean that the credibility of council tax as a property tax will gradually be eroded. There is a real risk that failure to revalue only makes it more difficult ever to do so, whereas an expectation of regular revaluations

(as is already the norm in business rates) would contribute to the long-term sustainability of a property tax. While not the most urgent priority, I recommend that the Government should conduct a revaluation of all domestic properties for council tax and regularly thereafter.

Reform of the council tax bands 156 At the point of revaluation the Government should reform council tax by adding new bands at the top and bottom of the current band structure. This would help to improve the progressiveness of council tax in relation to values, recognising that the effective floor and ceiling on current eligibility are a product of judgements made in 1993, not of natural law. Reducing the burden for many band A households by creating a new lower band would benefit many low-income households, while new top bands would affect those in the most valuable properties, where the correlation between income and house price is strongest. The Government should also consider introducing separate bands for Inner London, to reflect the unique shape of the property market in that region and to reduce the turbulence caused by revaluation there.

Council tax as a service charge 157 While income or ability to pay is often the focus of discussions around council tax fairness, for others, ‘fairness’ means paying according to the benefits received from services. It appears that popular emphasis on the service-charge element of the council tax may have contributed to the strong, and sometime unrealistic expectations people have of a very direct return on their payment for local services. In practice, the balance between tax paid and services consumed will vary between individuals and households, and indeed over time.

158 I believe it is right that council tax should continue in the short to medium term to incorporate elements of both a property tax and a service charge. The service charge element of council tax is well understood by the public and reflects an important link between residence in an area, and a household’s interest in local services and local prosperity. Retaining a hybrid tax, which operates as a service charge but which also incorporates some of the advantages of a property tax, appears to be the right model in the present system. There is, however, room for a wider and more transparent debate about the balance between taxes and user-charges in paying for local public services, as discussed below.

Council tax discounts and exemptions 159 I have also looked at scope for reform of the discounts and exemptions currently available against council tax. In particular, I recommend that the Government ensures that grant to areas with large student populations is based on realistic data about the numbers of exempt households in the area, in order to be fair to other council taxpayers. The Government should also consult local authorities on the scope for greater flexibility in tax on second homes, including the possibility of levying a local supplement on council tax for second homes, particularly where these represent a significant proportion of local housing.

Council tax benefit

160 Council tax benefit (CTB) was designed to protect those on low incomes who may not be able to afford to pay their council tax bill. I believe that reform and more effective delivery of council tax benefit are the key to dealing with perceptions of unfairness associated with council tax.

161 If current entitlement to council tax benefit were fully taken up, council tax would be progressive to income overall for the poorest households. However, CTB is not yet fully achieving that aim in practice, primarily because not all entitlement is being taken up – only 62–68 per cent of households entitled to CTB actually receive it. For the poorest ten per cent of households council tax therefore remains a large average burden relative to income.

162 Making council tax benefit work better is particularly important to ensure that older people are not paying an unacceptable share of their income in council tax. Take-up of entitlements by

older people is lower than average at just 53 to 58 per cent, and the great majority of unclaimed benefit is owed to pensioner households.

Rebate, not benefit 163 The term benefit has a particular resonance, which may prevent some people from taking up their entitlements. It is also something of a misnomer: council tax benefit's primary purpose is not to provide income support as such, but to adjust households' liability for council tax according to their ability to pay. CTB should therefore be recognised as a rebate and be renamed 'council tax rebate'.

164 I believe that renaming CTB is justified in its own right. However, I am clear that this is not purely a question of presentation, but implies a wider recognition that steps should be taken to ensure rebates reach those households that are entitled to them. Ideally, CTB would therefore be renamed alongside the announcement of measures to improve take-up and delivery of entitlements.

Improving take-up 165 Local authorities will always have an important role to play in reaching their citizens and connecting them with services and other entitlements and there is scope for more effective action in many areas, learning from the efforts of the best performers. But they cannot be solely responsible for the successful delivery of CTB; central government has a prior responsibility for getting the framework right. It is clear to me that with up to £1.8 billion per year in CTB entitlement going unclaimed, much of it by older people, low take-up is a systemic rather than just a local problem, and as such requires a structural change in the way rebates are administered.

166 Many of the barriers to claiming are administrative in nature, putting a premium on joined-up action by public bodies to help make claiming easier for taxpayers. In the short term, the Government should take steps within the current system to ensure that rebate entitlements are delivered as effectively and as fully as possible. These steps should build on recent efforts to streamline delivery of CTB through the Pension Service, including by enabling them to help those people who are eligible for CTB but not Pension Credit. The barrier to the Pension Service liaising directly with local authorities in processing claims should be removed.

167 However, given the particularly low take-up of CTB compared with other benefits, and the fact that there appear to be significant barriers to take-up, I believe there is also a need to look at a more radical overhaul of the way council tax rebates are delivered in the medium term.

168 The government should therefore consider the scope for data sharing between agencies to proactively deliver council tax rebates to those who are entitled, with a view to achieving a step-change in take-up. The ultimate extension of this approach would be that, in theory, households could be billed for council tax net of any rebate entitlement, but with a responsibility to inform the government if the details on which it was calculated were incorrect.

169 Increasing take-up in this way would involve significant costs; the amounts currently unclaimed are large (up to £1.8 billion in 2004–05) and additional money spent on increased CTB take-up would clearly reduce the amount of money available to spend elsewhere. Nonetheless, I am clear that the success of the system of council tax rebates – and particularly its success in reaching entitled pensioners – is critical if council tax is to continue to play such a major role in the local government finance system, and should be considered a priority.

Eligibility criteria 170 Achieving high levels of take-up would be a real step forward; however, even with full take-up of current entitlements some households would still face a relatively high council tax burden as a proportion of income. There is a strong case for more generous eligibility criteria for council tax rebates to some groups.

171 My primary focus in considering changes to eligibility criteria has been on pensioners, as the group most likely to be on fixed incomes, and about whom I have received by far the greatest number of submissions expressing concern. Evidence from survey and public deliberation work carried out for the Inquiry also supports a focus on older people as the group around whom concerns about council tax fairness are strongest.

172 The Government should increase savings limits on council tax eligibility for pensioners, which act as a disincentive to save for retirement and are currently set at a modest £16,000. The upper capital threshold should be increased to £50,000 and could over time be abolished altogether, in line with capital thresholds for pension credits.

173 I have also considered the impact of council tax and benefit eligibility criteria on working-age households, and particularly the income thresholds at which council tax liability begins. It would be possible to make adjustments to the income thresholds that would benefit large numbers of households, though the amounts gained would be relatively small. It may be better that hardship for working-age households is considered in the context of wider welfare policy.

174 I have also considered wider options for helping to ensure that no household pays an unacceptably high burden of council tax in relation to their income. For instance, some US states use a circuit breaker rebate to ensure no household pays more than a set proportion of their income in property tax. Other countries operate schemes which allow pensioner homeowners to defer payment of taxes against equity in their homes. If the costs of council tax benefit reform proved a barrier to its implementation, these other options might deserve serious consideration.

Local income tax

175 While the immediate focus should be on council tax benefit and management of pressures to stabilise council tax, it may be that in future, a developmental approach to reform could allow a wider look at the balance of local taxation. It is part of my remit to consider both alternatives to council tax and possible sources of supplementary revenue for local government. In that context, local income tax (LIT) has been a prominent feature of the debate on local government finance.

176 Survey evidence suggests that, in principle, many people like the idea that council tax should be replaced with a local income tax, with nearly half of all respondents to an Inquiry-commissioned survey saying that council tax should be partly or fully replaced by a LIT. Many saw income as a fairer basis for taxation than property, since it would be seen to reflect 'ability to pay'. A local income tax would indeed be more progressive to income than council tax, even with full take-up of council tax benefit.

177 However, it may be that support for the idea of the local income tax is not based on a true understanding of what it would mean for respondents' own bills. While people recognise that pensioners would probably do well from a move to income-based taxation, relatively few think that they would pay more themselves.

178 Income tax, unlike council tax, is naturally 'buoyant', in that revenues grow as earnings or employment levels increase. By the same token, revenues could fall during bad times, so local authorities would need to be equipped to manage this risk if they were to depend on income taxes for part of their revenues. It is important also not to overstate the extent to which a local income tax would be buoyant. My research indicates that while the natural buoyancy of an income-based tax would be an advantage, it would not make a local income tax immune to the pressures that are felt in relation to council tax.

179 Modelling for the Inquiry suggests that for income tax to be levied locally, it would probably have to apply to the basic rate of tax, since the higher rate of income tax provides a much less even tax base for local authorities. If levied on the basic rate, a local income tax of, on average, 7.7 pence in the pound would raise the same amount as council tax does now. I have also explored the possibility of introducing a LIT as a supplement to sit beside a reduced council tax and to relieve some of the pressure on it. A supplement of one pence in the pound on the basic rate would raise approximately £2.9 billion in 2006–07, though survey evidence suggested a lack of public appetite for LIT as a supplement to council tax, because of a concern among respondents that they might be paying twice for the same services.

180 The implementation of a new local income tax would be complex, and would be likely to require a long lead time of around six to seven years from the point at which the Government decided to work towards it, to the point at which the new tax went into operation. Particular attention would need to be given to the likely impact on employers of operating locally-variable tax rates through their payroll system.

181 While I am not recommending a local income tax at this time, my work indicates it would be feasible to implement one in England. It remains therefore a choice for future governments.

Local service charges

182 Income from charges already represents a significant part of local authorities' revenue comprising about 8.5 per cent of total income. Over a quarter of all councils raised more income from sales fees and charges than from council tax.

183 There is significant variation between areas in their use of charging powers, and it seems likely that while some of that variation reflects local choice or circumstances, it also partly reflects councils' willingness to engage with charging and take a strategic approach to its use.

184 I am convinced that there is room for a much fuller conversation with local service users and taxpayers about the best way to fund local services. Given the pressures on council tax, a move towards services users meeting some costs directly might be a valid local choice, and one which councils could legitimately open up for public debate. I would encourage all local authorities to take a strategic approach to the use of charges, including as part of the range of levers available for managing pressures on budgets and on council tax.

185 I am not recommending changes to the general framework of charging powers, though the powers to trade and charge conferred on 'best value' authorities in the Local Government Act 2003 should be extended to all local authorities.

186 As discussed above, there are specific and growing pressures on waste services as the UK aims to reduce its dependence on cheap landfill, in the face of growing waste volumes. In that context, the Government should create permissive powers for local authorities to charge for domestic waste collection, as a means by which incentives can be created to reduce household waste and manage costs – and to help ensure that the remaining costs may be shared in a way that is perceived as fair.

187 Road pricing is likely to play a larger role in the future. Under the Transport Act 2000, local authorities outside London may operate congestion charging schemes in line with their Local Transport Plan. As such, it is likely that the difficult engagement necessary to get a road pricing scheme off the ground would be delivered locally. It is therefore right that locally accountable bodies should also have the freedom to invest revenues according to the 'deal' communicated to and agreed with local citizens. The Government should consider removing restrictions on the use

of road pricing revenues, and as a minimum should ensure that any hypothecation operates at a strategic level that allows local authorities to take a broad view of their investment priorities and the views of their communities.

BUSINESS TAXATION

Business rates

188 Business rates are an important part of the local government finance system, providing around £18.4billion in 2006-07 to support public services delivered by local government. Until 1990, business rates and domestic rates were aspects of the same tax. It is not, therefore, true to say, as some continue to believe, that local authorities were able to choose to place a greater weight of taxation on businesses rather than residents. Since 1990, the tax rate has been set centrally and levied at a national rate, with the revenues redistributed by the government. However, local authorities still collect the tax and this contributes to some confusion about the purpose of business rates – they are still perceived by many businesses as a local tax linked to the provision of local services, but are actually used to fund at least in part the provision of services according to national expectations and requirements (something which has been intensified by the introduction of the Dedicated Schools Grant).

Rate of tax **189** Businesses as a whole have been protected from real term increases in rates. As local government grants and council tax revenues have both risen significantly faster than inflation, business rates have provided a falling proportion of local government spending over time. In 1990, when the national business rates system was introduced, business rates raised £9.6billion and provided 29 per cent of local government revenues. In 2006–07 business rates are expected to provide around £17.5 billion, 20 per cent of local government spending. Some of those who made submissions to my Inquiry felt that this was unfair, particularly given the significant real term increases in council tax since 1993, and argued that the contribution made by businesses should be increased.

190 However, I have concluded that for the present, the national business rate is not an appropriate way to raise additional resources to fund general local government spending. The most pressing need is to develop much more constructive relationships between local authorities and businesses, focused on joint interests in promoting economic prosperity and investment in local infrastructure. A general national tax rise to support local government funding could put the development of those relationships in jeopardy.

191 Nonetheless, I believe that communities need more power to choose to raise new local revenues to invest in themselves. In my discussions with businesses I have also found an appetite for greater engagement with local authorities on economic development issues. Businesses have identified a need to invest more in the infrastructure required to support future growth – a concern that can perhaps most easily be exemplified by reference to the debate in London on Crossrail, but of which examples exist across the country. Combined with effective incentives on local communities, greater flexibility over raising revenues to invest at the local level should allow communities to strengthen their own economies and tax bases over time.

Business Improvement Districts **192** Business Improvement Districts (BIDs) do already provide some additional flexibility and have been welcomed by businesses. However, BIDs have a number of limitations and they are not the answer to all problems, first, their purpose is specific and limited, focused on particular projects in tightly defined geographical areas. Second, concerns have been raised that the costs of developing and administering BIDs can be a barrier. Third, there is a concern that their priorities can be skewed towards short-term issues rather than longer term investments.

Localisation 193 Transferring business rates revenues and decisions over tax rates to local control would give local authorities a substantial new local revenue source and considerable flexibility over revenue raising. The business community has concerns that localisation would lead to increases in taxation without a greater say over local priorities and spending, and that the number of different local rates would increase complexity. There are also wider concerns about the impact of localisation on the ability to equalise resources between authorities. To maintain current levels of equity under a localised business rates system, around 70 authorities would need to pay some of their local tax revenues to central government to support other authorities.

194 It is technically possible to do this and other countries adopt such an approach. However, I am not attracted to it. I do not believe that it would help to create the direct and accountable relationship between local authorities and businesses needed. In many areas businesses would be paying taxes to their local authority that would then be reallocated elsewhere in the country. In addition, I think that local authorities and the business community still have to work on developing trust and shared objectives, and I am therefore concerned to avoid changes which could put the developing shared agenda at risk.

Supplement 195 An alternative option for reforming the business rates to provide additional flexibility would be to introduce a power for local authorities to levy a supplement on the national business rate within their area. This would provide authorities with a more limited flexibility to raise revenues, but it would also be more transparent and have a more limited impact on businesses. Chapter 8 examines the possible impacts of a supplementary rate.

196 Local supplementary powers should be designed in a way which can gain credibility with business and the wider community. The key issues to be considered are:

- the appropriate scale of the supplement. At the upper end, some Business Improvement Districts have levied supplements as high as four pence. A lower limit would provide less revenue and less flexibility, but might enable confidence in new arrangements to develop more gradually. In that situation, there might be a case for allowing a higher limit in some cases subject to more stringent approval mechanisms;
- retention of revenue, where I believe all revenues should be retained locally;
- the right form of accountability to business taxpayers. The most obvious options are some form of voted approval or a statutory consultation process. On balance, I propose that there should be a requirement to consult local businesses, and the wider community, before introducing a supplement with a clear proposal and timetable. Revenues from a supplement should be hypothecated to the purposes agreed through consultation;
- how to ensure that supplements contribute to, rather than detract from, the local economy. I propose that authorities should be required to make an assessment of the impact of a supplement on the local economy, and the potential economic benefits of the spending they propose to finance from the revenues generated;
- the authority by which supplements should be levied. I recommend that supplements should be levied by unitary authorities and metropolitan districts, and in London and areas with two-tier local government, a single rate should be set through agreement between the relevant authorities, with a joint plan for the use of revenues. Where arrangements develop for collaborative working between authorities elsewhere in the country this could usefully include cooperating around

supplements. Powers to introduce Business Improvement Districts should remain with shire districts and the London boroughs;

- whether authorities should have a degree of flexibility over which sizes of business pay the levy, which I would support; and
- whether there should be a threshold below which small businesses do not pay the supplement.

Reliefs and exemptions 197 The existence of reliefs and exemptions can create distortions, or weaken incentives to make the best use of land and property. In addition, they represent a cost in terms of revenue foregone – money which could otherwise be used to cut the overall rate of tax or fund service enhancements.

198 Empty property relief provides a substantial relief from taxation for all empty property and full relief for some types. Although in the main, the prospect of commercial returns from the property should ensure full use of properties, the risk of not earning a return does not just result from external factors but is also determined by the actions of the owner. It is also clear that given concerns to protect the environment and support urban regeneration we need to ensure that all previously developed land is used most effectively. I recommend that the empty property relief be reformed to provide better incentives for this.

199 These arguments also apply to derelict property and previously developed land and suggest that a tax on such land (which is currently exempt) would provide a way of improving incentives to use this land. It would also provide a way of closing a potential loophole which allows property owners to avoid taxation by deliberately making their property derelict. These proposals are not yet fully developed, and further work will be needed to test whether this is a feasible proposition and how implementation and administration could be undertaken. I recommend that the Government consults further on this proposal.

200 There are myriad other reliefs and exemptions in the business rates system. The most substantial in terms of revenue foregone are the reliefs for charities (£700million), and the exemption for agricultural land and buildings (£450million). Some of those who made submissions to my Inquiry also called for new reliefs to support the environmental agenda. I recommend that the Government should undertake its own review of the reliefs and exemptions in the system in order to consider whether current reliefs and exemptions remain justified, and to consider the case for environmentally motivated reliefs.

Options for future governments 201 My recommendation for the introduction of a local supplementary power is a limited new power for local authorities. In the longer term, the re-localisation of the business rate, including the option to set a lower tax rate, could be considered. Businesses have made clear their concerns about such a radical step in the short term, although they are supportive of greater local choice and flexibility. It is a question future governments may wish to consider as new arrangements evolve.

Section 106 and Planning-gain Supplement

202 Both Section 106 contributions and the proposed Planning-gain Supplement (PGS) have been extensively reviewed by Kate Barker in her work on housing supply and land use planning.

203 If the Planning-gain Supplement is introduced, it should be designed primarily as a local revenue source, with a regional share of an appropriate scale, not as a national source which may or may not be allocated to authorities. It is imperative that a transparent and predictable link between local development and local resourcing exists if development is to take place or incentive effects are to be realised. Therefore, I think that in two-tier areas there is considerable merit in

pursuing a joint option for the management of the revenues, in which county and district councils would be jointly responsible for developing and implementing a plan for the use of the revenues from the Planning-gain Supplement in the area.

Taxes on tourism pressures

204 Some local authorities have supported the proposal for some form of tax on tourist pressures. Over the past year, this proposal has generated significant debate within the tourism industry and beyond. Accommodation taxes have been deployed in a number of places around the world, with varying degrees of success. It is clearly important to weigh the contribution that tourists make to the local economy against the costs they impose and the likely impact on the tourist industry of any taxation proposal.

205 I do not support the introduction of any new taxation powers carelessly, and proposals for these sorts of taxes are likely to be relevant only in some areas. In my view, a local accommodation tax is only likely to be acceptable if a local authority can demonstrate that there is a robust evidence base, local support for the tax, and has a proposal developed in partnership with local businesses and residents, who will continue to have a voice in the evolution and review of the scheme.

206 With that in mind, I think that the Government should consult on the costs and benefits of providing a permissive power for local authorities to levy taxes on tourism, including a possible tax on accommodation, and on whether local authorities would use such a power. It should use the results of that consultation to examine the case for extension of such powers to local authorities.

GRANT AND THE USE OF NATIONAL TAXATION TO SUPPORT LOCAL SERVICES

207 Reforms are needed to produce a more productive and transparent settlement between central and local government. This should aim to re-balance the current grant system to improve incentives for local areas to grow their tax bases. There should also be consideration of ways of improving the transparency of the funding system by seeking ways to reflect more explicitly the shared nature of revenues (from central and local taxation) which support local services.

Grant and incentives 208 Grant is at the centre of the relationship between central and local government and the equalisation process which, while having aims that I support, acts to insulate local authorities from the effects of differences in local tax bases and growth. The impact of this is that, while local authorities see it as a core part of their concern to pay attention to local prosperity and to the needs and future prospects of their citizens and their local areas, there are no coherent or systematic financial incentives that encourage growth either for them or, more importantly, for their communities.

209 There is a strong case for equity and stability to remain key objectives of the grant system. However, in order for local authorities to be able and encouraged to perform their place-shaping role to the full, I believe that a further objective needs to be considered for the funding system – providing financial incentives for local authorities and communities to promote economic prosperity and residential growth.

210 My proposals are not intended to dramatically reduce equalisation or to impact on local government's ability to plan by increasing instability. Rather, I want to find a way to provide space – at the margins, but with enough weight to change local government behaviours – to incentivise local authorities to grow their tax bases and, crucially, to enable local communities to receive some reward for allowing their areas to develop and grow.

211 Providing incentives to grow local tax bases could serve three purposes:

- it could aid a more balanced decision-making process, because financial benefits for the community could be used to compensate those affected through either improved services or reductions in tax bills. In this sense they will help to rebalance the costs and benefits of economic or housing growth by providing clearer local benefits to offset the costs of this growth – such as additional congestion and pressure on services – to the current residents;
- it could help to influence local authority behaviour in general by providing a more direct relationship between local authority finances and the health of the local economy encouraging investment to make the area attractive to businesses and to strengthen the local skills base;
- it could provide a potential source of revenue which could be used for local investment in measures to promote growth, such as infrastructure improvement, which may need long term-planning and greater certainty over funding mechanisms.

Incentives within the system 212 While limited incentive schemes do exist, I believe that incentives rooted in the wider system of local government finance could have the potential to be a more constant feature of local-central relations and could, over time, embed a different relationship between authorities and their tax base, creating better incentives to support growth and prosperity.

213 The complexity and short-term nature of the Local Authority Business Growth Incentives (LABGI) scheme are felt to reduce its incentive effects. A significant part of the scheme's complexity can be ascribed to the objectives the Government set when designing it, as LABGI attempts to redistribute resources for policy reasons at the same time as providing a growth incentive based on increases in the size of the tax base. In the short term, reform of LABGI seems likely to be the most effective way to continue to provide business growth incentives to local authorities. That reform needs to deliver a more transparent and long-term scheme.

214 There is potential, however, to introduce incentives into the grant system to ensure better reward for growing both residential and business tax bases. The current design of the grant distribution system through the four-block model, based as it is on relative measures of tax raising capacity, means that it is difficult to implement such schemes for residential or business growth. A fuller explanation of the current grant regime is provided at Annex A. This means, therefore, that changes to the grant system should be considered to accommodate incentives on council and business rates.

Shared revenues 215 There are some services which are clearly driven by a national promise, and there is a case, in principle at least, for arguing that these should be funded from national taxation in order that it is clear that central government is, in some sense, responsible for these services. Conversely, there are issues that are rightly local, and again there could, in principle, be a case for funding these from local resources.

216 However, there are many service areas where it is not possible to distinguish clearly between national and local responsibilities. Such services can be considered a shared responsibility and, given this, there is benefit, in terms of accountability, in such services being funded more explicitly from a shared source of revenue.

217 Better information about the degree to which both national and local taxation support local services should improve public understanding of the cost of services and how they are funded. This could make it easier to manage expectations, and pressures, and to have a more informed discussion about the priorities for local services.

A shared revenue to support shared services 218 In the short term, I am interested in there being a clear annual statement of the proportion of national taxation that is used for local services. Local authorities should be able to use council tax bills and accompanying leaflets to communicate this information if they choose. This would require a relaxation in the regulations that prescribe the information that can go onto these documents and the form they take.

Assigning taxes 219 There are more radical options that can be envisaged in relation to shared revenues, such as dedicating part of income tax to support local authorities expenditure – this is formally known as assignment.

220 These options could also give local government access to a buoyant form of tax whose yield would grow and fall back in line with the general economy, without the rate having to be increased as is the case in council tax. Income from this buoyancy could be used to relieve the pressure on council tax or services. It is important to recognise that this is not ‘free’ money but would represent a transfer – in the form of buoyancy – from central to local government.

221 Such changes would be a radical departure for the way in which national taxation is currently used to support local services and could only be seriously considered as part of a ‘new deal’ between local and central government. If local government had access to a buoyant tax source central government could properly expect it to act with more self-reliance and be less concerned about the detail of the grant settlement.

222 I examine a range of options for assignment in the report. These are in the main illustrative with the aim to stimulate thinking and debate on whether assignment could be a viable and positive way of funding local government in England. I conclude there would be merit in central government considering introducing a form of national assignment.

A DEVELOPMENTAL APPROACH

223 I have sought to describe a vision of local authorities as part of a single system of government, playing a place-shaping role, engaging with citizens to build an understanding of their needs and preferences, working with central government and contributing to greater satisfaction and the more efficient use of resources. To go back to the question that the Layfield Committee posed, I do believe that many of the decisions of government can and should be taken in different places, by people of diverse experience, associations, background and political persuasion.

224 Achieving this vision will take time. It requires not just the development of new relationships between local and central government, but also a strengthening of public understanding of, trust in and support for local government (and indeed, to a significant extent, government in general). For some of the more radical possibilities discussed during the report to be feasible, a much greater level of public confidence in local government will be needed. Reflecting this, I seek to set out an approach that is explicitly developmental – that acknowledges that trust and relationships need to be built, and seeks to use a wide-ranging but reasonably modest set of short-term changes to create the space and the mutual understanding needed for wider reforms in the future.

Changing behaviours 225 One of the conclusions that I have drawn from my work is that legal obstacles are not, in the main, the major hindrance to local government performing its place-shaping role. While I have

made a number of recommendations for substantive legal and policy changes for the Government to implement, more important is that local authorities develop a sense of powerfulness and capability to perform their place-shaping role and change their behaviours to pursue that goal.

226 Changes in behaviours will be important for both central and local government, including:

- for local government, the recognition of the place-shaping role and a greater focus on engagement with citizens and being recognised as a champion of efficiency; and
- for central government, providing greater flexibility for local authorities and the space for local decisions on priorities, with a reduction in centrally determined and monitored targets and the pressures these can create. The Comprehensive Spending Review later this year offers a key opportunity to implement changes, and particularly to ensure a corporate approach across government to the necessary prioritisation and resourcing.

Legislative and policy changes 227 The Government also needs to take action in the short term to ensure a sustainable finance system, including:

- making council tax fairer through changes to council tax benefit, including increased take-up, and increasing local flexibility to manage pressures on council tax;
- a package of measures on business rates to promote economic prosperity, provide local flexibility and capacity to invest, and support improved relationships between local authorities and businesses;
- building incentives into the system to enable communities to receive some of the financial benefits of growth and development;
- enabling local authorities to show clearly on council tax bills what proportion of national taxation is being used to support local services;
- other measures to support the place-shaping role, particularly with regard to local government's role in fostering economic prosperity.

228 Council tax should be retained as a local tax. In order to underpin its sustainability, the Government should conduct a revaluation of properties in the near future – with appropriate transitional protection – and introduce a process of regular revaluation for the future.

Options for future governments 229 However, even a reformed council tax would still have problems such as lack of buoyancy. Over time, more radical reforms could be considered to take further pressure off council tax, to improve the fairness of the local taxation system and to further increase flexibility and choice.

230 Successful implementation of my recommendations, combined with behavioural change by central government and local authorities, should allow future governments greater space to consider options which are at present not technically or politically practical, including:

- more substantial changes such as a more radical reform of council tax or the introduction of a local income tax as a partial or full replacement for council tax, or the assignment of a fixed proportion of national taxation to local government; and
- reforms to business rates, such as re-localisation, together with the power to reduce the tax rate.

Constitutional settlement 231 In order to reinforce and support this process of change, central and local government should negotiate a contractual agreement which sets out what central government requires of local government, how it should be funded, and the ways in which central government should appropriately influence and control other aspects of local government activity. That agreement should be open to external and parliamentary scrutiny.

CONCLUSION

232 My definition of place-shaping as the modern role of local government within a single system of government is intended to reflect the ambitions which are shared by both local and central government for the country we live in. What I have set out is not an agenda for technical and administrative changes, but a basis for the improvement of public trust and satisfaction through closer engagement, honest debate and transparent decision-making. That is something that all involved in government, at whatever level, should care about. It is about strong, self-confident communities shaping their destinies and making choices for themselves.

233 There is no simple solution to the problems affecting the system of local government and local government funding. These are profoundly complex and difficult issues which have their roots not only in legislation, but also in behaviours and deeply ingrained expectations on the part of local government, central government and the public they serve. Any reform will involve political trade-offs and is likely to have widespread impacts, and will therefore require a strong case for change. I have sought throughout my work, and throughout this report, to recognise the complexity and diversity of the country we live in and the relationships we share, while focusing on the genuine choices we have to make in developing and empowering government to act in the best interests of all our communities.



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