

Written evidence submitted by Professor David Heald [FSF 022]

By way of self-introduction,¹ I am not a specialist in English local government finance but a researcher on UK accounting and fiscal governance. I will respond to those questions falling within my expertise.

- **Is the local government finance system fit for purpose? If not, what needs to change?**

It is not fit for purpose. The failings are multiple, intertwined and will take years to resolve. It is much easier to smash things than to restore a coherent system. The problems in the English local government finance system are symptomatic of wider UK governance failures (Heald and Hodges, 2024). Particularly since the 2008 Global Financial Crisis, expedients in response to multiple crises have made an already stretched system dysfunctional. What is required is a reform strategy which commands cross-party support and sets out where the English local government finance system should be in 10 years' time and establishes milestones on the way. Whether that is possible is doubtful, making likely even tighter central government control of local authorities.

In this context, the headline points are:

- a) Failure to establish what the public sector will provide to citizens through public spending and to ensure that the tax and grant systems at national and local levels are designed to deliver the required resources
 - b) Failure to determine the role of local authorities, particularly whether they are self-governing principals or agents to implement central government priorities
 - c) Failure to work out what the fiscal equalisation system is attempting to achieve, as evidenced by the paralysis around the Fair Funding Review which was announced in February 2016 (Sandford, 2018, 2024)²
 - d) Failure to revalue domestic properties for council tax in England, with 1991 valuations still in use,³ damaging efficiency, fairness and credibility
 - e) Failure to address the damage that the abolition of the Audit Commission and District Audit inflicted upon English local government; there are common pressures across the UK nations, but the spectacular disaster of English local audit is telling evidence of England-only causes.
- **Does the local government finance system match funding to the relative needs of local authorities?** No. There is no clarity about the role of local government, with the UK being one of the most fiscally centralised democracies in the world (Barnett and Chandler, 2023). The erosion of the principled basis of fiscal

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² "In February 2016, the then Secretary of State, Greg Clark, committed to revising the 'underlying assessment of needs' contributing to the allocation of local authority funding: 'It is too long since the underlying assessment of needs was updated—it is more than 10 years ...'" (Sandford, 2024, p. 18).

³ This is also the case in Scotland, but not in Wales or Northern Ireland which have done domestic property revaluations.

equalisation has led to neglect of the maintenance of the system, including the use of out-of-date data because the adoption of up-to-date data would lead to politically difficult shifts in the distribution across local authorities. The core question is the extent to which the quality of public services in a jurisdiction should depend on its taxable resources and expenditure needs. Quite apart from difficult politics, there is always tension between (a) full equalisation for differential needs and own resources, and (b) ensuring that local authorities receive some financial benefit or loss from the performance of their local economies.

- **Does the funding system allow and incentivise local authorities to make sensible long-term choices about their finances and budgets, to better serve their residents?** No. Austerity since 2010 has differed from previous UK experiences of fiscal stress which characteristically lasted for only two or three years and were then followed by a renewal of spending growth (Hood and Himaz, 2017). This period has coincided with low economic growth and economic and political instability at the UK level. The Spending Review system, designed to plan three years ahead if not for the full length of a UK Parliament, disintegrated under fiscal pressure and political events. This led to one-year ahead spending decisions, later modified at additional fiscal events. This instability at the UK level intensified uncertainty about resources at the local government level. Faced with diminished resources and uncertainty about the future, local authorities have found it difficult to cope with short-term pressures, exemplified by Brexit and Covid-19, which made long-term financial planning exceptionally difficult.
- **How will this be affected by the introduction of multi-year funding settlements?** If the UK Government does implement its commitment to multi-year funding, and reverts to one fiscal event a year, this could be a game changer for local government. Credible three-year settlements would make the inevitably tight spending situation much easier for local authorities to navigate. Credibility requires predictable inflation, together with neither unexpected decreases or increases in funding. Local authorities could then better manage their available resources, collaborate with central government, and not resort to constantly lobbying for more grant. Similarly, there needs to be a clear understanding between the UK Government and the Local Government Association about how much flexibility local authorities will have on council tax levels.
- **What parts of the local government finance system are working well and should be built on further?** From outside England, it is difficult to see any parts of the English system which are working well.
- **Where are the most significant funding pressures in local government, and how does the finance system address them?** Since 2010 English local authorities have lost further functions, including in education. A fundamental political problem for local authorities is that cost and take-up pressures on statutory services have squeezed out expenditure on discretionary services which perform such a fundamental role in place shaping. These are not necessarily very expensive in themselves but are **visible** to electors and council

taxpayers. Much of the statutory spend has been going on statutory services to sub-groups of the population which is **invisible** to many electors and council taxpayers. Examples are social care and special educational needs. What is damaging is the sense that the spatial environment has been deteriorating, exemplified by dirty streets, neglected public buildings and closed local libraries. Local authorities get the blame.

- **Does the current statutory regime for identifying and responding to financial distress in local authorities support local authorities to get out of financial distress?**

This question is outside my area of expertise.

- **Have Government interventions in response to local authorities being in financial distress helped those local authorities to stabilise their finances and avoid further financial distress?** This question is outside my area of expertise.
- **What should a broader support system for local authorities in financial distress look like?** This question is outside my area of expertise.
- **Are there any specific circumstances that have led some councils into financial distress and others to avoid financial distress so far?** This is a question on which the Committee requires evidence from those familiar with conditions on the ground in English local government. There has been extensive media coverage of the financial distress of councils which have issued Section 114 notices declaring quasi-bankruptcy (Hoddinott, 2024). I do not have information about whether other English councils have similar but as yet unpublicised problems.

I engaged with the Committee's predecessor on the English local audit crisis (Heald, 2023). In brief, there would not have been a local audit crisis in England:

- (a) **if** the UK Government had not abolished the Audit Commission and particularly District Audit
- (b) **if** the UK central government department responsible for English local government had met the gap in sectoral supervision and had not drastically cut audit fees to private audit firms, making such audits unattractive and unprofitable. Scotland, Wales and Northern Ireland have not had a local audit crisis, though I am concerned that some of the consequences of the English local audit crisis might be spreading to them
- (c) **if** the UK Government had not encouraged English local authorities to search for commercial revenue as replacement for reduced central government funding, without adequate surveillance.

- **How much control do local authorities have over the levels of funding they receive, including from local taxation, business rates, central Government grants, and returns on commercial investments?** A detailed answer to this question should be sought from within the English local government sector. My understanding is that the answer will be "little control". For many years council tax increases beyond a certain level have been made politically impossible by the local referendum requirement;⁴ the grant system has used out-of-date data; and commercial investments

are risky for local authorities which generally lack private sector-quality expertise and are non-diversified investors in sectors where diversification is imperative. I have sympathy, though hinged with doubts, with councils taking financial risks to revive their town centres, but none with out-of-jurisdiction commercial investment using below-market rate borrowing from the Public Works Loans Board (PWLB).⁵

- **How does this differ between different types of local authorities and between authorities with different devolution agreements?** This question is outside my area of expertise.
- **What are the impacts of statutory restrictions preventing the use of capital returns (e.g. from asset sales) as revenue funding, and are those restrictions beneficial for local authorities?** I have no involvement in these specifics. However, I make the general points that:
 - (a) The distinction between capital and revenue is an important part of UK government accounting and public expenditure planning, and feeds into fiscal aggregates (Hood et al., 2023)
 - (b) There are long-term financial sustainability concerns if local authorities use one-off asset sales to fund ongoing expenditures. For these reasons, I would expect there to be statutory restrictions, but I do not know whether the existing ones are fit for purpose.
- **How much control do local authorities have over their costs, including on mandatory services (which they are required to deliver by statute) and demand-led services (for which the level of cost is determined by the needs of residents)?** Continued expenditure constraint enforced on local authorities by UK governments since 2010 has compounded the pre-existing fragility of the English local government finance system. Cost pressures from statutory services, especially those that are demand-led, have contributed to the deterioration of visible non-statutory services.
- **How does this differ between different types of local authorities and between authorities with different devolution agreements?** This question is outside my area of expertise.
- **What flexibility do local authorities have in the delivery of their mandatory services, and to what extent do they have the ability to deliver non-mandatory services?** The expenditure pressures on sometimes invisible statutory services intensified pressures on visible non-mandatory services. Such enforced neglect damages the relationship between local authorities and electors and aggravates long-standing problems of council tax reform. Most people would privately agree that 1991 valuations are indefensible, but no political party dare propose revaluations which would substantially shift the household and geographical distributions of the tax base.⁶ What the Chancellor of the Exchequer said at the

⁴ Only one referendum to increase council tax above central government prescribed increases has been held, proposed by the Bedfordshire Police Commissioner for 2015-16 and decisively rejected by those voting (Sandford, 2023, p. 10).

⁵ The PWLB lending facility is operated by the UK Debt Management Office on behalf of HM Treasury.

Treasury Committee on 6 November 2024 does not encourage expectations of council tax revaluation or reform in the 2024 Parliament (Treasury Committee, 2024).⁷ Without a more legitimate local taxation system, the decline of local government credibility and capacity will continue.

- **Has the level of demand for local authorities' services changed recently? If so, in which specific areas and why?** This is a question best answered by representative organisations such as the Local Government Association.
- **Where local authorities cut costs by reducing the services they pay for or provide, what services are most affected and what is the impact on residents?** This is a question best answered by representative organisations such as the Local Government Association.
- **How well does the Government understand the consequences of funding and mandatory service decisions?** There is not much evidence that it has been understood. Audit Commission overview documents were invaluable in the 1990s and 2000s. If such analyses had existed in the 2010s, the present crisis would not be so deep. Early warning systems were dismantled, and no substitute mechanisms were put in place, which was probably convenient for central government at the time, but subsequently disastrous. Rebuilding early warning systems is imperative.

January 2025

⁶ Since 1991, more expensive residential properties have increased in price by more than less expensive properties and house prices in prosperous areas such as London and the South East have increased by more than prices in the North and Midlands.

⁷ The following exchange on 6 November 2024 at the Treasury Committee (2024, Q239) does not suggest that there will be council tax reform in England in the 2024 Parliament:

Harriett Baldwin MP, referring to IMF policy suggestions in the recent Article IV Consultation: “First is one that you supported in a paper you published earlier in your career in Parliament: to overhaul council tax and replace it with a broad-based property tax. Is that something that you considered in this Budget and have rejected, or is it something that we can anticipate you will be considering in the future?”

Rachel Reeves MP, Chancellor of the Exchequer: “It was one of the many things that was put to me as an option. It is not something that we wanted to take forward. People have gone through a massive cost of living crisis in the last few years, and increasing council tax above the 5% increase a year that the previous Government capped it at would not be the right approach.”

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