A new account?

Choices in local government finance

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A NEW ACCOUNT?

This paper presents an argument about local government finance that tries to break through the deadlock that has surrounded the debate for much of the last two decades. The paper is not so much a commentary on the government's Green Paper on *Modernising Local Government Finance* (DETR, 2000), published in September 2000, as a discussion of what the Green Paper did not say. The Green Paper, perhaps inevitably in the run up to a general election, is 'very green', although the proposals for capital finance are quite radical. On the current account side, the paper concentrates on how best to improve the existing system. Caution has won out, with local councils not being stripped of their funding role with respect to education and other 'frontline' services but equally the proposals in the Green Paper suggest no overall shift in the central–local balance of funding. In short, the Green Paper does not break the deadlock over local funding but seeks to shore it up. It can be complimented on the clarity of its analysis of the current state of local government finance but is somewhat more limited when it comes to its prescriptions for the future.

The weaknesses of the Green Paper are a reflection of a wider malaise. The debate over local government finance has become formal and stale. On the one hand, central government maintains its claim that it needs to control public spending, including that at the local level. On the other hand, local authorities bemoan the continuing loss of autonomy and argue that local democracy will not be revitalised until they have greater capacity to raise local revenues.

The first section of the paper reviews the debate. The second lays out four criteria by which to assess systems of public finance. A third section looks at how the political realities surrounding local finance have changed. The next sections outline a new choice between a universalistic centralism and a new localism. The concluding section of the paper seeks to chart a path to a new local finance settlement.

The established debate

Finance like so many policy areas is all about choice. The problem is that at the moment the choices on offer are false, in part because they reflect outdated thinking at their heart. The Layfield Committee (1976) that reported a quarter of a century ago in 1976 has largely framed the debate over the finance of local government. Layfield argued then that central government had a vital choice to make. It expressed concern about the growth in central funding provided to local authorities. A level of funding where two-thirds of resources came from the centre undermined local accountability. National government had to choose between a continuing drift towards further centralisation or a reaffirmation of local responsibility by providing local government with a more extensive and robust tax base. If the centre funds local government spending it will ultimately have to take responsibility for that spending and therefore extend centralisation. The only other option is to create the conditions for local choice and local democracy by ensuring that local politicians have to raise the money to pay for their decisions about policy choices and service levels.

The debate, articulated by Layfield, about the proportion of local government revenue raised from local taxation has continued to dominate all discussion about the future of local government finance. In fact, in the years after Layfield reported in 1976, the proportion of local authority revenue expenditure financed from local taxation rose from about 34 per cent to 55 per cent by 1989–90. The grim convulsions that accompanied the introduction and removal of the poll tax cut this locally funded proportion back to 20 per cent. It has subsequently risen to around 25 per cent in 2001–02. It is impossible to discern any particular link between local autonomy and the changes in these percentages. Arguably, rate (and expenditure) capping was far more important in constraining council freedom. It would certainly be bizarre to insist that local government was more autonomous in the late 1980s than in the mid 1970s simply because it raised more of its own income in the late 1980s.

The issue of whether or not it is necessary to increase the proportion of council income raised locally has become virtually theological. On the one hand, local government traditionalists assert that only an increase in this proportion will ensure real local accountability. On the other hand, governments of both parties have behaved as if they believe there is no such link between local taxation and political freedom. In truth, governments make decisions about the proportion of local authority income to be funded from local taxation on a number of grounds, including the constitutional needs of local government in Britain, national economic circumstances, the personal concerns of particular ministers, general taxation policy and electoral advantage. Those who believe that the constitutional position of local government is the key, overriding concern delude themselves.

Moreover, there are overseas examples of countries that have more settled and visibly autonomous systems of local government – almost all of which enjoy higher local election turnouts – with (in some cases) higher and (in others) lower proportions of revenue income raised from local taxation. Thus, for example, all the Nordic countries have local income taxes and considerable degrees of local government autonomy. But the Netherlands and Italy have very low proportions of locally raised income as the basis of healthy local democracy. International evidence suggests that national political expectations and traditions are the key to an acceptable balance between central and local government funding. Britain, by contrast, has raised the struggle between national and local government over council finance into something of an art form. No one really knows where they are going any more.

The seeds of the stalemate that has characterised the local government finance debate can be seen clearly in the argument laid out by Layfield. The centre has never been persuaded that it should cede control of public spending. Local government – with its sustained low profile and poor electoral turnouts – seems a highly unlikely prime candidate for a major new tax-raising power such as the local income tax favoured by Layfield. The debacle following the introduction of the poll tax in 1989/90 (which, it is worth noting, did create a high-profile but deeply unpopular new form of local tax) suggests that it would be foolhardy for any government to consider a major increase in the burden of local tax (or, for that matter, a significant shift in local tax burdens). The claim to have the business rate returned to local government following its removal in 1990 (as part of the poll tax changes) is not consistent with Layfield since the burden of the tax falls on businesses not residents, so local accountability to voters is not enhanced. In short, no national government has been prepared to choose the option favoured by Layfield and local accountability supporters have not come up with any way of increasing local revenue-raising capacity that is politically feasible.

Is there a politically realistic way out of this position or are we forever trapped between a laudable claim for local accountability and practical arguments – backed by genuine public and elite opinion concerns – which favour central control? The first step in the journey we propose out of the impasse is to consider what we want a system of local government finance to deliver.

Four criteria for a system of local finance

One of the most frustrating things about much of the post-Layfield debate is its failure to take account of the full range of political pressures, which bear down on it. As the debate about local government finance in Britain has evolved since 1976, the Layfield report can (because of its place in history) be seen to have come to terms with only some aspects of the problems of local finance. Moreover, many commentators have ducked the full implications of the Layfield analysis. In designing a local government finance system, there are at least four dimensions that now need to be considered.

The first is the one Layfield focused on, namely, the need for transparency in connecting spending decisions, tax raising and voters' choices. As Layfield claimed, a virtue in any system of public finance is that the public has the best chance of understanding which part of the government system is responsible for which tax/spend decision.

A second issue rests around a concern with justice in the distribution of resources. The question of equalisation, as it has become known, is about recognising that a system of local government finance needs a capacity to give additional resources to areas of high need or with a low taxable base. In the post-Layfield years, the search to match need and resource allocation has taken on an unstoppable momentum (see Glennerster *et al.*, 2000, pp. 3–8). Layfield's commitment to local accountability surely implies a willingness to accept a considerable unevenness in both service provision and local tax burden in different areas. If you advocate local accountability, you are to a degree also advocating greater territorial inequality in distribution of public services and taxes. There can be little doubt that the Layfield report recognised this choice but all too often in subsequent years people have made ritual calls for more local accountability, followed by a demand for the nth degree of fairness in the distribution of national funds.

A third feature that designers often look for in a local finance system is a certain flexibility and buoyancy in the capacity to raise revenue. The art of government, so the argument goes, requires a mix of revenue-raising powers in part to cope with contingencies and in particular shortfalls in some revenue streams. Another factor is that a mix of different taxes enables public perceptions of the tax burden to be manipulated in order to achieve what Adam Smith referred to as ‘easy taxes’ which do not hurt the payer too much because the burden is in some way disguised or is felt indirectly. Expressed in this manner, the case for flexibility is an argument that dare not be heard for fear of accusations of supporting ‘stealth’ taxes. Yet the argument can be expressed more positively, namely, that a degree of buoyancy and flexibility in respect of taxation gives government the capacity to deliver in the context of a modern democracy. In this sense, greater freedom in local taxation might better deliver what voters really want. In helping to ensure service delivery, a flexible tax system supports the development of a level of trust in government and enables government to act with greater effectiveness in meeting people’s concerns.

A fourth desirable aspect of a modern system of public finance is that it facilitates a holistic approach to funding to ensure consistency in the activities of the diverse sets of agencies that in a complex world form part of the governance system. The realities of modern public administration mean that to meet the needs of individuals in the round or to tackle complex social and economic problems different agencies need to co-operate with one another. What is required is some element in the system of public finance that enables these agencies jointly to plan their budgets and to find ways of co-funding shared endeavours to meet the challenges faced by individuals and communities. Typically, the local council will be responsible for one-quarter of public expenditure within its area: the remaining three-quarters will be under the control of institutions such as health authorities, universities and colleges, Training and Enterprise Councils, police authorities, Regional Development Agencies and the Benefits Agency. At present, it proves incredibly difficult to get public bodies to work jointly in the provision of, say, the criminal justice system or services for the elderly. Until and unless local authorities and other institutions are given incentives to fund services jointly, there is virtually no chance of achieving consistent and seamless provision. The government's recent paper, *A New Commitment to Neighbourhood Renewal*, has proposed remedies for the lack of effectiveness of public provision in a number of deprived areas (Social Exclusion Unit, 2001).

Transparent accountability, an equitable distribution of resources, sufficient flexibility and some capacity for consistent budgeting to enable government to act effectively are all desirable features of a system of local government finance. There are, of course, tensions between the various valued features. The balance between them will be very different in Britain to what is desirable in another country (for example, equity appears to be particularly prized in this country). Not all are entirely consistent with one another. There are trade-offs, as has already been argued, between local accountability and a concern with territorial equity.

In a similar manner, there is a potential trade-off between absolute transparency and the flexibility needed by effective governments in managing their tax raising. To insist that every tax is so painfully obvious that it hurts to even think about it let alone pay it is not a recipe for effective government. Designing a local finance system involves judgements about how to balance out the various desirable design elements. Political realism needs to combine with principle.

The post-Layfield stalemate reflects to a substantial degree the profound realities of the complexity of the choice facing those with a responsibility for local finance. Layfield so emphasised one virtue – transparency – that it undermined the potential for a settlement that could give due recognition to other desirable design features, much demanded in modern Britain, such as equity or flexibility. If we add in the requirement that the system delivers the framework for joined-up government or effective partnership, it becomes clearer still that a complex challenge confronts us. That sense of complexity needs to be matched by a new sense of the political realities surrounding the local finance debate.

Changed times

Perhaps the key factor that could encourage a breakthrough in the stalemate affecting local government finance is a sharper recognition that the context has changed substantially since the formulation of the issues offered by Layfield. New political realities should colour our debate.

The first change to consider is that the central task of local government has been redefined. We have moved from an era where local government was delineated by its capacity to provide a discrete set of services as required by its local residents to one where the key responsibility of local government is to steer or guide its communities towards desired local outcomes. We have moved from an era of traditional local government to the wider sphere of 'governance'. The challenge imposed by this role is one that suggests the need to rethink the requirements of an effective local finance system. Local authorities in this new world operate in the context of a mixed economy of providers with a key role in commissioning services and regulating their quality.

Local government should nowadays seek to guide, in partnership, a whole range of agencies – public, voluntary and private – that through their actions and spending can have a major impact on the well-being of a locality and its residents. Local authorities need to have a capacity to bring together the various complex parts of the system of governance and be seen as worthwhile partners by the relevant players. In many respects, considerations of this sort give a boost to the case for flexibility in a local finance system. The key is to have sufficient discretion in the system to enable local authorities to buy into various partnerships and oil the wheels of consistent, inter-agency working.

A second area in which a significant change of context can be observed is the growth in strength of a view among opinion leaders, and probably more generally the public, that certain services should be a matter for the imposition of national standards and not local discretion. Education is perhaps the most clear-cut example of where we have seen a shift in thinking both among elites and the general public as compared to 1976 when the Layfield report was published. Education is now clearly defined as a national service delivering outcomes central to the nation's economic future. A 1999 British Social Attitudes Survey (Rao and Young, 1999, pp. 51–3) found over two-thirds support among the public for central government to decide school standards. Social services is another area where elite opinion has moved against what is referred to as the 'postcode lottery' of differential access to services depending on where you live. Public opinion is perhaps less clearly in support in this instance, although the judgement probably depends on the sort of decisions or services which are being asked about. The same 1999 survey found, for example, the public split half-and-half in their judgement about whether the allocation of home helps should be a matter of local or central decision.

Demands for 'fair treatment' in resource distribution to localities, coupled with pressures for equal treatment by public services of individuals in different areas, has become utterly ingrained in British politicians of all parties. Elected representatives – both MPs and councillors – almost always support the idea. The Thatcher government, despite all its market-liberalism rhetoric, significantly increased the sophistication of local authority equalisation grants.

Debates about the future of local government finance in Britain since the 1970s have concentrated on a struggle between 'centralism' and 'localism'. There is, without doubt, a desire within national politicians of all major parties to seek to make radical and rapid changes to public services, directly from London, through new legislation. Britain is a unitary state with no constitution, so it is easy enough for the UK parliament to tilt the balance of power away from localities if it chooses to do so.

However, UK governments cannot be held entirely responsible for this process. A confusion lies at the heart of British voters' thinking. Opinion polls suggest that people want increased local government autonomy (and thus, presumably, more variation in services from area to area) at the same time as they demand uniform services in every local authority (see for example the evidence in Miller *et al.*, 2000, pp. 73–4). The debate has moved on from being about centralism versus localism, to a conflict between localism and what might be called 'universalism'.

In specific areas – such as education – it is clear that elite and public opinion is firm (however regrettably from local government's point of view) about the need for national standards to be imposed. In other areas, the response is likely to depend on the sort of decision or type of service at stake. Moreover, there is no great base of support in Britain for an exclusive local citizenship in which local politicians offer local voters particular bundles of local services in return for their taxes. An ESRC (Economic and Social Research Council) survey in 1995 (Miller *et al.*, 2000, pp. 66–7) asked if people should be excluded from local voting about services if they had not been in tax-paying residence for over two years and found very little support for the idea. People may have a sense of local identity to some extent but do not appear to have the strong sense of local citizenship. On the contrary, social citizenship – in terms of rights to universal education, health and other core services – is clearly seen as part of national citizenship and as such national responsibilities.

In designing a system of local finance, the realities of people's perceptions of their citizenship need to be taken into account. This is not an argument necessarily for full-blown equalisation but it does suggest that the choice between national and local responsibilities is more complex – because of conflicting public expectations – than the original formulation of the Layfield report allowed.

The final element of change that can be highlighted is a broad loss of trust in government and an enhanced need to persuade people that any increase in the tax burden is justified. Again, it is difficult to provide definitive evidence of trends in public opinion since the time of the Layfield report in the mid 1970s, but there can be little doubt that there has been a change in at least the judgement of political elites about the willingness of the public to pay taxes. It should not be assumed that any proposal to increase taxes will be met with an automatic refusal but the assumption is that any increase will have to be negotiated and perhaps tied to a specific package of benefits.

To conclude: a shift in the role of local government towards a steering function; a growing sense of realism about the demand for national standards with respect to some core welfare state services; and a perceived increase in the ambiguity of the public towards paying taxes together mark out the changed political and economic environment since the time of the Layfield report.

The new choice over local finance

The choice facing the future of local government finance is parallel to that identified by the Layfield report but it has different starting points and end goals. The choice is not between centralisation and local accountability. Rather, it is possible to identify what might be called new centralist (possibly 'universalist') and localist perspectives. While, previously, the choices were of polar opposites, the new positions outlined below are closer to one another and share more common ground in the complex design of local finance systems. Crucially, it would be possible to put elements of one together with elements of the other.

New centralism (or universalism)

The new centralist perspective goes beyond the goal of a simple attempt to control public spending by local government to a more demanding goal of how to buy better outcomes at the local level. Local authorities in this scenario become less agents and more franchisees, authorised to produce a service subject to the achievement of certain standards. The concern is not about detailed control over the local organisation but rather how best the centre can create the incentives and controls to ensure that the outcomes it wants are delivered. The new centralist perspective is therefore not demanding control over spending but rather the delivery of outcomes that achieve social and economic opportunity for all. The concern is at least as much with social opportunity or justice as with spending or fiscal constraint.

The new centralist perspective would recognise the reality that both elite commentators and the public have come to expect many local government services to be universally provided, though with no particular concern about which particular institution provides them. Demands for territorial equity (i.e. similar treatment for people living in different places) and universality are immensely strong within Britain. The existing local government finance system currently struggles to reconcile absolute precision in the achievement of equity while continuing to operate within an environment where commentators (and ministers) extol the virtues of local autonomy. Frankly, this is a confusing sham.

A system that fully reflected the reality of public and elite expectations would probably require central government to guarantee levels of public expenditure and the outputs achieved by such spending, at least in a number of so-called 'welfare' services. Such provision would definitely include education and personal social services. On the basis of modern political expectations, the police – though not really a welfare service in the normal use of the term – would also be included in this list. It would be up to the government to decide if any other services were of such overriding universal importance that they, too, should be included among those to be provided in this way.

It would no longer be possible for central and local government to pass the buck between each other as to who is responsible for a particular level of spending or service failure. If education provision did not operate effectively within a particular area, the Department for Education and Employment would be held fully responsible. Any school that did not deliver would be seen as the Secretary of State's personal (or, at least, departmental) failure.

The finance system underpinning such a system would, to be consistent, have to make Whitehall explicitly responsible for the amount spent on every individual institution. In a system of this kind, the government would probably have to contract with each local authority about the amount of money that would be paid for the delivery of a specified level of service. There would not be a need for an equalisation formula to allocate resources: each department of state would negotiate with individual local authorities about the sum that would be paid, per annum, for a particular service. There would be 100 per cent central funding for the services concerned, though it would be necessary to adjust grant and council tax levels accordingly. If an authority failed to deliver, the service would be taken away from it and provided by another agency or company.

A centrally determined system of this kind would put immense pressure on central departments such as the Department for Education and Employment, the Department of Health and the Home Office. Those responsible for education, personal social services and the police would certainly operate using the franchising/contracting method outlined above.

To run a system of this kind, civil servants would have to advise ministers about the detail of education, social services and police provision in every city, town and village in England. This need to provide detailed, legally robust advice would be an immense new burden on central government. Because there was a contract between the government and a local provider (who might or might not be a local authority), there would inevitably be a risk of litigation if contracts were believed to have been broken. The relationship between the government and local authorities would become more like existing ones with major private companies. But, crucially, the public would be absolutely certain where the responsibility for the universal service standards lay.

Local government would still, in many (probably most) cases, be a key agent responsible for managing resources, audit and the local regulation of services. In many ways, the new pattern of funding and responsibility would resemble the existing administration of parts of the benefits system (or, in a different field, housing associations), though with the certainty that, if an authority failed to deliver effective services, it would find them put in the hands of another service provider. Funding would be provided in exchange for specified service provision and outputs.

For the rest of what is currently local government provision it might be possible to fund services in the same way as today, perhaps with local taxation financing a very high percentage of the residual, genuinely local, services. However, it is important to note that existing local government grant arrangements attempt fully to equalise between authorities for variations in their spending on all services. The public, by implication, now expects equity in the provision of libraries and environmental services just as much as they do for education and social services. Within the centralist model, it might be necessary to maintain a full equalising grant even for more 'local' services. If the public demanded it, there might be little room for local freedom. The issue of how far people are willing to accept local differentiation in any local services is one that must be put before the electorate and debated. A continuing fudge, where universalism/full equalisation and a rhetorical desire for 'local discretion' are given co-equal prominence, is simply unacceptable.

The new localism

The new localist perspective argues that the franchising model is not sufficient or appropriate. In a more localist model, there could be (possibly much simplified) grant arrangements similar to those that operate more generally at present. These could be aspects of spending needs and equalisation of both needs and taxable resources. Such a system would be a modification of what operates already in England. Perhaps with respect to welfare services such as education, the Department for Education and Employment (DfEE) might just be able to know enough about every school and authority (on the basis of OFSTED reports) broadly to specify what the government wants and to achieve its goals. But, for a whole raft of service areas and policy goals, it is unrealistic to rely on such a centralised model. What is required is a system of finance that can support the practice of local governance and provide local authorities with enough flexibility and room for manoeuvre that they can be good partners to other public agencies and the private and voluntary sectors.

A new localist solution would have to face the reality that it is impossible to continue to pretend that (i) full equalisation and (ii) local autonomy are co-equal (or, for that matter, consistent) objectives for the system of local government finance. The need to equalise in elaborate detail between local authorities inevitably gives the centre an overwhelming – and necessary – interest in the detail of grants and, indirectly, in service-by-service spending levels. The way successive governments have advanced from using expenditure needs assessments as the basis of general equalisation to the current situation where education Standard Spending Assessments (SSAs) are 'passported' into schools shows just how problematic equalisation grants can become. In the British (more correctly, English) context, public pressures for fair treatment of particular areas inevitably place great strain upon an equalising grant system.

The new localist solution could – like the new centralist one – separate out local 'welfare' state services such as education and social services (as discussed above) and fund them fully with central grants. Funding for education could either be allocated to the authority itself or to individual schools using a formula similar to the existing SSA. However, in the localist option, authorities would then be free to top up central funding for such provision or to reduce it below the government norm. It would be entirely clear how much expenditure the government felt was needed, and how much each authority was then prepared either to add or take away from that figure. A similar approach would be adopted for social services, police and any other 'universal' services.

In a pure version of the new localist solution, for all other services there would be no grant support at all. Authorities would finance them out of local council tax with no equalisation of any kind. This would mean that the fire brigade, environmental provision, local roads, planning, street lighting, arts and leisure and all other services would be financed from a local tax or a range of taxes (and, in some cases, fees and charges). Top-up spending for education, social services and the police would also be funded in this way. Authorities with larger local tax bases would be able to fund their services more easily than those with smaller ones. Local government would, in many ways, be put in the position it was in during its late nineteenth-century heyday.

In this model, local government could be given access to new local taxes as part of the localist deal. Local authorities in addition to council tax could use congestion charges, tourist taxes, partial or limited non-domestic rates, 'green' levies and other forms of tax. Indeed, authorities could be given discretion as to whether or not to have any or all of these taxes, possibly following a local referendum on the subject. The yield of these taxes would then be available to fund local services and also to add extra amounts to the government's funding of education and other 'social' services.

At present, council tax alone raises 25 per cent of existing local authority revenue. If education, social services and police were centrally funded, council tax could represent up to 100 per cent (on average) of income for 'all other services'. If new taxes were added to local government's revenue sources, some authorities could find themselves with the capacity either to increase expenditure on 'local' services and/or to reduce council tax below existing levels.

The addition of new income sources could give local government – overall – greater flexibility to determine local service provision (including additional provision, potentially, for ‘welfare’ services). It would be essential for new taxes to be transparent and widely understood. The public would then be able to decide whether additional (or reduced) local tax were a price worth paying (or not) for services. Such a balance of taxation and expenditure is not new, though in Britain in recent years the relationship between the two has been broadly observed. Referendums could be held as to whether or not new local taxes should be introduced.

Another feature of the ‘localist’ option would be experiments such as business improvement districts (BIDs) and other zones, which might be differently treated in terms of the yield of local taxation. BIDs have existed in North America for a number of years, offering the opportunity to create small areas within which small additional property taxes could be levied. Alternatively, it would be possible to allow some areas (micro zones) to keep the yield of rising local tax monies as property values increased. Such special tax districts were proposed by Lord Rogers’ Urban Task Force and have been outlined in the Government’s recent Green Paper on local authority finance (DETR, 2000).

Experiments with micro zones of this kind could, in fact, be a feature of either the ‘localist’ or ‘centralist’ models. Such very local initiatives would encourage community and business involvement in decision making and would work to enhance public interest in local public provision.

It is important to note that this pure localist solution would produce very significant differences in the taxable capacity per head from authority to authority. Some councils (notably central London boroughs) would be able to support relatively high levels of expenditure with relatively low local tax rates. Others (in particular older towns and cities in the North of England) would find themselves in the reverse position (lower spending and/or high tax rates). Because of the British cultural attitudes towards territorial equity considered earlier in this paper, it might prove very difficult for any central government to justify the crude localist solution outlined above. A simplified resource-equalising grant (where, for example, an extra pound per head of expenditure cost a similar amount per head in local taxation) could, in principle, be used. But it is worth pointing out that any move in this direction would immediately generate a continuous debate about the precise nature of equalisation (though, to be fair, so would no equalisation at all). A genuine localist solution would be painful for some.

The need to create incentives for joint activity, possibly led by local authorities, is another goal for an improved system of local government finance – indeed, it could be a key element of a new localist approach to funding local services. Local government could be given a lead role in proposing spending programmes within their area, which brought together the budgets of the council with one or more other agencies. For example, a council could publish proposals for a joint spending initiative that involved improved services for the management of juvenile delinquency. Such a local spending partnership could, subject to light oversight by national or regional civil servants, be made binding on the public bodies concerned. This kind of public expenditure co-ordination would represent an enormous step forward in the achievement of consistent and effective government. It could, with some modification, be part of the new centralist system as well as being a more natural part of the new localist solution.

Strengths and weaknesses of the options

Unlike the choices laid down by Layfield, the new centralist and localist perspectives are not mutually exclusive, as our discussion so far suggests. Both are more attuned to the complexities demanded of any local finance system in Britain and give appropriate respect not only to accountability but also to the virtues of equity and effectiveness. It may be that different mixes of the two options might be suitable for different services or even different local authorities. In short, the two perspectives may provide the starting point for a new consensus on finance that breaks through the current stalemate.

However, there would be strengths and weaknesses in both the new centralist and new localist approaches. Table 1 summarises these strengths and weaknesses as compared to the four criteria for a system of finance set out at the start of this study.

Thus, for example, both the new centralist and new localist approaches score highly in terms of 'transparency': in both options, it would be clear how far central government was prepared to control and/or fund a number of universal or national services, while local government would be held to account for all the rest. It would be very easy to show how far central and, separately, local government were respectively responsible for the funding and regulation of two sets of services.

'Equity' would be more likely to be achieved by the new centralist model, as it provides 100 per cent funding for welfare-type services, with some form of equalisation grant continuing to underpin remaining locally funded spending. The new localist option, by contrast, would significantly reduce equity, as it is currently understood: the quality of services provided in different areas would vary more.

Table 1 A comparison of the new approaches to local government finance

	Transparency	**Equity**	**Flexibility**	**Holistic**
New centralist	High	High	Medium	Low
New localist	High	Low	High	Medium

'Flexibility' would be no worse than at present under the new centralist model. Arguably, an arrangement where council tax funded a large proportion of remaining wholly local services would give councils greater freedom than at present (the 'gearing' ratio between spending changes and tax changes would be made far more favourable for local authorities). Under the new localist model, flexibility would almost certainly be enhanced by the introduction of new local taxes. Local authorities would be put in a position analogous to that found in many countries overseas (e.g. France, the United States) where councils have access to more than a single, highly visible, tax.

Finally, how would the two options fare in terms of 'holistic' or consistent public service provision? Arguably, the new centralist model would score badly in its propensity to deliver holistic local services. Because central departments would contract directly with local authorities or other local providers for the supply of services, the notorious functional orientation of Whitehall would be entrenched forever in services such as education, social services and the police. Local government would, of course, still be free to ensure consistency in the remaining locally controlled services. The new localist model would be rather more effective in terms of holistic governance, because authorities would still be free to determine local spending levels on all services. There would also be an incentive for joint service provision, involving not just local government but also other public providers.

Implications of the options for key elements in the local finance debate

Equalisation

As stated above, relatively precise equalisation of the kind currently used within Britain would broadly remain as part of the new centralist solution. The new localist model involved significant reductions in such equalisation. It is worth adding, however, that this solution is not very different from that adopted in, say, New Zealand or a number of other countries with local government finance arrangements that achieve less than 100 per cent equalisation.

Additional revenue sources

The new localist solution would allow authorities to introduce a new tax or taxes (under enabling legislation which would have to be passed in advance) following a local referendum. It would be possible for some authorities to introduce congestion charges, tourist taxes, parking levies, 'green' taxes or even a small, locally determined, non-domestic rate. The government could pass legislation allowing authorities to propose entirely new kinds of tax or charge. In principle, this option could be grafted onto the new centralist option.

Implications for capital finance

Both the proposed options would be likely to require changes to the capital finance system. For example, any system which transferred the responsibility for funding services such as education and social services to Whitehall would also, for consistency's sake, need central determination of capital spending in each authority, or institution. Indeed, it might also be necessary to finance all such capital using grants, rather than relying on authorities to fund debt or Private Finance Initiative charges. For locally provided and funded services, it would be consistent to move to a far more liberal control regime, possibly relating control to a prudential ratio of outstanding debt to, say, taxable capacity or annual expenditure.

Performance, outputs

The new centralist and the new localist options would both make it clearer than at present who (i.e. central or local government) was responsible for particular kinds of expenditure. The centralist model would tie funding contractually to performance or outputs determined by central government departments. Even the new localist model might tie funding of individual welfare-type services within local government to particular output or outcome achievements. Provision of the more local services – under either option – could be left to more traditional (i.e. electoral) judgements of performance.

Accountability

Both the new centralist and the new localist models outlined above are designed to produce far sharper political accountability than has existed in the recent past. The electorate would be far more certain than now about which tier of government was responsible for service provision: it would not be possible for 'buck-passing' about who was responsible for the funding or achievements of particular institutions.

Links to the rest of public expenditure

The adoption of either of the options examined above would generate a far clearer distinction between central and local funding responsibilities than at present. For this reason, the arguments for the inclusion of locally determined (and largely locally funded) spending within the public expenditure control system would be much reduced. Local government could be left, with its own taxes, to determine tax and spending levels outside Treasury control.

The possibility of allowing local authorities to lead joint husbandry of the resources of their own and other public institutions' budgets could lead to huge improvements in the consistency of delivery of public services. Subject to minimal central oversight, it would be possible for councils to lead such local spending partnerships in such a way as to harness the activities of a number of agencies.

Conclusions

Recent history suggests there will be a number of readers who simply refuse to move away from the idea of a system of local government in which things resemble closely the world in, say, 1966. This imagined golden age was one where central government knew its place and councillors ruled their communities broadly untroubled by modern horrors such as child sex abuse scandals, school league tables and police accountability. We cannot but argue other than that such naive thinking does great damage to arguments for greater local freedom.

However, there is also a risk in the apparently growing assumption (among many central government policy makers, some commentators and the media) that uniformity is both achievable and desirable. It is absurd to pretend that all (perhaps any) services can be provided uniformly to all citizens throughout England or Wales or Scotland. People in different areas may want different service levels. Devolution to Scotland and Wales will, of itself, move Britain away from universal national services. Local government has long been a democratically legitimate way of securing efficient and locally sensitive services in different parts of the country. As with all democratic systems of government, there will need to be a balance between broadly uniform service provision for certain kinds of welfare-related services and greater differentiation in those services most directly related to residents and their homes.

The proposals outlined above for a 'new centralist' or 'new localist' settlement for local government finance are based on a real-world understanding of the complexities of public service provision, local government finance and British political life. It is not possible to un-invent past ways of operating, political assumptions and public expectations. Things can be changed over time, but not within a couple of years. We need to build from where we are not from some ideal state of nature.

Local government could, in theory at least, embrace either of the options described here (though they would be more likely to favour the localist one) on the realistic grounds that central government would once and for all be held to account for the demands they place on local public services. The capacity for the centre to place obscure and awkward demands on local councils sure in the knowledge that the public will never understand why it is difficult to finance such activities would be ended. Local authorities would be freed to secure the provision of a range of high-profile, locally important services. The deliberate confusion of central and local accountability would be much (if not entirely) reduced.

Whitehall is likely to find either the new centralist or the new localist models difficult to accept precisely because of the improvement of transparency that would be achieved. In preparing this paper, we undertook research which suggests that ministers are generally all too happy to retain a local government finance system which includes obscured accountability, on the grounds that clear accountability would inevitably (given current trends) leave central government exposed to criticism for any public service failures. The truth of this observation finds reflection in the fudges and compromises of the Green Paper.

Yet the centre should beware of pushing the new centralism or universalism by stealth in an attempt to avoid accountability. Low and declining turnouts in local elections, the difficulties in recruiting candidates experienced by all the main parties when it comes to local elections and general trends in public opinion surveys indicate that whether it likes it or not the centre is going to be held to account for the performance of key public services. The public is working out whom it wants to blame.

There may also be concerns about any reductions in equity implied by the localist option. A debate about whether or not there is a reasonable price to be paid for real localism (i.e. by a reduction in territorial equity for a number of areas) could take place. If, in the end, the public wants uniform provision of all services, including refuse collection, street lighting and parks, there may be no strong case left for local government, as we have known it.

We think that such a conclusion is unlikely and that a new consensus could be built around a combination of new localist and centralist perspectives. The universalist spirit of both elite and public opinion when it comes to core services such as education, social services and police needs to be recognised but beyond that we should maximise the scope for local supplements to and capacity for joining up of these universalist services. Beyond that there is a vast swath of services to do with the physical environmental and community well-being that should be seen as substantially local and therefore locally funded.

We believe passionately that local government is worth preserving and enhancing. But the continuation of a sterile debate about local government finance will continue to prove a distraction, allowing other centralising reforms to continue to occur from time to time. We would advocate a fresh debate about the extent to which the public is really happy to allow local government services to vary from place to place, and also therefore about the most appropriate financing system. Simply to continue the existing debate will do little more than provide a sideshow and it runs the risk of allowing by default the erosion of all remaining local government influence.

Local government needs a new financial settlement, one that recognises the new realities of public opinion and the complexities of what any system of finance is trying to cope with. This paper is intended to provide a debate that will lead to a stable, long-term arrangement that could be acceptable to both central and local government. If no reform is made, local government in England risks a continued slide, unconsciously, into central control.

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