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FISCAL DEVOLUTION

Why we need it and how to make it work

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Overview and recommendations

Fiscal devolution is emerging from the policy wilderness. Despite a range of localised revenue-raising powers being the norm in many of our peer countries, it has long been viewed as far too radical here. English public policy traditionally approaches local government finance separately to economic growth, but it has repeatedly failed to shift outcomes - particularly our persistent regional inequality despite nearly ten years of devolution policy.

So, the once niche issue of fiscal devolution is fast becoming more mainstream: it is increasingly advocated for by a range of policy groups and mooted without squeamishness by politicians.

But the term 'fiscal devolution' needs some demystifying. It covers a wide range of measures – some fall short of real devolved revenue powers, some are incredibly risky, while others really do hold the potential to shift the ability of local areas to drive growth. This *New Thinking* paper explores the different options and weighs up some of the potential merits and risks of each. If our centrally managed system of public finances is to become more decentralised, it will be important to navigate new territory with care.

As a rather technocratic and complex issue, while there is increasing interest within policy and devolved communities, the potential of fiscal devolution is yet to capture the public's imagination and progress to date has been fragile. With that in mind, the paper makes three core recommendations which focus on developing and embedding the principles:

- **A 'local tax guarantee' should be the priority for fiscal devolution:** Letting areas retain a share of income tax and VAT generated locally would bring important economic and democratic benefits. This should be articulated in a more tangible way than the often prohibitively technical manner fiscal devolution can be presented. The idea of more strongly linking community contribution and community benefit has strong potential political appeal.

- **A 'solidarity system' of equalisation between areas should underpin the local tax guarantee:** The different economic starting points between places will require a robust system of equalisation. This would identify different spending requirements and resource bases to calculate fiscal transfers from areas with a surplus to those with a deficit. This needs to be a regularly revised to account for adjustments in revenue bases which would be expected over time. National government has an important role to support widespread public understanding and buy-in, actively reinforcing our shared collective stake in growing national prosperity and ensuring no places are left behind.

- **Fiscal devolution should be undertaken in the context of wider constitutional and legal protection for local governments and communities:** If fiscal devolution is only ever viewed as an isolated policy initiative it will be vulnerable to the whims of different national administrations. It needs to be hardwired into our governance landscape, in which an increasing element of devolved power and initiative is here to stay. This should be backed up with a legally binding guarantee on behalf of national government to stable and sufficient resourcing for local areas, which is a common feature of other countries with mature fiscal devolution frameworks in place.

Why should we care about fiscal devolution?

Once a policy outlier, the prospect of fiscal devolution is rising up the agenda. Despite a range of local revenue-raising powers being the norm in many other countries, the idea has seemed alien in an English context for a long time. Now, set against the repeated failure of centrally-managed approaches to transform local economic outcomes, a question once whispered is getting louder. Might tight Whitehall control of local revenue-raising and investment actually be holding our regions back?

As devolution evolves and is increasingly challenging our centralised governing norms, the need for more local fiscal freedoms is now seriously discussed in polite policy circles and across the political spectrum. The March 2023 Budget confirmed the Conservative Government's deepening acceptance that devolution should involve areas having more control over their devolved funding, which had until then retained a significant degree of Whitehall control. The "trailblazer" deal areas of Greater Manchester and West Midlands will receive new revenue flexibilities, with full discretion over a single, multi-year funding pot and 100 per cent retention of business rates. West Midlands Mayor Andy Street has called to go further and is making an ongoing case to Government for more fiscal powers.

Meanwhile, for Labour's part, Gordon Brown's constitutional reform commission contained a clear analysis of the links between fiscal centralisation and economic underperformance. It called for a range of new fiscal powers for local government to incentivise growth – quite something for a former Chancellor of the Exchequer.

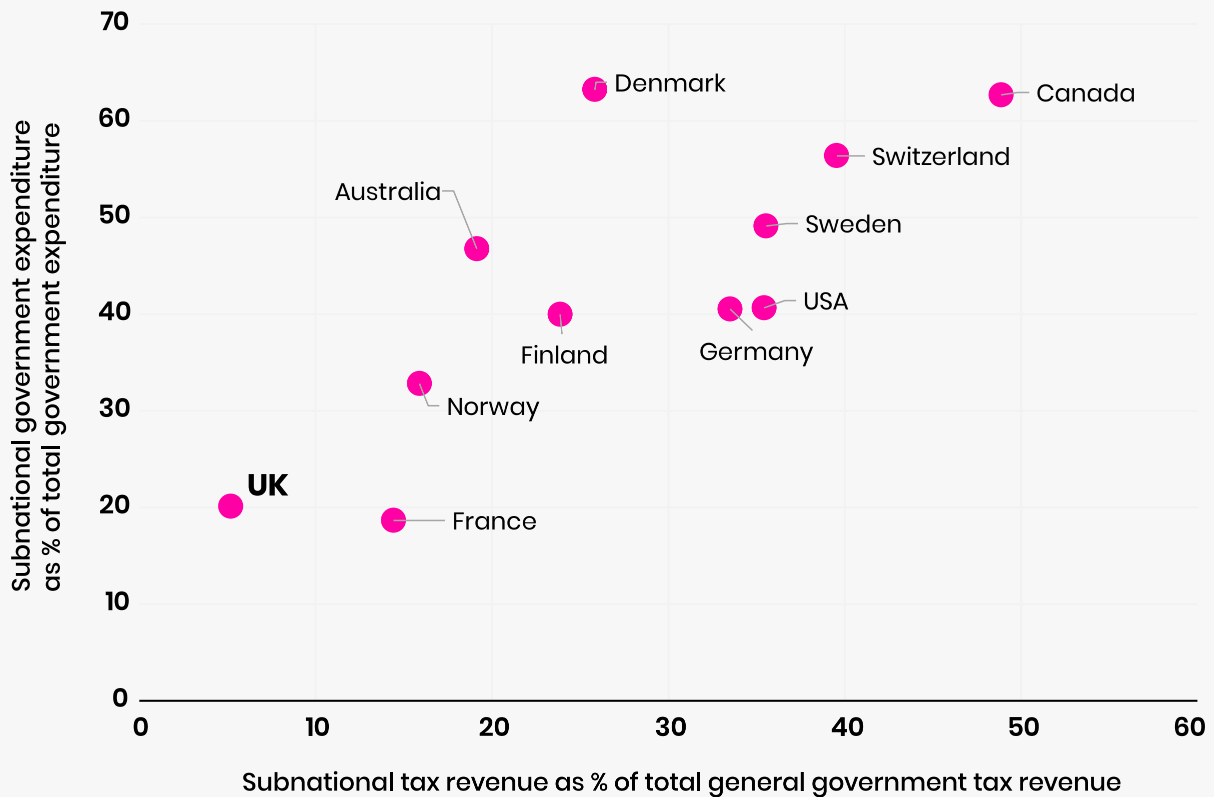
So, why should we care about fiscal devolution? This piece will explore the unique context of our public finances. It will set out the different options for fiscal devolution and identify how particular measures could make an impact on driving local growth, taking decision-making closer to communities and potentially overcoming regional inequality.

The context: The UK's fiscal centralisation and regional inequality

England has a highly centralised system of public finances in comparison to other large wealthy countries. Figure 1 shows the extent of this, using data from the OECD. Only five per cent of revenues are collected locally in the UK, whereas many of our comparator countries have much higher proportions of subnational tax revenue. Fiscal centralisation also extends to spending decisions: only 20 per

cent of all government expenditure is decided at subnational level in England, counter to the trend for greater such devolved decisions in most other countries.

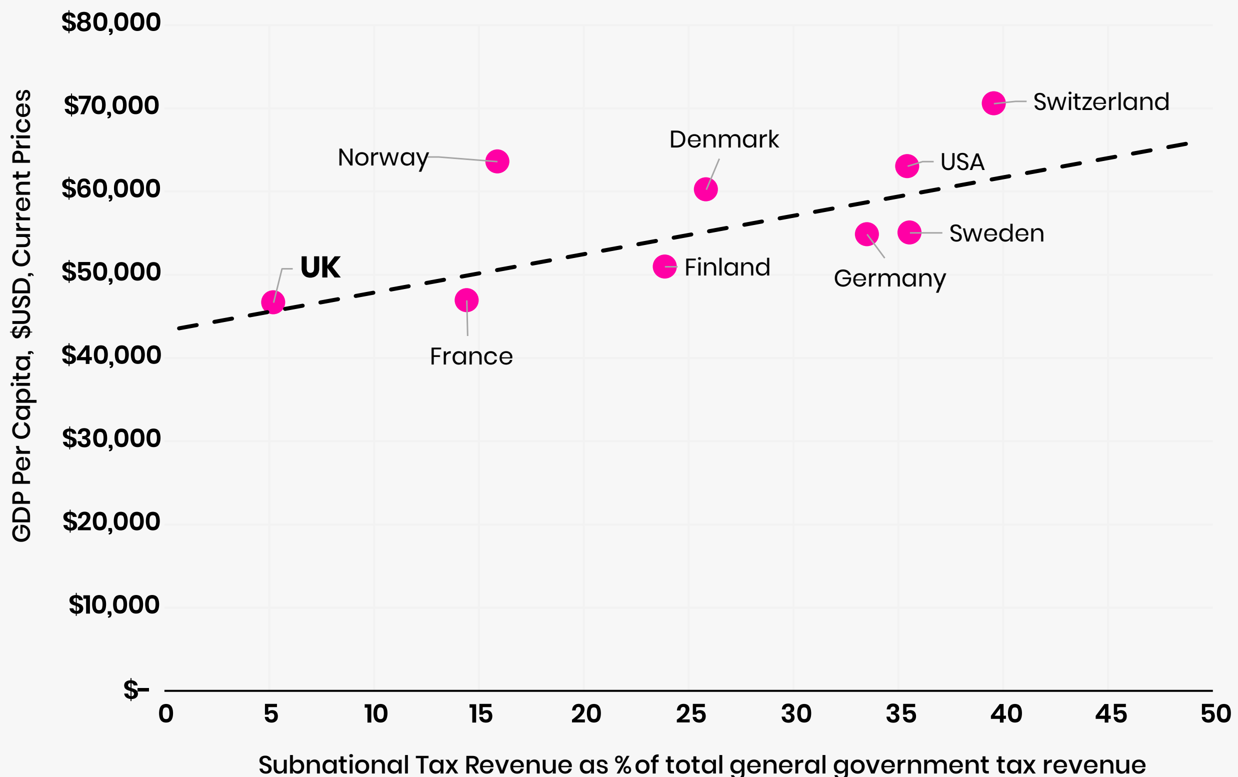
Figure 1: Compared to similar countries, the UK has one of the lowest proportions of local taxation and lowest proportions of local spending.



Source: New Local Analysis of OECD Fiscal Decentralisation Database, 2021

Meanwhile, as analysis by the University of Sheffield has established, across a range of indicators the UK has a higher level of regional inequality than any other large wealthy country. International empirical research by the OECD has shown that fiscal decentralisation is positively correlated with a range of outcomes including GDP per capita. Figure 2 uses OECD data to demonstrate this, with the extent of fiscal devolution by subnational tax revenue and GDP per capita measures indicating a correlation.

Figure 2: The UK has one of the lowest proportions of local taxes and lowest levels of prosperity compared to other wealthy countries.



Source: New Local Analysis of OECD Fiscal Decentralisation Database & Annual National Accounts, 2021. Note: GDP per capita is in current USD at current purchasing power parity.

Despite this evidence of links between fiscal decentralisation and some economic outcomes, English public policy treats local government finance as largely a separate policy area to national growth. Our centralised public finance system has existed for decades, but before 2010 the effects of this on regional inequality were relatively hidden by an abundant spending environment and funding formulas that allocated more to deprived areas. As Rishi Sunak himself has openly declared, this changed after austerity policy commenced, leaving poorer areas more exposed.

On the one hand, successive governments since 2010 have pursued policies which have decreased the resource available to all councils, and disproportionately to the most deprived. But on the other hand, each administration has actively pursued a policy of regional growth and rebalancing in one form or another. Devolution under Cameron and Osborne set the sub-regional model for mayoral combined authorities, but fiscal powers

were not strong features of deals. Levelling up was a concept initiated under Johnson and continued by Sunak, mostly via the common link between the two administrations of Michael Gove as Secretary of State for Levelling Up. This policy coexisted with ongoing devolution, but has largely taken practical form as a national fund that all local areas can bid into for investment.

It is increasingly hard to deny the tensions inherent within a local funding model that takes away with one hand and gives back with the other a much smaller amount, via complex and competitive bidding mechanisms. This 'begging bowl culture', with all its Dickensian connotations, perpetuates a hand-to-mouth dependency on Westminster for local areas. Moreover, most revenue rewards from growth uplift go straight to the Treasury, with limited ability for local partners to capture and reinvest any benefit. Overly centralised public finances further embed fragility by forcing local areas to focus on ever-changing national agendas rather than being able to fully pursue their own identified priorities.

Our underperforming regions are stuck as policy takers rather than policy makers. In this context, the devolution of more fiscal power offers a route to a more mature system of public finances with greater clarity between the centre and localities, and crucially the latter being able to develop long-term, sustainable revenue streams and investment plans.

This is important not just for economic reasons – there are democratic imperatives too, because fiscal centralisation undermines local accountability and the legitimacy of local institutions. In being forced to dance to the tune of the Government of the day, local partners lack the ability to create local economic plans that are fully responsive to their communities.

Low turnout in local elections is often blamed on local government and used as a reason not to devolve power further, but international evidence suggests that there's nothing inherent about low democratic participation locally. A fiscally decentralised country like Denmark regularly has turnout for municipal and regional elections of around 70 per cent (70.8 per cent in 2017 and 67.2 per cent in 2021 despite the pandemic), on a par with our national turnout. The Danish experience suggests that voting has more efficacy a devolved system with clear powers located and exercised locally.

In an era when the public's trust in established institutions is at a historic low ebb, understanding how fiscal devolution can play a role in increasing the legitimacy of local decision-making and ensuring direct local benefit, should be a priority.

Fiscal devolution and equalisation can happily co-exist

It is important to address an objection to fiscal devolution which is frequently made: that the unequal starting point of different areas is a barrier to localising tax powers. In the context of regional inequality, local economies have very different existing revenue bases and capacities to raise revenues. So, there can be an assumption that suddenly giving local areas more fiscal freedom will embed that inequality and leave more deprived areas to depend on weak resource bases while wealthier areas will prosper.

This objection is made with the best intent, but it is not based on a clear understanding about how fiscal devolution works in many countries. Fiscal devolution need not be zero-sum with equalisation measures: greater fiscal freedoms can be combined with national formulas which compensate for variable resource bases and population spending needs. Again, Denmark provides a good example of this - municipalities receive 70 per cent of their income from local taxes, mostly a local personal income tax. This decentralisation is combined with an annual review of municipal revenue and spending requirements, and areas with an identified structural deficit receive additional equalisation grants. Meanwhile, Denmark has regional disparities below the median of OECD countries.

The frequency of equalisation reviews is crucial, because it enables regular adjustments to respond to changes in resource-raising capability over time. The core aim of fiscal devolution should be to gradually grow incentives and rewards for growth, aligning them locally so that partners can develop and deepen their own economic investment plans. A regular rhythm of equalisation would be based on a formula designed to even out local and regional disparities in available resource and local needs. This would overcome the risks of different starting points and be capable of adjusting as places grow their revenue base sustainably. Policy should have one eye on mitigating the risks of immediate change, and the other on the long-term opportunity of developing greater regional parity and sustainability.

Overall, it is important to recognise that there is a difference between the regional inequality which confronts us today, and the rebalancing we need to work towards in the future. The short-term challenge must not be the enemy of long-term benefit. Our regional inequality has persisted despite a uniquely centralised system of public finances, so it becomes increasingly perverse to continue defending the status quo, which is obviously not benefitting regional growth or productivity. However, venturing into new territory requires a full understanding of the options for fiscal devolution. Some measures are more likely to empower local areas than others, so each should

be understood on their own terms – and weaker options for fiscal devolution should not be used as a reason for not pursuing the better alternatives.

What are the options for fiscal devolution?

The term fiscal devolution broadly refers to the ability to generate more taxes locally and have more control over how that money is spent. In practice, the term gets loosely applied to a range of specific and different policies: more flexibility over existing local revenues; more freedom over existing central government funding streams; the ability to retain a share of existing national taxation locally; the ability to raise new taxes; and the ability to vary rates of existing taxation.

These will each be explored in turn, including the different benefits and consequences for communities and local governments.

1. More flexibility over existing local revenues.

The prospect of more freedom over existing local revenues is more about fiscal flexibility rather than fiscal devolution per se. The two current local taxes – council tax and business rates – comprise just five per cent of overall taxation, so a focus on these alone is something of a distraction from the wider debate about fiscal devolution. They both relate to fixed property and so have problems associated with distortions in value and are detached from wider productive activity. However, they are worth mentioning up front, in order to demonstrate the limits of such a narrow focus and move on to consider wider fiscal devolution measures.

Both existing local taxes are heavily proscribed by centrally mandated limits. Council tax, levied on residential properties, is the only purely locally collected and retained local tax. Even so, it has limits on how much can be raised each year without a local referendum – under three per cent for lower-tier councils, or under five per cent for upper-tier authorities who are allowed a dedicated social care precept. Everything else is fixed – including entitlements to discounts (for example students and single people) and the eight payment bands. These were defined in 1991, since when our property market has skyrocketed so that the gap between the highest and lowest value properties is far wider than the gap between the highest and lowest bands.

This means council tax is regressive, with those in wealthier properties paying proportionately less. Some have called for higher bands to be added as a short-term remedy. However, this would not do anything to increase the extent

of fiscal devolution as the proceeds would likely need to be directly redistributed nationally, such are the distortions in property values. This would equalise nationally but not incentivise local areas to pursue growth.

Business rates are levied on premises and calculated using a national valuation formula linked to size. A slow degree of not-quite-devolution has been underway for years now: business rates retention. It was previously the case that local authorities just collected business rates on behalf of central government, but now local authorities retain 50 per cent. Some areas have been piloting 70 per cent retention and now the 'trailblazer' devolution areas are set to retain 100 per cent.

The rationale behind retention is that it will give local authorities a stake in future business expansion, and thereby an incentive to grow their local economies. However, premises floor size is a poor proxy for productive business value. Space-hungry businesses such as retail parks and warehouses create largely minimum wage employment, and many highly productive businesses now operate with limited or even zero office space. Local authorities have no control over how business rates are levied, and they are a blunt instrument often penalising small local businesses to the detriment of high streets.

Above all, both council tax and business rates are property-based taxes, meaning the fiscal freedom to expand or re-calibrate these revenue streams will always be limited by the huge distortions in property values. Simply expanding flexibilities on these taxes will systemically embed incentives for local partners to pursue low-value, space-hungry growth and high-cost housing. A reliance on property taxation alone won't link local fiscal power to productive growth activity, and so won't support the emergence of virtuous cycles of growth and investment.

VERDICT > **A distraction from real fiscal devolution.**

2. More freedom over existing central government funding streams.

The idea of a 'single pot' of funding streams from different Whitehall departments and given over to local areas has been around for a long time. Over 10 years ago, Michael Heseltine's ambitious report No Stone Unturned called for the considerable sum of £49 billion of central government funding streams to be devolved to a single local growth pot to drive skills, housing and transport schemes.

Nothing like this scale has been achieved. Even though successive devolution deals have involved the devolution of funding streams, separate departmental reporting requirements have been retained. In other words, this has not created complete local discretion over how to spend the funding, with central oversight and set parameters still strong. In theory, such freedom from separate Whitehall departmental conditions and funding timescales would mean local partners can develop long-term growth plans which better align sector support with skills pipelines and anticipate future infrastructure needs. This would overcome the fragmentation and short-termism when these aspects are addressed in isolation from each other by national policies.

In recent years the problems with fragmented national funding in local areas have come into sharper focus. The design of the £4 billion Levelling Up Fund exposed the problems of the 'begging bowl culture' of bidding for separate funding pots, and the limited impact of local projects mandated directly from the centre. Although Whitehall remains extremely cautious to let go, intense negotiations have resulted in new deals for Greater Manchester and West Midlands, which are seen as 'mature' enough devolved administrations to gain the confidence of civil servants.

These two areas are now set to receive multi-year single settlements with full flexibility and independence to make investment decisions, albeit with new accountability lines to Parliament to reassure on progress and outcomes. This means a precedent has been set and a new devolved accountability framework has been created, which also involves some new local scrutiny measures, and should pave the way for other areas to follow.

A single pot approach is certainly radical in the English context of low levels of subnational control over expenditure, but again it is not outright fiscal devolution. To begin to come close to the devolved public finance systems of peer countries, fiscal devolution needs to involve the ability to retain existing taxes or raise new ones, over which local governments would be fully accountable to their local communities.

VERDICT > **Overcomes fragmentation but is not outright fiscal devolution.**

3. The ability to retain a share of existing national taxation locally.

This option for fiscal devolution holds the prospect of genuine transformation locally. Currently, 95 per cent of all taxation raised in the UK goes straight to the Exchequer. This includes the main taxes that are proxies for income-generating productive activity – income tax, VAT and corporation tax. As a result, local government has no direct stake in the proceeds of encouraging productive growth – increasing higher paid employment and sector growth (to boost income tax take); creating an environment conducive to business transactions (VAT) or growing private sector profits (corporation tax). This doesn't mean councils don't consider these dimensions – every local area develops and pursues its own local economic strategy. But it does limit the impact of these approaches and creates an incentive gap between investment and reward – the latter of which the Treasury consumes in full.

There are increasing calls from many quarters for local areas to be able to retain a share of locally generated taxation. Onward have made the case for mayors to be handed control of 1p in every £1 of income tax raised in their areas. New Local previously called for areas to be able to retain a third of corporation tax raised locally to support productivity growth. The Northern Powerhouse Partnership has included devolving 1p of employer's national insurance contributions as part of a wider blueprint for fiscal devolution. West Midlands Mayor Andy Street is still seeking control over a share of VAT, corporation tax and stamp duty generated locally.

Beyond the 'trailblazer' devolution areas, other mayors are making the case for local retention of a proportion of national taxation on the basis that it would be more cost effective and produce better outcomes. North of Tyne Mayor Jamie Driscoll has argued that every £1 invested in job creation locally had returned £3 in payroll taxes to the Treasury. So, enabling the area to retain a share of those savings upfront would build stronger links between boosting economic activity and decreasing welfare spend, benefitting the public purse overall.

The core argument for granting local areas powers to retain a share of taxation is that it would give them a direct stake in generating more of it – in other words, boosting productive activity. And crucially, in the context of regional growth, by combining a revenue share with a range of other powers such as skills and infrastructure flexibility, it gives local areas the tools to ensure people locally benefit from growth, reducing the risk of displacement. If the full range of devolved levers are then in place and aligned, it could realistically be expected that this would establish stable revenue streams which local governments could plan around and

borrow against. This would develop long-term investment capability and the ability to attract private sector investment.

Under this approach, the rates of such taxation would still be set nationally, so wouldn't increase the amount individuals or businesses must pay. It would only result in higher revenues generated overall if more people were in work, in better paid work, and businesses were earning more profits. This is a key point of distinction from the next two aspects of fiscal devolution this article will explore – the ability to levy new taxes and the ability to vary the rates – both of which obviously would potentially increase or decrease the amount payable by individuals or businesses in different ways.

This is important to clarify, because sometimes the prospect of local revenue powers can be written off altogether, as Shadow Chancellor Rachel Reeves has appeared to do, on the basis that the tax burden in the UK is already too high. An approach which enables areas to retain a share of tax generated locally, will not result in *more* tax for people, rather it would have the potential to create *better* tax they more directly feel influence over and see the benefit of. In fact, the prospect of local areas retaining a share of tax earned on local incomes or activity may well have more popular appeal than national politicians are prepared to acknowledge.

This option for fiscal devolution should be conceived as a "local tax guarantee" for communities, ensuring that a certain proportion of tax generated locally is retained and reinvested locally. The language of fiscal devolution is very technical and inaccessible to the general public. But proposing the idea in more common-sense terms would open up the potential to resonate more with people.

VERDICT › **The best option to transform local economies.**

4. The ability to raise discrete new taxes or charges.

Giving local areas the ability to raise discrete new taxes or levy charges would add to local tax bases. On the one hand, this holds the prospect of widening out the revenue streams available to democratically elected local governments, to which the rigour of the local ballot box would keep in check the risk of overburdensome taxation on the local electorate (in much the same way as national government must account for its decisions at election time). On the other hand, as noted above, the prospect of additional taxation is a difficult political sell, which immediately raises the prospect of a fraught debate about winners and losers from any change. With that in mind, one of the most popular new forms of taxation happily and

frequently mooted by national politicians is a tourist tax, probably levied via a supplement on accommodation. Although hoteliers would presumably not welcome this, it is seen as relatively uncontroversial given that the local residing electorate wouldn't be affected (and in the Airbnb era may actively welcome some direct benefit). Yet despite its rhetorical attractiveness, it has so far failed to become a reality in England - the Government refused to let Birmingham City Council levy a hotel tax to help pay for hosting the 2022 Commonwealth Games. However, north of the border, Edinburgh is set to introduce a transient visitor levy (TVL), subject to permissive Scottish legislation, so the impact of this may further the case for change in England.

The idea of a land value tax is gaining increasing attention. This would tax land according to its value rather than the quality or nature of the development on it. This, proponents argue, would be more economically efficient and morally just, because land derives its value from its location and proximity to wider infrastructure, factors which landowners themselves have not created yet indirectly benefit from. NEF have argued that a land value tax should replace business rates as the prime source of funding for local government. The Northern Powerhouse Partnership have set out a blueprint for fiscal devolution, with the centrepiece the eventual replacement of all local residential property taxes with a land value tax and a fair redistribution mechanism which would cut out the Treasury entirely.

Certain potential new sources of localised income are more linked to behaviour change or directly targeted investment, rather than long-term revenue security, such as a road charging tax. Some areas have had the freedom to introduce a road charge, notably London's congestion charge zone, and other areas such as Greater Manchester, Bristol and Cambridge have or are considering options. The proceeds of such a charge are tightly linked to investment in alternative transport so the core long-term aim isn't necessarily to contribute to broadening out a stable future revenue base. Indeed, the ultimate success of such a tax would be low collection rates, if it encourages a significant shift away from car reliance towards better public transport options. Yet it remains an important option for intelligent local governance to invest in sustainable infrastructure and transit, particularly with regard to net zero targets.

VERDICT > **Diverse and democratically accountable revenue bases are an important part of fiscal devolution.**

5. The ability to vary the rates of existing taxation.

The most radical version of fiscal devolution would involve enabling local areas to vary rates of existing taxation, rather than relying on uniform national rates. The case for giving local areas this ability is based on an assumption that they would use the power to lower rates to attract residents and businesses. However, there is a real risk this could encourage 'race to the bottom' competition, a trend apparent in the United States where inter-state tax rivalry is the norm. The problems of such an approach were clear recently when Amazon leveraged the prospect of where to locate its second headquarters to force American cities into a bidding war over which could offer the most attractive tax incentive package. This episode demonstrates how such an approach can disempower local areas overall, while significantly empowering mobile capital. Inter-state tax competition in the US has intensified in the post-pandemic remote working era, leading to increased competition for residents, with low tax states offering income tax incentives to mobile workers. A dispute between New Hampshire and Massachusetts recently ended up in the US Supreme Court.

Almost no-one is seriously suggesting we should establish such a system of localised tax fragmentation and competition here. But it is important to note that a precedent for a degree of low tax competitiveness in certain areas has already been established in freeports and is now being extended beyond goods entry-points, to specific local areas as part of plans for investment zones. The Spring 2023 Budget announced that investment zones will be designated special tax sites, involving a package of reliefs from a series of standard taxes including business rates, stamp duty land tax and employers' national insurance contributions. The measures can be characterised as local fiscal opt outs rather than fiscal devolution per se, but they do establish a principle of certain areas benefitting from the ability to vary tax downwards.

The development of special tax site status for investment zones can still be located within the broader trend of tight central control over local fiscal levers overall, rather than system-wide devolved fiscal power. Some countries with stronger degrees of fiscal decentralisation do enable local areas to vary tax rates, but within clearly defined parameters in order to balance the ability to be competitive with the need to ensure sufficient resources overall.

Germany is a good example of this. Municipalities with a population of more than 80,000 levy a trade tax on businesses with a base rate of 3.5 per cent and a local multiplier that ranges between 8-20 per cent. This is in the context of the wider

German system of fiscal decentralisation which locates significant revenue raising and expenditure powers to both the regional Länder and local municipalities, making it one of the most devolved in Europe. Crucially, this is combined with Germany also having one of the most robust systems of equalisation between the Länder; between the municipalities within them; and nationally overall. This model is not without complications, but it does demonstrate again that it is entirely possible to combine fiscal decentralisation with fiscal transfers which serve to equalise resource between areas. This better balances incentives to attract investment and grow, with the need to ensure every area is able to cover spending requirements, recognising progression over the medium to long term.

So, the German model is worth keeping in mind should we go further down the route of tax rate flexibility. This enshrines an overall principle of tax variability, combined with protections which define ranges and ensure equalisation. It thereby avoids the problems inherent in a US 'race to the bottom' model of radical unfettered fiscal freedoms on the one hand, and the investment zone model of centrally proscribed cherry-picked opt-outs on the other.

VERDICT > **Risks encouraging a 'race to the bottom' tax competitiveness between areas.**

From niche to mainstream: Recommendations for taking fiscal devolution forward

The prospect of fiscal devolution is gaining more traction within policy debates, but is yet to capture the public's imagination. As this paper has explored, there are different ways of adopting greater local revenue freedoms, some of which are less effective. Implementing fiscal devolution as part of moving towards greater regional equality, requires clear policy thinking and taking lessons from successes in other countries. To that end, this piece concludes with three recommendations to develop the case for fiscal devolution in an English context.

- **A 'local tax guarantee' should be the priority for fiscal devolution:** Letting areas retain a share of income tax and VAT generated locally is the logical next step for devolution. This should be articulated in more tangible terms which have more resonance with people than the sometimes prohibitively technical way fiscal devolution can be presented. Of all the options for fiscal devolution, creating such a local tax guarantee would bring important economic and democratic benefits.

The ability to retain a share of the main taxes which are proxies for productive activity would create a stronger local stake in the revenue gains of getting more people into better jobs and stimulating business activity.

Enabling local areas to diversify their own revenue streams in this way should establish sustainable sources of funding over the medium to long term which can be reinvested and borrowed against to support future growth. This would be designed to shift the trajectory of local partners currently too dependent on short term, ad hoc national government funding decisions. It would establish stronger direct benefit to communities from their own tax generation, supporting the creation of responsive and mature economic plans over the long term. Strengthening local accountability in this way has real potential to enhance local democratic participation, since there would be clearer lines connecting community contribution and community benefit.

- **A 'solidarity system' of equalisation between areas should underpin the local tax guarantee:** Alongside measures which enable local areas to nurture and reinvest sustainable, independent revenue streams, a robust national system of equalisation is required. Taking lessons from countries like Denmark and Germany, which have strong systems of equalisation between localities and regions, this must reflect a number of dimensions. Firstly, an equalisation system needs to be capable of effectively assessing the revenue resource base and spending requirements of areas, in order to identify fiscal transfers from places with a structural surplus to places with a structural deficit. Secondly, this needs to be conducted on an annual basis, in order to respond to changes in fiscal starting points between areas which should evolve over time.

Finally, such a system needs to secure mainstream public understanding and buy-in. The language of 'solidarity' is borrowed from the German system which emerged from reunification and a concerted effort to promote shared national bonds. Our national starting point is different, but in recent years the popular debate about regional inequality is becoming increasingly polarised as "north versus south", with competitive bidding processes between areas further encouraging a sense of atomisation. Within a system of greater fiscal devolution, there is a strong role for national government to actively reinforce our shared collective stake in growing prosperity and ensuring nowhere is left behind. A new equalisation system should not be the preserve of local government finance specialists, as the long-postponed fair funding review has been, but should be designed to secure mainstream public recognition and understanding from the start.

Fiscal devolution should be undertaken in the context of wider constitutional and legal protection for local governments and communities: Countries with established systems of fiscal decentralisation have such measures embedded within wider constitutional and legal protection for local governments and communities, which national governments must adhere to. In the case of Germany, devolved fiscal powers and a national system of equalisation are underpinned by a constitutional guarantee of equivalent living standards. This is designed to require the federal government to ensure all areas have sufficient resource to meet needs.

Where progress has been made to date in England, it has been as an isolated policy initiative. It has not involved a wider legal clarification of the role and independence of subnational governments, or any legal commitment on behalf of central government to regional resourcing and rebalancing. This means that even the limited progress made to date on some local fiscal flexibility remains vulnerable to the whims of different national administrations. A system of greater fiscal devolution and equalisation needs to be built to last, enduring beyond successive governments at Westminster, to put down firm roots within localities and regions. It also needs to be set within a wider context of devolved and aligned decision-making powers across a range of economic and public service areas, alongside a broader commitment by central government to sufficient funding.

The arguments for fiscal devolution are likely to continue, as the devolution agenda deepens and spreads to more areas, and local leaders make increasingly compelling cases for more meaningful powers. As we head towards the next general election, both main political parties may yet seek to outbid each other.

Levelling Up Secretary Michael Gove has previously stated that levelling up will need fiscal devolution, and appears to be driving the Conservative Government's progress to date on fiscal flexibility for trailblazer areas. West Midlands Mayor Andy Street may yet succeed in making his case for a share of national taxation, which would prove to be a very significant advance.

Meanwhile, Shadow Levelling Up Secretary Lisa Nandy has indicated the Labour Party is considering whether local government could keep more of the

tax base raised locally. Labour leader Keir Starmer's commitments to a Take Back Control Bill and a mission-led approach to government establish a clear direction of travel to radically shift power out of Westminster and closer to communities. Although both currently fall short of explicit measures on fiscal devolution, they offer ripe ground for it.

So, nearly ten years after the first devolution deals were negotiated, we are potentially entering an exciting new phase – a growing consensus that Whitehall needs to let go, increased confidence of local areas to take on more powers and local communities that demand meaningful control. Fiscal devolution may well be out of the policy wilderness at last.

About us

New Local is an independent think tank and network with a mission to transform public services and unlock community power.

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Published by New Local

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