Executive Summary

The rationale for change

In two months' time, a couple of weeks after the elections in Wales, it will be the 40th anniversary of the publication of the Report of the Committee of Inquiry into Local Government Finance —the Layfield Committee. This 1976 report set a benchmark on issues of local government finance that have surfaced intermittently since then but by and large have remained unresolved. Layfield spoke of the lack of buoyancy in local property taxes and the need for regular revaluations, the need to find other forms of local funding, the rigidity of central government grants and the need to balance equity across the whole of local government with accountability at the local level. Numerous reports and inquiries ever since have revisited the same themes.

Whilst there has been broad consistency in the solutions that these reviews have put forward, wholesale reforms have never been implemented. The financial challenges faced by councils across the UK pose a profound threat to some local services. In Wales the prospects of structural reform offer an opportunity to address weaknesses in the system of local government finance that have remained intractable to others. We are mindful that the pace of reform has been slow and the changes to the local government finance system in Britain have been piecemeal. This is the background to our review.

The Welsh financial settlement has to some extent protected local authorities in Wales from the levels of cuts seen in English local authorities. However, funding reductions have nevertheless been unprecedented and have drawn into sharp relief a financial regime that is hindering the ambition of Welsh local authorities, constraining the innovative instincts of the local government workforce and holding back innovation which could make a substantial contribution to economic growth. On average, local government in Wales is dependent on the Welsh Government for 83% of its income[1] (45% from the Revenue Support Grant, 26% Specific grants and 12% redistributed business rates), with only 15% being raised locally through council tax (the remaining 2% being made up through appropriations and adjustments), leading to a deficit in democracy. Local Leaders are faced with decisions that have implications that are almost universally unpopular whilst having little flexibility over the quantum of finance available to allow for other scenarios or options.

There is a unique opportunity within Wales to grasp and embrace changes to the financial system. As plans are made for local government reorganisation, so too plans should be made for strengthening the finance of local government, whatever the shape of local authorities in the future, allowing for greater freedoms and flexibilities for local decision making, enabling local authorities to grow their tax base and reinvest in their areas to boost both the local and national economies.

[1] These figures exclude local authority fees and charges, which in 2014-15 amounted to £616m

As additional taxes such as stamp duty, landfill and income tax are devolved to Wales, there is an opportunity to improve the relationship between local and central government from one that argues about allocation, hypothecation and dependency to one where local government has the freedoms to make local decisions, boost the local economy and in so doing raise the total tax base in Wales so that the Welsh Government itself has greater flexibility to pursue other priorities.

The introduction of the Well-being of Future Generations Act (WFG) is another driver for change in the financial system. It is intended to provide a framework for all public service activity and to encourage longer term, more collaborative planning. There is a need to find ways that the public sector can move together in harmony rather than efficiencies in one part of the sector off-loading costs onto another part. A more flexible financial system with multi-year settlements is virtually a prerequisite if this is to be undertaken in a meaningful way

The Commission's vision

A finance system which provides choice and opportunity to be creative, enabling local authorities to meet the ambitions of their citizens is fundamental to securing good quality, sustainable public services.

The Commission's vision is for a finance system that:

- Promotes greater self-reliance and self-sufficiency
- Encourages entrepreneurialism and innovation
- Is more stable, thus allowing for better and easier planning and forecasting
- Promotes local decision-making on service delivery leading to enhanced accountability
- Incentivises growth of the tax base and thus economic growth for the whole of Wales
- Reduces and manages the level of dependency at all levels – Welsh Government (WG) dependency on the UK Treasury, local government's dependency on the WG and the individual's dependency on public services
- Facilitates the pursuit of the seven goals of the WFG Act in an integrated way

Approach to reform

This report provides recommendations for how the finance system for local government in Wales should be altered to better enable local authorities to meet the needs of their local populations. It is often the case that one size does not fit all and that centrally determined policies and programmes will not work effectively at the local level. Local authorities operate in different places under different contexts; they have different priorities and will fund different services depending on their communities' needs. They will collaborate in different ways and with different partners. The principle of variability has been accepted already; the Cardiff Capital Region Deal, negotiated by authorities working in collaboration, has begun to change their responsibilities and funding regimes to suit local circumstances. When local leaders met with the Commission, they confirmed that if business rates were to be localised they would want this done regionally so as to work together for the wider region; rather than risk authorities wasting time and resources competing with each other for local gain, which causes local loss elsewhere.

The Commission has a vision that councils as a whole can achieve greater self-sufficiency. This does not mean the absence of government grants, but rather stability in grant allocations and control over directly raised revenues (and possibly in the future assigned resources) such that councils can shape the destiny of their area without over-dependency on central government. We believe that not only is this better for local accountability, but is essential to underpin the new methods of working needed to protect service outcomes to residents at a time of public funding austerity. As councils drive growth in their local areas, this in turn will drive growth in the central government tax base as income tax is devolved to Wales.

Aims of the reforms

The Commission is mindful of the ongoing process of local government reorganisation in Wales and has satisfied itself that the recommendations made would work for the existing model of 22 authorities, whilst being transferable to any new map of local government created by the Welsh Government.

The Commission concluded that the existing system has not failed, but believes that by making a series of alterations it would work far better for both citizens and for the organisations themselves. We are clear that by adopting our pragmatic recommendations, there are reasons for cautious optimism whatever the future number of local authorities in Wales. Once these recommendations are implemented, they should lead to a system that:

- **Strengthens local accountability** – if a greater proportion of a council's funding comes directly from its local tax base, it is more directly accountable to its citizens and businesses for the impact of decisions it makes

- **Supports and encourages innovation** – local councils in Wales should be free to respond to local issues flexibly and creatively. Greater freedom and acceptance that there is often not a "one size fits all" solution to problems that appear similar but often have differing factors at play due to demography and geography
- **Allows greater local discretion** to respond differently in different areas – with fewer constraints via grants there is an opportunity for expenditure decisions to become more localised, prioritising needs to be met in the most appropriate way according to local knowledge
- **Reduces local government's dependency** on the Welsh Government
- **Incentivises growth** in the local economy – with a direct link between economic development and their own financial well-being through retention of business rates
- **Allows the Welsh Government to hold local government to account** for performance and outcomes in a more rigorous and effective way
- **Enables and encourages** the pursuit of a more prosperous Wales to be tackled simultaneously with pursuit of the other six goals in the WFG Act.

The Commission feel that the recommended package of reforms that follow will significantly enhance the ability of local government to better respond to the needs of its citizens whilst being low risk, logical, achievable and, above all, practical. They will also be applicable regardless of the shape of local government in the future.

Reforms

Taxation

- Non-domestic rates be retained in full by local authorities
- In the year of implementation for non-domestic rates retention, measures be put in place – such as adjustments to grants receipts or pooling arrangements – to ensure that no authority is better or worse off financially than in the previous financial year
- City Regions are given the power to add a supplementary business rate whose sole purpose would be to assist in paying for large capital projects. These powers should be available to other regions as they evolve
- A revaluation of council tax be undertaken as soon as possible and at least every five years thereafter
- The Welsh Government introduce legislation to make it possible for city regions, or other sub-national groupings of authorities, to reform bandings and the ratio of council tax payable from band to band

- Existing council tax discounts be reviewed with the objective of giving individual local authorities discretion over their use
- The Welsh Government legislates to introduce a permissive list of small local revenues for local authorities to use
- As Welsh Government achieves greater fiscal devolution this should flow through to the local level
- The merit of a locally-retained share of Welsh Government income tax should be considered again in the next five years

Fees and charges

- Local authorities be given greater discretion over the range and level of fees and charges

Grants

- Existing specific grants be incorporated within the Revenue Support Grant (RSG) unless there is a compelling case for a time-limited use of a particular grant
- Every specific grant be reviewed on a two yearly basis to ascertain if the case for hypothecation remains valid or to decide if the grant is to cease or be incorporated within the RSG

Multi-Year funding

- Indicative rolling three yearly grant settlements are introduced

Capital expenditure

- De-hypothecation of capital funding streams

New independent bodies

- A Welsh Office of Budget Responsibility be created to independently examine the Government's revenue and expenditure forecasts, including the assumptions made about local government finance and expenditure
- The existing RSG formula be frozen and an Independent Grants Commission be established to oversee the development and future operation of a new grant distribution formula

Performance management

- The Welsh Government review its arrangements for the performance management of local authorities, so authorities are able to properly evidence how well they are using their increased revenue raising powers and how well services are performing

Benefits for the Welsh Government

These proposals, if progressively rolled out, would increase the tax base from devolved income tax due to the increased growth in local areas. The system for distributing dwindling resources would be de-politicised as the new Grants Commission would work on a new formula to replace the existing one which has been added to over a number of years and which few, if any, can now claim to fully understand, let alone explain to members of the public. The removal and reduction of ring-fenced grants would enable councils to better respond to the drivers of local needs, whilst also reducing the significant administrative costs involved from all sides. The freedom would also encourage a greater spirit of public sector entrepreneurship that is fettered by existing constraints, but is vital if the approaches required by the WFG Act are to become a reality.

Recommendations

The Commission recommends full localisation of business rates, with 100% of business rates and business rate growth being retained by local government. In the year of implementation measures would need to be put in place – such as adjustments to grants receipts or pooling arrangements - to ensure that no authority is better or worse off financially than in the previous financial year.

The Commission commends the fact that Wales is the only nation in the UK to have undergone a council tax revaluation exercise, and recommends that since even in Wales, properties are taxed based on a 2005 valuation base, a further revaluation needs to be undertaken, with commitment to this being done on a five yearly basis in the future.

The Commission recommends that the Welsh Government introduce legislation to make it possible for city regions, or other sub-national groupings of authorities, to reform bandings and the ratio of council tax payable from band to band.

The Commission recommends that the incoming government should devolve to local authorities the setting of council tax discount and the power to determine who receives council tax support.

The Commission recommends authorities be given a suite of permissive powers that can be introduced locally, depending on local circumstances. Examples of powers to be conferred would be the introduction of a tourism tax. There should be a logic in choosing to levy these taxes, with money raised to be utilised according to related priorities, so tourism tax to assist with local development/ regeneration which would aid the tourism industry.

From April 2017, the Welsh Government will also assume responsibility for the replacements for Stamp Duty Land Tax and Landfill Tax with the proposal for partial Income Tax devolution by 2020. As the Welsh Government achieves greater fiscal devolution from the UK Government the Commission recommends that this should flow through to further devolution to the local level.

The Commission recommends a substantial reduction in the number, scope and scale of specific grants. It is the Commission's belief that specific grants force councils to use resources on services that may not be a local priority and are a challenge to local autonomy, service users and good government, whilst adding additional administrative burdens with each grant. The Commission's view is that specific grants should only be used for a national priority, or for a national function for which the local authority is an agent. Innovation grants should be limited to a maximum of three years. All existing specific grants should be folded into the RSG unless there is special justification. The Commission also recommends that any further specific grants should be reviewed on a two yearly basis to ascertain if the case for hypothecation remains valid or to decide if the grant is to cease or be incorporated within the RSG.

The Commission recommends that the incoming government commits to full and clear multi-year settlements to enable effective long-term planning for local authorities and other public services. The Commission would urge rolling three yearly settlements to allow effective planning and appropriate consultations for required service changes.

The Commission supports councils having the freedom to determine fees and charges locally.

The Commission recommend that councils are given greater freedom on capital expenditure by de-hypothecating capital grants.

The Commission recommends the establishment of a Welsh equivalent of the UK Office for Budget Responsibility (OBR): an advisory, Assembly sponsored public body to provide independent economic forecasts and analysis of the public finances in Wales. It would produce fiscal and economic forecasts and report on the Welsh Government's taxation and expenditure assumptions. It would work alongside the UK OBR. Other duties could include scrutiny of the Government's policy costing and assessing the long term sustainability of the public finances in Wales. The finances of Welsh local government would be reviewed as part of this process.

The Commission has received a great deal of evidence about the formula for the RSG being based on outdated data, complex and lacking in transparency. The Commission therefore recommends the existing grant regime is frozen and, for the immediate future, used as the basis for the rolling three year settlements proposed above. This change would provide temporary stability and predictability, allowing councils to plan effectively and assist planning with partner organisations. To improve the system in the longer term, an Independent Grants Commission should be set up to commence work on a more effective and fairer formula for the future. The Commission also believe the Grants Commission should be asked to comment on the use of local authority grants by the Welsh Government and to undertake a periodic review of specific grants. As the Grants Commission would be independent, it would be possible to separate the legitimate role of the Welsh Government in setting the quantum of grant from decisions about grant distribution.

The Commission recommends that the City Regions are given the power to add a supplementary business rate, whose sole purpose would be to assist in paying for large capital projects (similar to the way the Crossrail scheme in London has been funded). These powers should be available to other regions as they evolve.

In the longer-term, the Commission see merit in the idea of a locally-retained share of Welsh Government income tax, or a purer form of local income tax. But in the short term, we are mindful of the fact that any such recommendations would be complicated by the fact that the Welsh Government itself is in the early stages of seeing the devolution of income tax to Wales. Consequently, we recommend considering this issue again in the next five years.

The Commission query whether Wales currently has a suite of outcome performance measures that can effectively judge good performance for councils. The Commission therefore recommends that robust outcome measures are devised to provide a way of ensuring that increased devolution of tax powers can be seen to improve performance.

About the Commission

The Independent Commission on Local Government Finance Wales was set up because the local government funding system in Wales is in urgent need of reform.

The Welsh Local Government Association and the Chartered Institute of Public Finance and Accountancy asked the Commission to make recommendations for the reform of local government finance and finding better ways to fund local services and promote economic growth in Wales. These priorities form the context for the Commission's recommendations on the local government finance system.

The Commission's aim is to provide recommendations that will be valuable regardless of the quantum of funding in the system.

Professor Tony Travers - Chair

Tony Travers is Director of British Government @ LSE at the London School of Economics. He is also a professor in the LSE's Government Department. His key research interests include local and regional government and public service reform. From 1992 to 1997, he was a member of the Audit Commission and was a member of the Urban Task Force Working Group on Finance.

He is currently an advisor to the House of Commons Communities and Local Government Select Committee, having previously advised a number of other Parliamentary committees. He chaired the London Finance Commission (2012-13) and was a member of the City Growth Commission (2013-14), and also a member of the CIPFA/LGA Independent Commission on Local Government Finance (2014-15).

He has published a number of books on cities and government.

Chris Hurst

Chris is a chartered accountant with 25 years' board experience. He started his career in the banking sector and then worked in local government for 15 years, in both Wales and England, before returning to the private sector. Chris re-entered the public sector in 1992, as Finance Director for an NHS Trust and 4 years later was appointed Deputy Regional Finance Director at the NHS Executive. In 2000 he took up the role of Deputy Chief Executive at the Oxford Radcliffe Hospitals NHS Trust, a post he held until 2009 when he appointed Finance Director for Health, Social Care & Children at the Welsh Government.

Chris left the Welsh Government in 2012 to set up Dorian3d, a management consultancy and executive coaching practice. He is a Board Trustee of UK Healthcare Financial Management Association (HFMA), a non-executive director of a small digital development company in the Midlands; and an independent advisor to Philips new healthcare technologies division. Until 2010 he was a long-term member of the Secretary of State for Health's Advisory Committee on Resource Allocation (ACRA), in England.

Professor George Boyne

Professor George Boyne is Pro Vice-Chancellor, College of Arts, Humanities and Social Sciences and Professor of Public Sector Management at Cardiff University. As Pro Vice-Chancellor, Professor Boyne is also a member of the University Executive Board. He has published eight books and over 150 articles in academic journals.

Professor Boyne's main research interest is the explanation and evaluation of organizational performance in the public sector. Professor Boyne founded the Public Management Research

Group at Cardiff Business School in 1995. In 2014, the quality of research in Public Management at Cardiff University was ranked third in the world.

He served as President of the US Public Management Research Association from 2009-11 and was Chair of the Public and Non-Profit Division of the Academy of Management from 2011-14.

He has acted as advisor to organisations including the National Audit Office, UK Central Government Departments, the Welsh Government and the United Nations.

Gill Lewis

Gill Lewis has worked in the public sector for nearly four decades as a qualified chartered accountant (CIPFA). Her early career was in the NHS and she joined the Audit Commission in 1988, and was appointed a District Auditor in 1996. She has held a number of senior positions in the Audit Commission in Wales, and Wales Audit Office, Head of Audit in Wales and Senior Partner respectively.

Since 2010, she has undertaken a wide variety of important roles across the public sector in Wales. These include, Deputy Chief Executive, Director of Resources and statutory Section 151 officer in two Local Authorities and Director of Change Management in another Local Authority. She was also the Director of a Health and Social Care programme. She undertakes high level corporate governance work, change management and organisational turnaround for organisations.

Gill is currently a board member on the Chartered Institute of Public Finance Accountants in the UK, Chair of the Board for the Regions and Past President of CIPFA in Wales. In July 2015, whilst working as a Commissioner, Gill was appointed by Leighton Andrews AM, Minister for Public Services as the Chair of the Public Services Staff Commission.

Harry Thomas

Harry graduated from Manchester University with a degree in Economics and subsequently qualified as an accountant with the National Audit Office in South Wales before moving on to join Cheshire County Council. He has worked with the former Welsh Water Authority and Gwynedd County Council. After the 1996 Local Government reorganisation he was appointed Treasurer with Gwynedd Council and in 2003 was appointed Chief Executive, where he remained until his retirement in 2014. He is a former finance spokesperson for SOLACE Wales.

Lynn Pamment

Lynn Pamment is a prize winning Chartered Accountant and a member of CIPFA. She has over 25 years of experience of working with private and public sector bodies across the UK both in an assurance and advisory capacity. During her career, Lynn has undertaken a number of secondments into the public sector in Wales to manage large projects.

Lynn is PwC's Cardiff Office Senior Partner and is also the regional leader of PwC's Government and Public Sector practice in Wales and the South West. Her client base includes organisations in the central government, local government, health, education, housing and charities sectors.

Lynn is the Chair of the CIPFA / LASAAC Board responsible for the accounting code for local authorities in the UK.

She is a board member of RCT Homes and of Tirion Group. Lynn is also a member of the Cardiff Capital Region Transition Board.

Simon Parker

Simon Parker (Director) has led the New Local Government Network since 2010. He is a respected voice in the localism debate and is frequently called upon to advise senior leaders in local and central government. As well as frequently authoring publications and articles, he has led strategic consultancy work for authorities that include Warwickshire, Essex and Suffolk.

Before joining NLGN, Simon worked as a fellow at the Institute for Government, where his work was described by The Economist as helping to develop a 'science of government'. His work was covered in most national newspapers and presented to very senior central government audiences, including the Cabinet Secretary. His career also includes time as an organisational development fellow at the Office of Public Management, head of public services for the think tank Demos and as a senior policy advisor for the CBI, where he led negotiations on the public service workforce and promoted the use of public private partnerships in local government. Before joining the policy world, Simon had a successful career as a journalist at the Guardian and LGC. His latest book, Taking Power Back, was launched in October 2015.