



A Fiscal Framework for Local Government

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Published 9 March 2017

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This paper is published as a contribution to the debate over the future of local government finance. It presents a proposal for a Fiscal Framework for Local Government in Scotland – a framework that would set down clear, transparent and binding rules about how local fiscal policy and central government grant powers should interact to provide greater autonomy, flexibility and certainty to the future of local government finance.

A Fiscal Framework for Local Government

Background

Historically, local government was responsible for raising the vast majority of its own revenue. Over the course of the 20th century, there has been an increase in the proportion of central government grant and a corresponding reduction in the revenues raised by local government through fiscal powers under its control. In recent decades, these limited fiscal powers have themselves come under increasingly central control. Rate-capping was introduced in 1984 and non-domestic rating was removed from the control of councils in Scotland in 1989. Since 2007, central government has sought to restrict the freedom of councils to set the Council Tax rate.

This direction of travel is the opposite to that in relation to the increasing devolution of fiscal responsibility from the UK Parliament to the Scottish Parliament. In short, whilst the Scottish Parliament is becoming more fiscally autonomous, local government has been increasingly constrained and limited in its own fiscal competence and autonomy.

A Fiscal Framework will not, in itself resolve this situation but it can play a role in bringing clarity, certainty and transparency to local government finance and can be used to embed greater fiscal autonomy should the political will be there to do so.

Local Government Finance Today

Local authority finance comprises capital and revenue expenditure¹. **Capital** spending is supported by the Scottish Government's payment to local authorities of a general capital grant, as well as specific ring-fenced capital grants.

Local Authority **revenue** funding is currently comprised of five main elements: General Revenue Grant, Non-Domestic Rates (NDR) income, customer and client receipts, Council Tax and specific revenue grants. Local authorities may also receive funding directly from the UK Government or European Union². The allocation of the General Revenue Grant is based on a complex distribution formula³, which includes population statistics, pupil numbers, and service delivery costs across different locations.

Scottish local authorities raise less than 12% of their own resources through one tax – the Council Tax⁴. This is out of step with many OECD countries, where local taxes contribute to well over a third of local expenditure and where councils have control of multiple local taxes⁵. The Council of Europe has questioned whether this limited fiscal competence is compliant with international obligations under the European Charter of Local Self-Government⁶.

This 'balance of funding' between the Scottish Government and local authorities has changed over the past few decades, with the General Revenue Grant forming an increasingly significant part of local authority finance. In the late 1980s, prior to the introduction of the Community Charge, the balance of funding was an almost 50:50 split between central government funding and locally generated taxes (domestic and non-domestic rates)⁷.

This shift towards central government control has taken place alongside the 2007 introduction of the Concordat, which saw the removal of 60% ring fenced grants – giving local authorities some increased autonomy – but which also saw the introduction of Council Tax freezes lasting until Draft Budget 2017-18, when a 3% Council Tax rise was “permitted”⁸. The Concordat also committed local authorities to delivering some Scottish Government policies, including additional police officers, the Small Business Bonus Scheme, free personal care and carers’ support. Commitments like this have continued to be present in subsequent Local Government Settlements. For example, in 2016/17, local authorities were expected to maintain the Council Tax freeze, maintain a national pupil teacher ratio, and pay the Living Wage to all social care workers.

What’s the problem?

At present, there is no statutory framework underpinning local government finance. The Green Book for Grant Aided Expenditure outlines the method of calculating the General Revenue Grant but the budgeted amounts are in the gift of Parliament and are frequently accompanied, as outlined above by conditions set by Scottish Ministers that constrain local autonomy. The overall context in which the current financing arrangements operate has been characterised by a tendency to situate greater levels of decision-making power and prior knowledge with the Scottish Government, rather than placing local authorities and the Scottish Government on an equal standing.

The current arrangement provides that each draft budget is accompanied by a Local Government Finance Settlement⁹ which is issued to local authorities by the Scottish Government. This details provisional total revenue and capital funding allocations for the period covered by the Draft Budget, and forms the basis for several months of negotiation and possible adjustments. Any local authorities not agreeing to the initial provisional offer made for 2017-18 were told that they would be made a revised offer, which would be ‘inevitably less favourable’¹⁰.

With the General Revenue Grant forming a significant proportion of local authority finance, councils are reliant on reaching a financial agreement in a context in which the Scottish Government has disproportionate power. As noted by the *Commission on Local Tax Reform*, because Council Tax is the only tax under the formal control of local government, councils are limited in their ability to raise additional revenue independently of the Scottish Government. As such:

‘for a particular council to achieve a modest percentage rise in overall spending, a disproportionately large increase in Council Tax would be required – this is known as the “gearing effect.”’¹¹

A recent report for Scottish Green MSPs, *Local Government Debt in Scotland*¹², highlights some of the problems that can arise when local authorities lack options and information in long-term financial decision making.

That local authorities have also been obliged to deliver Scottish Government manifesto commitments as part of their funding allocations – rather than as separate budget lines – further highlights an imbalance of power and constraints this places on local democracy and autonomy.

The Scottish Government has recently sought to address what it views as imbalances of power in its fiscal relationship with the UK Government, by bringing together a definition of Scotland’s funding arrangements and fiscal rules in an updated Fiscal Framework¹³. This accompanies legislation which gives the Scottish Government control over

increasing amounts of revenue generated in Scotland. Devolved and assigned revenue as a percentage of total current revenue has risen from 10% in 1998, to 22% in 2012, to 50.2% once the Scotland Act (2016) powers are in place¹⁴.

An Alternative: Local Government Fiscal Framework

In recent sessions of the Scottish Parliament's Local Government and Communities Committee, discussions have taken place with Audit Scotland about the benefits to long term financial planning of developing a Fiscal Framework between local authorities and the Scottish Government¹⁵.

Scottish Greens agree that reform is needed to the ways in which local authority finance settlements are determined by the Scottish Government, Scottish Parliament and Local Government. A Local Government Fiscal Framework, similar to that which exists between the UK Government and the Scottish Government, would provide clarity, transparency, predictability, sustainability, and autonomy to the fiscal relationship between central and local government.

A Fiscal Framework for Local Government is a legal instrument that governs the financial relationship between central government and local government. It provides a clear statement of the process by which the local government settlement is agreed, the respective responsibilities of both parties, the consequences of decisions made by each party on the other, the degree of latitude and freedom afforded each party and a set of rules governing debt, contingent liabilities, forecasting and reserves.

A fiscal framework would offer local authorities some of the benefits which the Scottish Government has itself experienced through the Fiscal Framework agreed with the UK Government. It would increase local authorities' standing, financial control and accountability for, as well as contribute to, the strengthening of local democracy.

This paper has been published to stimulate discussion in the context of ongoing debate over the future of local democracy and local taxation. Comments are welcome and should be sent to: andy.wightman.msp@parliament.scot

References

- ¹ Revenue funding covers 'day to day' spending on services, salaries and administration. Capital funding is for investment, for example in infrastructure, and is spending which is expected to generate future growth.
- ² Background details of current Local Government Funding arrangements are available via SPICe, *Financial Scrutiny Unit Briefing, Local Government Funding: Provisional Allocations for 2014 – 15* http://www.parliament.scot/ResearchBriefingsAndFactsheets/S4/SB_14-04.pdf
- ³ This formula and the accompanying Green Book on Grant Aided Expenditure for 2016-17 is available: <http://www.gov.scot/Topics/Statistics/18209/2016-17settlement>
- ⁴ NDR income, whilst technically a locally-raised tax, is in practice outside the control of local authorities with the rate, reliefs and all other aspects of design set by the Scottish Government.
- ⁵ Gibb, K. & Christie, L (Policy Scotland), *International Literature Review*, in *Just Change: A New Approach to Local Taxation: volume 3: Compendium of Evidence*, available: <http://localtaxcommission.scot/download-our-final-report/>
- ⁶ See Section 4.2 of the Council of Europe Report on Local and Regional Democracy in the United Kingdom (26-28 May 1998) <https://wcd.coe.int/ViewDoc.jsp?id=887457>
- ⁷ The Commission on Local Tax Reform, (2015), *Just Change: A New Approach to Local Taxation*, p. 10, available: <http://localtaxcommission.scot/download-our-final-report/>
- ⁸ The Scottish Government, (2007), *The Concordat*, available: <http://www.gov.scot/Resource/Doc/923/0054147.pdf>
- ⁹ Local Government Finance Circulars, available: <http://www.gov.scot/Topics/Government/local-government/17999/11203>
- ¹⁰ Local Government and Communities Committee, *Report on the Scottish Government's Draft Budget 2017-18*, 2nd Report, 2017 (Session 5), p. 7, para 29, available: http://www.parliament.scot/S5_Local_Gov/Reports/LGCS052017R02.pdf and *Scottish Government Response 22 December 2016* (see response to para 59 on page 3), available: <http://www.parliament.scot/General%20Documents/20161222SGtoLGCCtteeresponseNosig.pdf>
- ¹¹ The Commission on Local Tax Reform, (2015), *Just Change: A New Approach to Local Taxation*, p. 10, available: <http://localtaxcommission.scot/download-our-final-report/>
- ¹² Watson, A, (2016), *Local Government Debt in Scotland*, available: <https://greens.scot/sites/default/files/Local%20Government%20Debt%20Report.pdf>
- ¹³ This non-legislative document accompanies the Scotland Act (2016), and you can read more about it here: http://www.parliament.scot/ResearchBriefingsAndFactsheets/S5/SB_16-88_The_Fiscal_Framework.pdf

¹⁴ See *Government Expenditure and Revenue Scotland 2015-16*, available <http://www.gov.scot/Resource/0050/00504649.pdf>

¹⁵ See Local Government and Communities Committee Official Report, (14 September 2016) (<http://www.parliament.scot/parliamentarybusiness/report.aspx?r=10524>) and Local Government and Communities Committee Official Report, (14 December 2016) (<http://www.parliament.scot/parliamentarybusiness/report.aspx?r=10697>)