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INQUIRY

In place of centralisation

A devolution deal for London, Greater Manchester, and the West Midlands

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Steering Economic Change

As the UK is buffeted by the economic shocks and challenges of the 2020s, The Economy 2030 Inquiry, a collaboration between the Resolution Foundation and the Centre for Economic Performance at the London School of Economics (LSE), funded by the Nuffield Foundation, is setting out a new economic strategy. To feed into this process we are publishing a series of externally-written policy essays. Each aims to provoke public debate on a specific policy area, and sketch out an agenda that will contribute towards the wider goal of the UK becoming a higher growth, lower inequality economy.

The essays cover topics ranging from the role of smarter regulation in supporting economic growth, ensuring that the goal of 'good jobs' is embedded in our national industrial strategy, and the role of the higher education sector in providing the skills needed to power our services dominated economy.

They are written by a range of leading economists and policy experts, and reflect the views of the authors rather than those of the Resolution Foundation, the LSE or The Economy 2030 Inquiry.

They have been commissioned and edited by Gavin Kelly (Chair of the Resolution Foundation and member of the Economy 2030 steering group) and various members of The 2030 Economic Inquiry team.

The Economy 2030 Inquiry

The Economy 2030 Inquiry is a collaboration between the Resolution Foundation and the Centre for Economic Performance at the London School of Economics, funded by the Nuffield Foundation. The Inquiry's subject matter is the nature, scale, and context for the economic change facing the UK during the 2020s. Its goal is not just to describe the change that Covid-19, Brexit, the Net Zero transition and technology will bring, but to help the country and its policy makers better understand and navigate it against a backdrop of low productivity and high inequality. To achieve these aims the Inquiry is leading a two-year national conversation on the future of the UK economy, bridging rigorous research, public involvement and concrete proposals. The work of the Inquiry will be brought together in a final report in 2023 that will set out a renewed economic strategy for the UK to enable the country to successfully navigate the decade ahead, with proposals to drive strong, sustainable and equitable growth, and significant improvements to people's living standards and well-being.

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Executive Summary

Economic growth is the political priority for the rest of the decade. Without an increase in growth, living standards will not improve, public services will deteriorate, and national goals such as net-zero will be thrown into jeopardy. The past decade has been one of economic stagnation, as short-term shocks such as the Covid-19 pandemic and the energy crisis have combined with persistent problems including low productivity growth, low rates of investment, and difficulties in delivering supply-side reform.

One persistent problem has been the decades of underperformance of the big cities of Manchester, Birmingham, and more recently London. There is no path to greater national prosperity unless the largest local economies in the country meet their full potential.

The centralisation of the British state is at the heart of this problem. At present, taxation in the UK is exceptionally centralised for a country of its size and level of development. Only 5 per cent of the UK's tax revenues in 2019 were collected by local government, compared to 14 per cent in France, 23 per cent in Japan, and 35 per cent in Sweden. Accordingly, local government relies on grant funding, with only 19 per cent of all local spending in the UK funded locally, compared to 37 per cent in the average OECD unitary state. Although recent advances in devolution have begun to unwind this, local government still lacks the resources, powers, and incentives to take full responsibility for changing local economies. This is most clearly seen in England's lack of fiscal devolution, and the funding crisis that has engulfed the local government system after a decade of austerity.

Increasing national economic growth by unwinding centralisation is therefore plausible, but depends on us taking a new approach to devolution in England. The next phase of devolution should be both big enough to make a large improvement, while also being small enough to be easily delivered.

A 'triple deal' for England's three biggest cities

This report sets out what the next phase of devolution needs before 2030 to begin increasing local and national economic growth. These include:

- A 'triple deal' negotiated between the Government and the Mayors of Greater Manchester, the West Midlands, and London as a trio. The deal would go beyond the recent 'trailblazer' deals, and other mayors would be able to opt-into the triple deal at a later date.
- The triple deal would include devolution across the three 'legs of a stool', including: taxation and funding; responsibilities and powers; and governance and geographies.

Fiscal devolution would improve growth without increasing inequality

The core of the triple deal would be fiscal devolution, which previous devolution efforts have struggled to advance. Fiscal devolution would help end the centrally-imposed local government funding crisis for the three cities by widening the local tax base, and reconnecting improvements to resource to improvements in the local economy. In particular, the mayors, boroughs, and Exchequer would benefit from a new revenue-neutral fiscal settlement including:

- a local share of income tax receipts, with Greater Manchester and West Midlands keeping a larger share than London;

- complete retention of business rates, and control over the 'multiplier';
- a single grant to the mayors distributed on a per person basis; and,
- the ability for mayors to reform council tax.

It would then be up to the mayors in negotiation with the boroughs to distribute this revenue across the various responsibilities local government has across their city.

Higher growth in the three triple deal cities – which is likely if fiscal devolution is accompanied by other changes to policy and governance –would then translate into higher local tax revenues for the mayors. By 2038, Greater Manchester could raise between £49 million and £230 million, the West Midlands could raise £40 million and £187 million, and London between £2 million and £27 million beyond their current level of funding from keeping a slice of local income tax receipts and more prosperous local economies. These cities are so large that the success of these cities would strengthen the national economy and therefore increase national tax revenues too, with higher growth in the three triple deal cities meaning between £161 million and £505 million a year of additional receipts for HM Treasury.

These changes would not increase inequality between or within the three cities; instead, fiscal devolution would entail a shift from national redistribution to local redistribution. By removing council tax's regressive nature, the triple deal could see an average of 74 per cent of households – including a majority in every borough – receive an average council tax cut of £637 a year.

The triple deal should transfer responsibilities for planning, transport, and more to the mayors

Alongside fiscal devolution, changes to responsibilities are needed in the triple deal so that the mayors have the power to change their cities' economies. These include:

- planning reform to establish spatial planning at the city level, which merges planning for housing, commercial and industrial property with planning for transport and infrastructure through a new rules-based 'flexible zoning' system;
- giving mayors control of the commuter railway lines and stations in each city, along with the Key Route Network, all A and B roads, and city centre roads in each city; and,
- giving the West Midlands mayor the Police and Crime Commissioner powers that the other mayors have, and giving all mayors powers to govern city centre licensing of the hospitality and night economy, and greater responsibilities for waste management.

These changes would combine the tools the mayors need to improve the affordability, mobility, and productivity of their cities. Alongside the services which benefit from the economies of scale of being delivered at the city scale, mayors will have greater ability and responsibility to improve the local economy.

Devolution will require changes to governance and geography

Absorbing these additional fiscal and policy powers will require changes to governance and geography, so that local voters and central government can trust that the mayoral structures can absorb the greater responsibilities the triple deal will provide.

The triple deal should therefore consider:

- the replacement of First Past the Post elections with either a return to the Supplementary Vote system, or the introduction of an Alternative Vote system for the mayors;
- changes to the Assembly and Board structures to create a directly elected link between local places and scrutiny of the mayor, along with changes to improve representation and leadership in the boroughs; and,
- an agreement to ensure future phases of devolution align the political geography of the mayoralties more closely to their true economic geography.

The triple deal is a stepping stone to local self-government across England

More devolution to the rest of England will be needed in future. But the triple deal outlined in this report provides a stepping stone that can be delivered within a single Parliament, and which will begin improving local and national economic growth once it is in place.

The scale of the growth challenge, our regional inequalities, and our internationally exceptional level of centralisation cannot be addressed without big changes. The key to the next phase of devolution is understanding the importance of fiscal devolution and getting it right; how fiscal devolution connects to other aspects of devolution; and the central role for economic growth in local government reform.

Introduction

The Economy 2030 Inquiry has established that for living standards to improve, the British economy needs more growth. Centralisation has been a barrier to economic change, as local government has lacked the fiscal devolution, the range of powers, and the political structures and geography necessary to take full responsibility for their local economies.

Ending centralisation will be difficult and take time. But a different approach to devolution can deliver changes across all three aspects of devolution before 2030.

The British economy is stuck. Low economic growth is responsible for the recent stagnation in living standards and bleak economic outlook.[1] Although the UK has core economic strengths, the past year has seen external economic constraints and the outlook for the public finances tighten to their most restrictive level in decades.[2]

Some of the problems facing the British economy are the result of recent shocks, such as the Covid-19 pandemic, the energy and cost of living crises, political turmoil, and Brexit. Other problems are more persistent and have festered for decades, including low rates of private and public investment, low productivity levels and growth, and the difficulty our political system faces in delivering hard supply-side reforms.[3]

The underperformance of the big cities outside the capital – particularly Manchester and Birmingham – is one persistent element of this stagnation. Because of both their size (the urban areas of these two cities have a combined population of 5.6 million) – and their a pivotal role in the regional economies, there is no path to better national economic performance unless Manchester and Birmingham meet their full potential.

We have already shown that part of the reason these local economies – and the national economy – perform poorly is Britain's centralised state combined with the vetoes on growth and poor incentives to pursue it possessed by local government.[4] While the British national and local economies have already changed over the past fifty years and must change far more, our institutions of local economic governance have changed far less.

One option to resolve this is to complete centralisation, removing vetoes and local democracy to manage all local economies from Whitehall. Total centralisation would likely be inefficient, politically contentious, and is not guaranteed to improve national economic performance.

The other option is to go further with devolution. England has made progress on devolution in recent years, but the changes have been insufficient relative to the scale of the growth challenges the country faces.[5]

1 Resolution Foundation & Centre for Economic Performance, LSE, Stagnation nation: Navigating a route to a fairer and more prosperous Britain, Resolution Foundation, July 2022.
2 B Nabarro, UK outlook: why we need to do things differently, in IFS Green Budget: October 2022, Institute for Fiscal Studies, October 2022; Bank of England, Financial Policy Committee, Financial Stability Report December 2022, December 2022; OBR, Fiscal risks and sustainability, Office for Budgetary Responsibility CP 870, July 2023; International Monetary Fund , United Kingdom: Staff Report for the 2023 Article IV Consultation, Country Report No. 23/252, July 2023.
3 N Crafts, Adapting Well to New Circumstances? The UK Experience in Changing Times, The Economy 2030 Inquiry, November 2022.
4 A Breach & S Bridgett, Centralisation Nation: Britain's system of local government and its impact on the national economy, The Resolution Foundation, September 2022.
5 This report is England-only, but England's structure of governance drives the lion's share of the UK's centralisation.

Big increases in growth requires big changes, both to the economy and to the institutions that govern them. The built environment, infrastructure, size, skills mix, and productivity of the large cities outside London would have to be very different if their economies are to take on a different and more important national economic role.

The Economy 2030 Inquiry's Centralisation Nation report and the two 'deep dives' into the economies of Manchester and Birmingham both confirm this. The 'Tale of Two Cities' reports were conducted separately to this paper but have informed its analysis and conclusions. They argue that the UK's national economic strategy depends in part on the success of Manchester and Birmingham, and provide a strategy for each city to do this; we summarise their findings in Box 1.

BOX 1: **Greater Manchester and Birmingham Deep Dives**

The 'Tales of Two Cities' reports for the Economy 2030 Inquiry set out to explain the underperformance of the two largest cities in the UK outside the capital and set out a strategy to improve them. [6] The underlying logic is that the two cities are exceptionally important to the national economy due to their size, the role of the UK as a leader in tradable services, and the recent stagnation of the national economy. There is no plausible route to broadly felt national growth so long as some of its largest local economies continue to lag the national average.

The reports identify that there are a number of deficits across investment, capital stock per worker, transport accessibility to the city centre, homes and commercial property, and graduates. They propose that these be tackled with a focus on tradable services, changes to the built environment to improve the density and quantity of floorspace while reducing housing costs, and an increase in the number of graduates of 182,000 in Greater Manchester and 165,000 in the Birmingham urban area would close the productivity gap each city experiences with London to those of Lyon and Toulouse respectively.

Accordingly, tinkering around the edge of the existing devolution settlements or deals will not deliver the increase to local and national economic performance that the country needs. If devolution is to be a driver of national economic growth, then local leadership will be much more important for national prosperity than it is today.

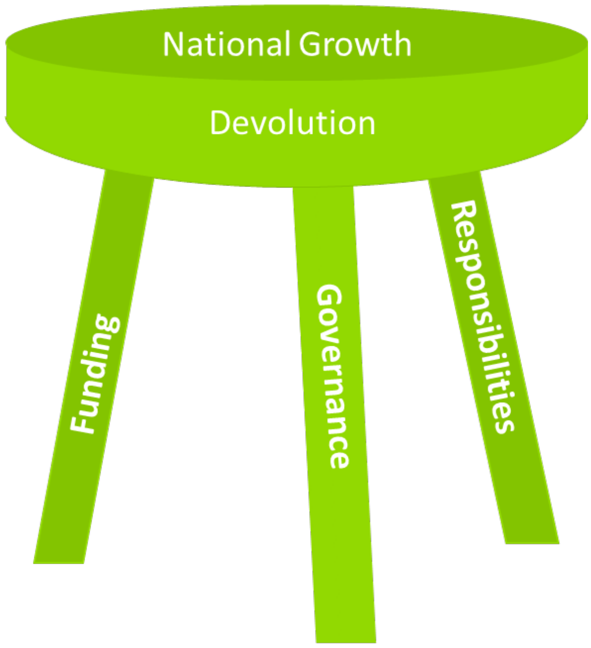
The previous Economy 2030 Inquiry report, Centralisation Nation, established that to make significant progress on devolution, changes to the state at the local level are required across three issues by 2030:

- funding and taxation;
- responsibilities and spending; and,
- governance and geography.

To make an analogy, these policy areas can be thought of as the 'three legs of a stool' of local government reform, as shown in Figure 1.

6 P Brandily et al, A tale of two cities (part 1): A plausible strategy for productivity growth in Birmingham and beyond, Resolution Foundation, September 2023, and: P Brandily et al., A tale of two cities (part 2): A plausible strategy for productivity growth in Greater Manchester and beyond, Resolution Foundation, September 2023.

FIGURE 1: **Devolution requires reform of all three legs of the stool**



Although it might appear daunting, the complementarities between each 'leg' means that fixing all three legs will be easier and deliver greater economic and social benefits than trying to do so one-by-one.

To date, the Government has been pursuing an alternative model of incremental, negotiated reforms with individual places. The devolution deals to establish and enhance the metro mayors have attracted the most attention, but unitarisation of district and county councils has also made quiet progress – for example, Lancashire is now the only two-tier council left in the North of England.

But although this incremental approach has made progress, it cannot deliver comprehensive reform by 2030. The lukewarm reaction to the latest 'County Deals' shows many of the remaining local authorities are uninterested in the reform on offer, and the bespoke deals for the metro mayors have been slow to negotiate and have muddled responsibilities between them.[7] These problems and bottlenecks are a result of devolution not delivering changes across all three 'legs of the stool'.

A different approach to advance devolution before 2030 must therefore do two things that are somewhat in tension. First, it must be bigger and bolder than the current approach. And second, it must also be practical and deliverable. The process has to be able to deliver results in the near future, while demonstrating to politicians and voters the benefits of the proposed reform.

This report sets out how the next phase of English devolution can achieve this. It requires a change to the process and thinking of devolution, and for those places where devolution occurs, reforms across the three 'legs of the stool' – funding and taxation; responsibilities and spending; and geography and governance. The precise details will be decided by negotiations between national government and the places benefitting from devolution, but this report provides the scaffolding for the changes needed in each of the three areas. Of these, funding and taxation – fiscal devolution – is currently the least advanced of the three legs, and is the focus of this report.

7 S Calkin, What part of 'mayor' don't you understand?, Local Government Chronicle, February 2022.

The following four sections will proceed through each of these topics, followed by a conclusion setting out the direction of future reform. Box 2 briefly describes the terminology used to refer to the different political units under consideration.

BOX 2: **Definitions**

City-region authority: the Greater London Authority and the combined authorities are legally distinct types of local government, but this report groups them together as 'city-region authorities.' When referring to London, Greater Manchester and the West Midlands as a group of places, the term 'troika cities' is sometimes used.

Local authorities/boroughs/councils: the local government districts within each city-region authorities are technically either London or metropolitan boroughs. In this report, they are referred to as local authorities, boroughs, or councils.

Local government: this term is used to refer to either to its wider system of local governance, or in cases where there is no need for a distinction between the boroughs and the city-region authorities (e.g. central government dispenses grants to local government).

Mayors: unless otherwise specified, 'mayors' refers to the mayors of London, Greater Manchester, and the West Midlands.

Changing the devolution process

A new approach is needed if the devolution process is to deliver big changes to local government and local economies. The case-by-case approach created the metro mayors, but has struggled to increase local growth, transfer competencies out of Whitehall, or deliver fiscal devolution.

The next phase of devolution should therefore do three things differently. First, it should make clear that its final goal is the self-government of local economies, and devolution proposals should advance towards this goal. Second, the next phase should be a 'triple deal' negotiated jointly with the mayors of London, Greater Manchester, and the West Midlands, so that a common set of competencies are granted to an emerging tier of the state rather than one specific place. Third, to have the best chance of improving local and national growth, the triple deal should include fiscal devolution, devolution of powers, and changes to governance.

Despite the consensus that more devolution in England would be desirable, there is no agreement on what the long-term goal of devolution should be.[8] Partly this is because it has not yet delivered obvious improvements to national or local economic performance.

It is not possible to design a system where there are clear, defined, and distinct responsibilities for local and national government if each place has a bespoke arrangement negotiated with central government, especially in taxation. Without change, there is therefore a risk that England does devolution badly.[9]

All this indicates that alongside the changes to funding and taxation, spending and responsibilities, and governance and geography, the actual process of devolution needs to change too.

Therefore, to deliver devolution before 2030 that can quickly begin to improve local and national economic performance, a new approach to devolution in England is needed. This will require:

- a defined goal for devolution;
- devolution to a tier, not individual places; and
- clear and common responsibilities for devolved government.

The goal of devolution – the self-government of local economies

If devolution is to have the best chance of improving economic performance, local economies need governance structures that align with economic geographies, have the funding and power to make the choices that are right for their places, and are accountable to voters for the decisions they take.

This is a recipe for the self-government of England's local economies. Places will make their own decisions about their own local affairs without permission from Westminster. For their choices to improve economic outcomes, the politicians that they elect to local government and hold accountable need to face strong economic incentives, while also having the responsibility to change their local economies and the ability to provide the services that voters desire.

As Box 3 shows, the evidence on devolution and growth shows that details matter, and exactly how

8 D Turner et al., Why hasn't UK Regional Policy worked? The views of leading practitioners, M-RCBG Associate Working Paper Series No. 216, October 2023.
9 A Breach & S Bridgett, The East Midlands devolution deal will make levelling up more difficult, Centre for Cities, September 2022.

this self-government is achieved will be debated accordingly. But defining the goal of devolution in this way makes clear what is not devolution: proposals for more taskforces, partnerships, boards, commissions, executive or regional agencies, statutory duties, local referendums, public sector relocations, local economic zones and so on, do not advance the self-government of local economies and are not relevant to the devolution debate.

Local self-government is also not a guarantee that every part of the country will be the same or that inequalities will disappear. Different economies are different. But it is a guarantee that places will have both the power to choose their own responses to the economic challenges and opportunities they face, protection from harmful politics and policy originating in Westminster, that local economic success will benefit local government, and that devolution will help ensure national prosperity as each place changes and fulfils its full potential.

BOX 3:**Would devolution be good for growth?**

An earlier Economy 2030 Inquiry report previously showed that there were two plausible approaches for reform of English local government to improve national growth. One option would be to complete centralisation and remove all economic powers from local government; the other would be to deliver the devolution needed for local government to take responsibility for local economies.[10]

At a high level, papers on the relationship between devolution and growth in OECD countries find mixed results – there is no clear evidence that federal or unitary states grow faster, for example.[11] But deeper studies that consider how institutions shape devolution find stronger evidence that (especially fiscal) devolution in England would be good for growth.

Under the 'right conditions' of high quality of governance and low fragmentation of local government, decentralisation is linked to higher productivity.[12] Greater 'coherence' of responsibilities and funding powers of subnational government is linked with higher growth. 'Unfunded mandates', where central government imposes responsibilities on local government without funding to match, appear to be particularly detrimental for growth.[13]

In addition, work that looks to identify the effect of decentralization on economic growth from before the financial crisis tends to report more positive results when the UK, as a high-growth, centralised country is removed from the sample.[14] If the UK is now experiencing stagnation, this perhaps indicates that Britain's growth model previously worked ***despite*** centralisation, and a different settlement is required to address our present stagnation.

This is further supported by the evidence indicating the benefits of fiscal devolution are non-linear.

10 A Breach & S Bridgett, Centralisation Nation: : Britain's system of local government and its impact on the national economy, The Resolution Foundation, September 2022.
11 A Rodríguez-Pose & R Ezcurra, Is fiscal decentralization harmful for economic growth? Evidence from the OECD countries, Journal of Economic Geography, Vol. 11(4), July 2011; T Baskaran & L Feld, Fiscal Decentralization and Economic Growth in OECD Countries: Is There a Relationship?, Public Finance Review, Vol. 41(4), November 2012; N Akai & M Sakata, Fiscal decentralization contributes to economic growth: evidence from state-level cross-section data for the United States, Journal of Urban Economics, Vol. 52(1), July 2002; D Cantarero & P Gonzalez, Fiscal Decentralization and Economic Growth: Evidence from Spanish Regions, Public Budgeting and Finance, Vol. 29(4), December 2009; T Pope, G Dalton & M Coggins, How can devolution deliver regional growth in England?, Institute for Government, May 2023.
12 D Jong et al., A comprehensive approach to understanding urban productivity effects of local governments, OECD, January 2021.
13 H Blöchliger & J Kantorowicz, Fiscal constitutions: An empirical assessment, OECD, July 2015; A Rodríguez-Pose & M Vidal-Bover, Unfunded Mandates and the Economic Impact of Decentralisation. When Finance Does Not Follow Function, Political Studies, November 2022.
14 H Blöchliger & B Égert, Decentralisation and Economic Growth – Part 2: The Impact on Economic Activity, Productivity and Investment, OECD, June 2013.

More decentralization does little to growth in countries that are already decentralized, but in places that are currently centralised, such as the UK, the benefits of allowing more financial devolution are much greater.[15] Altogether, these indicate that fixing England's fragmented, weak, and centralised system of local governance is likely to improve local and national growth.

Devolution to a tier – the 'troika' of Greater London, Greater Manchester, and the West Midlands

If devolution is to advance local self-government in pursuit of growth, then it has to establish a uniform set of responsibilities across a tier of local government.

It is arguably unrealistic, however, to expect these changes to be rolled out across all of England in one go as the scale of the change required is so large. Devolution so far has shown that progress can be made by central government choosing which places can receive greater devolution and a temporary 'head-start' in powers and responsibilities. If successful, their model can then be rolled out to other places across England.

The tension between these two experiences can be resolved in one of two ways. One is central government delivering comprehensive reorganisation across England in one go, despite the difficulties of doing so. The other is to pick a group of cities that can absorb a shared tranche of powers, as a stepping stone to further devolution.

Manchester and Birmingham have to be included in this next phase of devolution. As other Economy 2030 reports have argued, it is not plausible to expect large improvements to national growth from improving local economies unless it addresses the underperformance of the two largest cities outside the capital.[16] The two city-regions also have capacity to absorb more powers due to the strength and legitimacy of their elected mayors across Greater Manchester and the West Midlands.

For example, they have greater capacity to absorb fiscal devolution, as their mayors are well-known to the public, and their geographies contain a mix of affluent and poor neighbourhoods across the same local economy. Other cities lack these advantages. The same logic has underpinned the recent 'Trailblazer' deals agreed by the combined authorities earlier this year and described in Box 4.

BOX 4: **The Trailblazer Deals**

The Levelling Up White Paper in February 2022 announced that the Government would negotiate with the mayors of both Greater Manchester and the West Midlands to establish 'trailblazer deals', that would act as a 'blueprint' for other mayoral combined authorities.[17] The deals were agreed and published in the March 2023 Budget.

The deals mark a step in the transfer of responsibilities from Whitehall. The most significant is the creation of a 'single settlement' to replace the disparate grants received by local government

15 J Kim & S Dougherty, Fiscal Decentralisation and Inclusive Growth, OECD, July 2018; H Blöchliger & B Égert, Decentralisation and Economic Growth – Part 2: The Impact on Economic Activity, Productivity and Investment, OECD, June 2013; P McCann, The Fiscal Implications of 'Levelling Up' and UK Governance Devolution, The Productivity Institute, Paper No. 008, 2022.
16 For more detail, see the previous two Economy 2030 reports: P Brandily et al, A tale of two cities (part 1): A plausible strategy for productivity growth in Birmingham and beyond, Resolution Foundation, September 2023, and: P Brandily et al., A tale of two cities (part 2): A plausible strategy for productivity growth in Greater Manchester and beyond, Resolution Foundation, September 2023.
17 HM Government, Levelling Up – Levelling Up the United Kingdom, CP 604, February 2022.

in each city, amounting to £736 million in Greater Manchester's case and £704 million in the West Midlands.

The single settlement unlocks greater responsibilities for the mayors; it means they get to decide local priorities and allocate funding accordingly, instead of priorities being decided by Whitehall, with greater autonomy over housing and regeneration, net zero, and transport spending. This single settlement will be agreed in the Spending Review, giving certainty to the mayors about their funding stream. But one drawback is that there is no fiscal devolution beyond the current business rates retention schemes.

The changes also see the mayors take on a broader range of powers around skills policy, including post-16 and post-19 education, and a new partnership with the forthcoming Great British Railways to enable integrated ticketing. However, apprenticeship funding is not devolved, and neither mayor will secure operational control over any heavy rail lines.

Although broadly similar, there are small differences between the deals: West Midlands has a greater role for energy planning, a licensing framework for micro mobility, and a commitment to work with the Department of Digital, Culture, Media, and Sport to develop tourism to the city-region.

London should also be included in the next phase of devolution. Despite its high level of performance, the capital faces economic problems of its own, with consequences for the rest of the country. London's rate of growth has been poor since the financial crisis, accounting for about 42 per cent of the national productivity slowdown between 2007 and 2019.[18] Although London has relatively advanced devolution with a strong statutory basis compared to other cities in the UK, there has been little change since the original settlement agreed before the turn of the millennium. London is overdue an advance in its powers and responsibilities, especially if the biggest cities outside the capital are to receive a big change to their mandate.

Therefore, if national government does not yet wish to reorganise local government, it should negotiate the next round of devolution as a 'triple deal' with the mayors of Greater Manchester, the West Midlands and London. Rather than speaking with the mayors as leaders of individual places, having all three mayors in the room as a 'troika' will mean negotiations are with an emerging tier of the state – one that matches the three most important local economies in the country – and the common powers and duties it should possess.

The three mayors will need to negotiate among themselves to decide what they want from the triple deal and negotiate with their cities' boroughs too. As revenue neutrality and fiscal devolution are such an important part of any successful advance in devolution, the mayors should build on the 'single settlements' negotiated in the Trailblazer Deals and negotiate the triple deal directly with HM Treasury. This will make it easier to deliver change across Whitehall. The result of the negotiations will then need to flow into changes in primary legislation, like the various London Government Acts.

But starting with only three mayors does not mean that the next step in devolution will be small-scale. Greater London, Greater Manchester, and the West Midlands contain 26 per cent of England's population, 30 per cent of its jobs, and 36 per cent of its economic output.[19] They have the authorities with the most advanced capacity and powers, and all three have viable economic geographies.[20]

18 G Rodrigues & S Bridgett, Capital losses: The role of London in the UK's productivity puzzle, Centre for Cities, March 2023
19 Based on analysis of: Census 2021; BRES, 2021; ONS GVA estimates, 2019.
20 As discussed in Section 5, the report argues that the triple deal should be offered to most of the other metro mayors once it has been agreed. Some metro mayoralties – notably the West of England, Cambridgeshire and Peterborough, and the forthcoming D2N2/East

Clear responsibilities – local taxation, the local economy, and stronger accountability

The triple deal should advance devolution to London, Greater Manchester, and the West Midlands across the three legs of the stool - funding and taxation; responsibilities and spending; and governance and geography.

By reforming across all three areas, devolution can advance local self-government for the most important economies in England with three major expectations.

- First, more resource, powers, and incentives for the three mayors to pursue local growth mean their local economies and the national economy can be reasonably expected to improve. As their new powers will be connected to greater responsibility over local services, local service provision can reasonably be expected to improve too.
- Second, the reforms are a stepping stone to devolution elsewhere. Even though these reforms will not fix everything and initially apply only to three specific places, they are scalable. Rolling out the triple deal to the other city-region metro mayors, which now cover roughly half of England's population, will be easier than the process of negotiating individual devolution deals and unitarizations because the framework for further reform will have already been established.

Even if this occurs, the project of self-government for all of England's local economies will be left incomplete by the triple deal, even if the other mayors take it up. Some aspects of centralisation – and local economic policy – cannot be fixed until the entirety of English local government is reformed and reorganised.

- Third, the current fiscal constraints upon both central government mean that these reforms should be expected to be delivered at minimal cost to the Exchequer. The current crisis in the local funding system may require additional resource from central government, but the amount of funding is a separate political decision to the issue of designing a new funding system. In a broad sense too, a shift towards local self-government for the country's most important local economies cannot reasonably be expected to entail greater outlays for central government to have any chance of implementation. If the mayors decide to make different choices about spending or redistribution to national government then they should be free to do so, but this should not be financed by central government.

Getting fiscal devolution right will be the biggest challenge of the triple deal and is the focus of the next chapter.

Midlands authority – have political geographies that are substantially misaligned from their underlying economic geographies. The triple deal should not be offered to these places until this is corrected, as it cannot be guaranteed that there will be large improvements to economic governance without worsening inequality.

Fiscal devolution

English local government currently has a tax base that is small, narrow, and does nothing to encourage growth. Councils receive few rewards for improving the prosperity of their area, and their local tax base is regressive and unpopular.

Even though it is challenging, any serious move to drive growth through greater local self-government needs to entail more powers for local government to set and collect taxes, as linking local revenues to local economic success rewards mayors for changing their local economies.

There are two distinct problems with the design of the current system. First, the central control of council tax disconnects it from the local economy and is why council tax is so regressive. Second, the lack of fiscal devolution means local government is funded through a tangled system of redistributing funds between councils using business rates and central grant.

Overcoming these problems with funding system can be delivered by letting the mayors retain a share of income tax receipts generated locally, with Greater Manchester and West Midlands retaining more than London; retain all business rates revenue and have control over its multiplier; have all their city's grants from Whitehall consolidated into a smaller single settlement distributed per head of population; and devolving council tax to reconnect it to the local economy and allowing mayors, if they choose, to give tax cuts to a large majority of households in every borough.

This approach to fiscal devolution can be done in a way that does not increase central government spending and preserves the finances available to the three mayors and the boroughs in the first year. Over the decade through to 2038, it would reward the mayors and HM Treasury for achieving higher growth with higher income tax revenues. It entails a shift from the funding settlement being imposed on borough councils by the Secretary of State to being agreed in negotiation between the boroughs and the mayor.

Fiscal centralisation is harmful, yet difficult to reform

Fiscal devolution is the first leg of the stool and at this stage the most important priority for devolution. If there is to be a stronger connection between improvements to the local economy and local resource, then the design of the funding system for local government has to change. Centralisation of funding weakens this connection, and accordingly reduces the rewards local leaders get for pursuing growth and leaves local government vulnerable to central austerity.

At present, taxation in the UK is exceptionally centralised for a country of its size and level of development. Only 5 per cent of the UK's tax revenues in 2019 were collected by local government – compared to 14 per cent in France, 23 per cent in Japan, and 35 per cent in Sweden – and for those the UK is uniquely reliant on property taxes, which provide 99 per cent of local tax revenues.[21] Accordingly, local government relies on grant funding – 19 per cent of all local spending in the UK was funded locally, compared to 37 per cent in the average OECD unitary state, and despite political devolution, fiscal centralisation has deepened since 2015.[22] From the economic divides across England, it

21 OECD, Revenue Statistics - Comparative tables: Tax revenues of sub-sectors of general government as % of total tax revenue. Local government collected 10 to 11 per cent of the UK's tax revenues before 1988, which saw the nationalisation of business rates, the rise and fall of the poll tax, and the latter's replacement by council tax.
22 A Breach & S Bridgett, Centralisation Nation: Britain's system of local government and its impact on the national economy, The Resolution Foundation, September 2022.

therefore follows that fiscal centralisation does not necessarily reduce inequality, even as it prevents local governments from keeping the rewards of local economic success.

Yet a chicken-and-egg problem has emerged in that advancing fiscal devolution when spatial inequality is already stark does risk greater inequality, if it means already-affluent areas are able to dramatically cut taxes while poorer areas are forced to either sharply increase taxes or cut spending further. Local government austerity over recent years has sharpened this problem, as the gap between the current funding available to a local authority and the true level of need for local services is likely to be very large.

There are, though, two separate problems to consider. The first is the lack of resource in the local funding system, and second is the design of that funding system. The design of the funding system has reduced the amount of resource available to English local government. Centralisation has brought the system to the brink of insolvency due to the restrictions central government has imposed on local taxation, combined with its cuts to the grant funding that local government relies upon.

But solving the funding problem simply by increasing the amount of resource, for example with more grant or higher council tax bills, would not solve the problems in the design of the funding system.

Council tax revenues are not 'buoyant', as they do not rise when an area becomes more affluent; business rates revenues are largely outside the control of local authorities; and grants provide a powerful disincentive against growth by being withdrawn as a place becomes more prosperous. These problems – all a result of the centralisation of local funding – need to change if the mayors are to take on greater responsibilities to pursue growth, as they need a stronger connection between local resource and improvements to the local economy to use their new powers to change the national economy.

Any serious proposal to boost national economic growth by increasing local self-government must therefore unwind fiscal centralisation, but without disadvantaging particular places. For the triple deal, this need to avoid worsening inequality limits the amount of fiscal devolution that can be introduced due to Greater Manchester and the West Midlands' relative underperformance – more flexibility and stronger incentives have to be balanced with reformed national redistribution.

There are also challenges beneath the surface. The public finances cannot be imperilled at either a local or a national level by fiscal devolution and a change to the funding system. And greater buoyancy means that councils would be more exposed to both the upside of economic growth but also the downside of recessions.

Proposing fiscal devolution for the troika cities first is a recognition of how difficult the challenge is. Other metro mayors may find it straightforward to 'opt-in' to the triple deal, but the complexity of local government in the rest of England and the need to avoid worsening inequality would make it challenging to extend fiscal devolution to the rest of the country, especially choices around grant funding.

Box 5 indicates that some of these problems in local government finance have remained stuck for centuries, and we cannot reasonably expect a single reform or one new tax to be introduced to solve all of them in one go. Reform today will have to deliver significant change across multiple parts of the funding settlement, without being too ambitious and falling into the pitfalls that have scuppered previous efforts.

In the rest of this section, we first set out the principles that should guide fiscal devolution in general. We then propose one possible funding model for the triple deal, before discussing the changes to council tax, business rates, grants, and income tax that such a model would require.

BOX 5: **A history of English local government finance reform**

English local government finance has been a political and policy issue for hundreds of years. Modern local government finance is traditionally dated to begin with the Poor Relief Law 1601 under Elizabeth I, which obliged parishes to levy a Poor Rate on property owners according to the rental value of the property.

Despite their name and some critical commentary, the Poor Laws provided generous welfare by historical and international standards, showing how local control of taxation – the rates – can enable high levels of redistribution within places.[23] The Poor Laws became less generous with the creation of the Victorian workhouse under the New Poor Law of 1834, following the Great Reform Act 1832 and the expansion of the franchise from the gentry to property owning ratepayers but not the working classes.

Throughout the 20th century both the rates and proposals to reform them remained controversial. The 1901 Royal Commission on Local Taxation failed to reach an agreement on reform.[24] Lloyd George's 1914 attempt to reform local government finance (including a shift towards separate rates for land and improvements, and valuations based on capital rather than rents) following the Kempe Report collapsed due to disagreement in Cabinet.[25]

The interaction of local taxation with the mismatch between political and economic geography has remained a persistent problem. After the First World War and the expansion of the vote to the working class, the Poplar Rates Rebellion of 1921 led by George Lansbury saw East End councillors imprisoned after setting illegal budgets, in protest at the unequal burdens of the rates between rich and poor boroughs within London.

Growing demand for public services with the expansion of suffrage saw the Local Government Act 1929 abolish the Poor Laws and transfer certain responsibilities for rating and services from the boroughs and towards the county councils. Most of these services were still financed locally. Of the £606.6 million spent by local government in England and Wales in 1929, £481.2 million (79 per cent) was financed by local funds, but central government grants had started to increase – rising from 12 per cent of local authority income in 1913 to 27 per cent by 1939.[26]

The postwar period then saw attempts to rationalise local government. The law on rating was consolidated from hundreds of years of case law and statute into the General Rate Act 1967.[27] This was followed in 1969 with the Redcliffe-Maud Report's proposal to overhaul the system of local government boundaries and responsibilities with a new map of single tier councils

23 B Waddel, The Rise of the Parish Welfare State in England, c. 1600–1800*, Past & Present, Vol. 253(1), November 2021; L Bonfield et. al, The World We Have Gained: Histories of Population and Social Structure, Wiley–Blackwell, 1986; D Thomson, The Decline of Social Welfare: Falling State Support for the Elderly since Early Victorian Times, Ageing & Society, Vol. 4(4), December 1984.
24 C Sanger, The Report of the Local Taxation Commission, The Economic Journal, Vol. 11(43), September 1901.
25 B Murray, "Battered and Shattered": Lloyd George and the 1914 Budget Fiasco, Albion: A Quarterly Journal Concerned with British Studies, Vol. 23(3), 1991.
26 T Burgess & T Travers, Ten Billion Pounds: Whitehall's Takeover of the Town Halls, Grant McIntyre, 1980.
27 D Kolinsky QC (2018), A Short History of Rates 1601-2015, Landmark Chambers

matching economic geography across England.[28] Ultimately this was unsuccessful and the Local Government Act 1972 established a two-tier system instead.

However, the underlying tax base of local finance was not reformed during this period, even though it was starting to come under serious pressure. Demand for local services in an expanding welfare state was continuing to grow, just as the delays to revalue property at postwar rental values in a period of rent control and high inflation were making it harder for the rates to raise revenue. As a result, central government grants began to spiral out of control. Grants rose from 37 per cent of local authority income in 1966 to 50 per cent by 1976.[29]

The problem was that the rates were increasingly seen as an unfair and regressive tax, especially by households that consumed few local services and those who were 'asset rich and cash poor', even though they were the only major tax that local authorities possessed. The revaluations in 1963 and 1973 were politically explosive as rating bills increased overnight for half of households, during a period of rising inflation.

The 1976 Layfield Report on Local Government Finance argued this state of affairs was unsustainable, and the only approach that could protect local self-government was the introduction of a local income tax with council control of several pennies in the pound.[30] This was not implemented, and the local finance system remained unreformed and narrowly based on property.

The Thatcher Government then saw a period of tense conflict between central and local government, culminating in unprecedented centralisation. Central government cuts to grant and the cancellation of the 1980s' scheduled revaluation in England ran headlong into Labour's rapid electoral advances in local government, particularly within the big cities, who then increased rates to absorb central cuts. The Greater London Council (GLC) under Ken Livingstone and other 'hard left' Labour boroughs escalated the confrontation with central government, resisting HM Treasury pressure to reduce local 'overspending'.

The Rates Act 1984 was the first time that central government gave itself the power to 'cap' the rates of 'overspending' councils, in turn prompting the 'rate-capping rebellion' as a minority of hard left councils attempted to set illegal budgets in defiance of the Rates Act. Alongside the Local Government Act 1985, which abolished the GLC and metropolitan county councils, the defeat of the rate-capping rebellion defanged opposition from English local government. However, the controversy of the Scottish rates revaluation in 1984-85 convinced the Thatcher Government that more needed to be done.[31]

Their solution was the poll tax and the abolition of rates for domestic property in the Local Government Finance Act 1988. Although the poll tax was deeply unpopular and had collapsed by 1991, the 1988 Act also introduced capping of all local government taxation and nationalised non-domestic (business) rates and their multiplier, both of which have been retained to this day. As a result, while the share of all taxation raised by local government in the UK was 10-11 per cent from 1973 to 1988, after 1988 it dropped to 4-5 per cent, where it has stayed ever since.[32]

Council tax was introduced by the Local Government Finance Act 1992 with little controversy due to its then-progressive structure compared to the poll tax. High council tax increases after

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28 The Royal Commission on Local Government in England, HMSO, 1969.
29 T Burgess & T Travers, Ten Billion Pounds: Whitehall's Takeover of the Town Halls, Grant McIntyre, 1980.
30 Local Government Finance: Report of the Committee of Enquiry Cmnd 6453, 1976.
31 D Butler, A Adonis & T Travers, Failure in British Government: The Politics of the Poll Tax, OUP, 1994
32 OECD, Revenue Statistics - Comparative tables: Tax revenues of sub-sectors of general government as % of total tax revenue.

this period failed however to counteract the growing importance of central government grant, which accounted for 76 per cent of council spending in England by 2009.[33]

Various proposals under New Labour and the Coalition Government, such as the Balance of Funding Review, the Lyons Review, and the London Finance Commission all recommend fiscal devolution to reverse this trend, but no serious reform of local finance was delivered, with the notable exception of business rates retention.

Austerity imposed on local government since 2010 has reduced the importance of grant to provide 51 per cent of council resource in England.[34] However, the cuts combined with a reassertion of capping of council tax and the growing importance of the statutory responsibility to provide social care, have desiccated local government resource. A wave of Section 114 notices – council bankruptcies – began with Northamptonshire County Council in 2018, culminating in the recent Section 114 notice issued by Birmingham City Council in August 2023.

Centralisation of local government funding has not delivered progressive outcomes or growth. Rather, the failure to reform outdated and unpopular local taxes and structures has led to regressive outcomes and damaged incentives for councils to pursue growth. Grant funding may temporarily paper over these problems, but at financial cost to the Exchequer and political cost to local self-government.

Principles of fiscal devolution

When negotiating the triple deal, the Government and the metro mayors will first need to establish clear principles for fiscal devolution to ensure the new funding system prioritises growth and continues to maintain an element of fairness.

Some of these trade-offs include:

- the amount and distribution of funding in any new system;
- redistribution between and within local economies;
- the balance between the allocation of revenues and autonomy over the tax base and rates;
- identifying which taxes are suitable for fiscal devolution.

These are discussed below.

Revenue neutrality for HM Treasury and the mayors

As previously mentioned, our proposals aim for revenue neutrality for the metro mayors, central government, and – in terms of council tax receipts – local authorities.[35]

We have done this for three reasons. First, if the mayors do increase local economic growth, then revenue neutrality guarantees that in the long-run the triple deal will be revenue-positive for the

33 D Innes & G Tetlow, Central cuts, local decision-making: changes in local government spending and revenues in England, 2009-10 to 2014-15, Institute for Fiscal Studies, March 2015.
34 DHLUC, Local authority revenue expenditure and financing: 2023-24 budget, England, 2023. These differ from the reference in footnote 22 as the OECD data for subnational revenue and spending includes some funding streams for which British local government is just a delivery vehicle for such as housing benefit – other countries are treated similarly.
35 As the estimates in this report combine many different data sources and the final settlement will be agreed in the negotiations between the troika and the government, only high-level estimates on total revenue can be provided. Reflecting this, the report therefore defines revenue neutrality in the triple deal as no city losing more than 5 per cent of its current budget, and central government not spending more than £500m a year more at present – any final small deficits which remain after the deal is agreed can be absorbed by the increased funding flexibility each city will possess.

mayors and central government.

Second, it demonstrates that fiscal devolution and changes to the design of the local funding system can be done without additional fiscal commitments or disadvantaging any particular place. If the central Government, the mayors, or local authorities wish to change their assessments of local need and fund their responses with higher or lower levels of taxation, then they remain free to do so.

And third, revenue neutrality makes clear the distributional consequences of fiscal devolution given the need to increase resource in the English local funding system.

Most local authorities across England must find more revenue to close the gap between their funds and their obligation to provide a minimum set of statutory services. Central capping of council tax increases plus cuts to central government grants had already created an austere environment, but the recent burst of high inflation has created a much more severe gap than previously expected. After a steady trickle of local authority bankruptcies since 2017, including Birmingham earlier this year, 30 per cent of urban local authorities are now considering issuing a Section 114 notice within the next year.[36]

This report makes no judgement on whether current proposals to close this gap are sufficient or what the mix should be between grant and higher local taxes. But by assuming revenue neutrality, this report is able to show which households see their local taxes (i.e. council tax) rise or fall when the design of the funding system is changed through fiscal devolution, separate to any increases to local taxes that are introduced to close the funding gap.

By assuming revenue neutrality, the report implicitly retains the political choices contained in the 2013 Local Government Finance Settlement, and how the 1991 Council Tax valuations determined 'relative need' between places.[37] These choices can be reviewed whether or not fiscal devolution goes ahead.

More redistribution within places and less redistribution between places

National government in England currently redistributes income across the country in a variety of ways. It does so through the national tax system and welfare state, as well as higher levels of public sector employment in poorer areas, and this is incontestably legitimate. But central government also redistributes across geography through the control it exercises over the funding system for local government. Grant and the 'competitive pots' are the most obvious examples of this, but even council tax and business rates – nominally local taxes – are ultimately decided in Whitehall.

Local self-government is harmed by this central control over local funding. Neither councils nor mayors have much power to differ from the Secretary of State on questions of local taxation or local redistribution. In the case of council tax for instance, local authorities are forced to levy a regressive tax.

A shift towards fiscal devolution would change this. But as so much national redistribution between local authorities flows into services for low-income or vulnerable people, fiscal devolution risks deepening inequality between individuals even if inequality across geography declines. This risk is particularly acute if the local funding system is not reformed and remains regressive.

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36 https://www.sigoma.gov.uk/news/2023/one-in-ten-sigoma-councils-facing-section-114-notice
37 For a summary and history of the emergence of this settlement, see DCLG, Fair funding review: a review of relative needs and resources - Technical consultation on relative need, December 2017.

To compensate for this, less national redistribution must be paired with more local redistribution. This does not mean that the total amount of redistribution would decline. It also does not imply any changes to national taxation or the welfare state.

Rather, it means fiscal devolution – reduced central control over the local funding system – should be paired with a less regressive local tax system. Different places will choose different degrees of local redistribution, but less national redistribution will only be fair if greater local redistribution from affluent to poorer neighbourhoods is possible. Central government will still redistribute between places, but it should use its own resources to do so, not those revenues raised by local authorities, and should be done with minimal disruption to the affairs of local government. If local government is to take on more responsibilities and more autonomy, then local taxes need to stay local.

In return, fiscal devolution can only be to structures where political geography and economic geography align. Across most of England, this will require larger local authorities than currently exist. On average, the smaller that local authorities are, the greater the variation in local affluence and need.

Therefore, local authorities that are fragmented across local economies – as is the case across much of England, especially outside the big cities – would be less able to absorb fiscal devolution: they would be less able to deliver local redistribution between their local economy's affluent and poorer neighbourhoods.

This means that, if political and economic geography are not aligned, then inequitable displacement becomes a real risk from fiscal devolution. Although local properties will not move and continue to be taxed, households and firms will, if access to the same local economy can be achieved from a lower-tax and more affluent jurisdiction. The experience of American cities – where advanced fiscal devolution plus highly fragmented local governance deepens segregation within local economies – must be avoided.[38]

Tax autonomy and tax sharing are both needed

There are broadly two ways in which taxes can be introduced into the funding framework for local government: either by receiving a share of revenues from national taxation or by granting local government the autonomy to vary the rates and bands of local taxes.[39] Both are common around the world in other unitary states: Japan and Finland both give local government lots of autonomy to vary local income taxes, while the Czech Republic and Poland share national income taxes with municipalities.[40]

The two approaches present a trade-off for policymakers that mirror the debates about fiscal devolution and centralisation. While tax sharing of national revenues helps reduce inequities in funding between places, it also limits local self-government and blunts incentives to grow the economy. If places are not able to decide how much funding they want to raise, then control over local services and the financing they receive is ultimately exercised by Whitehall. Conceptually, tax sharing functions in a similar manner to centralised grant funding for this reason.[41]

38 Y Freemark et al., Varieties of Urbanism: A Comparative View of Inequality and the Dual Dimensions of Metropolitan Fragmentation, Politics & Society, Vol. 48 Issue 2, 2020, pp. 235-274.
39 T Burgess and T Travers, Ten Billion Pounds: Whitehall's Takeover of the Town Halls, Grant McIntyre, 1980
40 OECD, Tax Autonomy Indicators: Explanatory Annex, 2021
41 Local Government Finance: Report of the Committee of Enquiry Cmnd 6453, HMSO, 1976; J Kim, J Lotz & H Blöchliger, Measuring Fiscal Decentralisation, OECD, January 2013; E Slack, International Comparison of Global City Financing, London Finance Commission,

Halfway houses exist that combine the good and the bad of both approaches. For example, business rates are currently both 'shared' and 'autonomous', as the multiplier and redistribution of revenues is controlled by central government, but a share of local revenues is retained. These hybrids reduce the risk of a 'race to the bottom' in tax rates and provide some economic incentives; but they are complex, give local government limited control over funding and taxation, and muddle national and local responsibilities. These trade-offs will be sensitive to the exact design of any form of compromise approach, but cannot be eliminated.

In practice, this means that neither tax sharing nor tax autonomy alone will be enough. Tax sharing is a promising approach to reduce the complexity of the grant system, but it will only have a small impact on economic incentives and growth unless paired with more local control over taxation. Income tax is a strong candidate for tax sharing due to its national role.

Property and income taxes are most suitable for fiscal devolution

Different taxes are more and less suitable for use by local government, and proposals to advance fiscal devolution should be clear about the criteria determining plausible candidates for devolution. Our view is that local taxes and the funding system overall should have, or be:

- Fair and progressive. Earlier approaches to local taxation in Great Britain – namely the rates and the poll tax – were under constant political pressure and eventually abolished because they were regressive.[42] The controversy surrounding them damaged local government's ability to rely on them as a source of revenue, and over time induced a dependence on grant and thereby fiscal centralisation.[43]
- Buoyancy of revenues. Taxes that are buoyant have revenues that grow as economic activity or prices increase. Taxes that are not – such as council tax – need politicians to choose to increase the levies to raise additional revenues. Buoyant taxes therefore provide strong incentives for councils to pursue economic growth, while non-buoyant taxes are associated with lower receipts over the long term.
- Local and universal, but not too mobile. Taxes such as corporation tax and fuel duty are often devolved in federal countries, but in a geographically small country like the UK are likely to induce significant tax arbitrage.
- Simple to collect. Taxes that are hard to collect are unsuitable as local resources for collection are limited, and the triple deal cannot impose significant burdens on residents or businesses. Even aside from the risk of tax arbitrage, proposals such as a local sales tax would be complex to administer when levied in addition to VAT, especially when the rest of the UK economy will not be paying such a tax.
- Sizable and predictable revenues. Proposals for tourist taxes, second-home taxes, Air Passenger Duty etc. are common, but are unable to raise substantial amounts of revenue. Stamp duty and taxes on capital gains are volatile and make it hard to prudently finance local services.
- Accountability for local voters. If voters are to exercise scrutiny of local leaders and ensure local government achieves value for money with local revenues, then direct taxation of households needs to be part of the tax mix to enforce hard budget constraints. As national insurance contributions are linked to employers and therefore commuters from outside the political

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October 2016.
42 D Butler, A Adonis & T Travers, Failure in British Government: The Politics of the Poll Tax, OUP, 1994.
43 T Burgess & T Travers, Ten Billion Pounds: Whitehall's Takeover of the Town Halls, Grant McIntyre, 1980.

geography of cities, they would break the link between local tax bills and local elections. Similarly, taxes such as duties are not ideal for devolution as the level of taxation is not clear to voters.

The obvious candidates for local taxation that meet these criteria are local residential and commercial property taxes and income taxes. Additional tax powers – such as a tourist tax – that go beyond the report's recommendations are not necessarily unwise, but will not deliver fiscal devolution without reform of these three core taxes.

A new revenue-neutral funding model

Having established the principles of fiscal devolution, the HM Treasury and the mayors will have to reach agreement on two distinct issues. The first is how policy should change to deliver a new funding model, and the second is what the mixes between grant and local taxation should be for the mayor and the borough. This report proposes a set of policy changes that would create a new funding model, but the funding mix between local taxation and the size of the grant for each city would in practice be for the mayors and HM Treasury to negotiate.

The funding mix will change for the boroughs too. Each place will need to agree a new internal funding settlement to support local services. Unlike the current funding settlement that is imposed by the Secretary of State upon all councils, the boroughs would negotiate with the mayors and each other to jointly determine the distribution of resources across the place to meet local need.

As the new funding model is complex and its components depend on each other, we described in its entirety below, including a suggested funding mix, before the individual choices that establish it are explained and justified.

In particular, we suggest that the triple deal can significantly advance fiscal devolution by:

- allocating a share of each city-region's income tax revenues to the mayor. To correct for both loss of funding from grant, the business rates system, and their historic underperformance, Greater Manchester and West Midlands should receive a significantly greater share of local income tax than London, providing them with stronger incentives to pursue future growth;
- replacing all the grants that councils and the mayors receive from Whitehall with a grant for each mayor, distributed on a per head of population basis;
- granting the mayors complete control over business rates revenues and the multiplier in their city-regions; and,
- revaluing council tax, adding more bands, and allowing local authorities and mayors to set percentage tax rates for each band no higher than the current highest tax rate.

In effect, this entails a 'single settlement' for the mayors that is more comprehensive but less generous than what they receive at present, but with revenue shortfall made up for by full retention of business rates, a share of local income tax revenues, in addition to greater flexibility to set council tax bills.

One possible funding mix – which we shall refer to as Funding Mix A, and is the basis for the estimates in the rest of the report – is shown in Figure 2. This includes all of the funding received by the mayor and the boroughs (excluding sales, fees, and charges), with changes to the budgets of each authority balanced by internal funding settlements agreed between the mayor and boroughs.

FIGURE 2: Fiscal devolution could allow a new funding mix for each of the troika cities and their boroughs
A possible local government finance settlement for the triple deal: 'Funding Mix A', 2022-23

SOURCE: Analysis of: DHLUC 2023, Business rates revaluation adjustment top-up and tariff calculator, Council Tax levels set by local authorities in England 2023 to 2024 Table 3, National Non-Domestic Rates Returns NNDR1 Tables, Revenue Account Outrun Returns; GLA 2023, Statement of Accounts; GMCA 2023, Statement of Accounts; HM Land Registry 2022, Price Paid Data; ONS 2018, Admin-based income statistics, England and Wales: tax year ending 2018 - Gross individual income by Local Authority (LA); ONS 2023, Country and regional public sector finances revenue tables; WMCA 2023, Statement of Accounts; WMCPP 2023, Statement of Accounts; WMFS 2023, Statement of Accounts; VOA 2023, Council Tax Stock of Properties Tables CTSOP1.0

In the scenario in Figure 2, the central assumptions are:

- The grant for every mayoralty is cut to £200 per person (this would be a fall from £480 per person in Greater Manchester, from £569 in the West Midlands, and £693 in London); it would mean a £567 million grant for Greater Manchester, £585 million for the West Midlands, and £1.8 billion for London.
- To fill most of the gap for London, there would be complete retention of business rates receipts without any changes to bills, and greater flexibility over council tax without any changes to total revenues.
- To fill the gap for Greater Manchester and West Midlands, they would retain a 20 per cent share of all income tax receipts levied locally (raising £1.45 billion and £1.35 billion, respectively); London would retain a smaller share of 1.5 per cent (raising £680 million).

Local government in Greater Manchester would see their total funding increase by 16 per cent to £3.1 billion;[44] in the West Midlands total funding would decrease by 2 per cent to £3 billion; and London would see funding drop by 3 per cent to £10.3 billion. In total this would cost central government £15 million in the first year.

44 Greater Manchester would see an increase in funding in every model as it currently receives a relatively low level of grant due to the city's business rates retention deal which saw it waive the public health grant. This is an example of how the case-by-case approach to devolution has made further devolution more difficult, and shows why it is particularly unsuitable for advancing fiscal devolution.

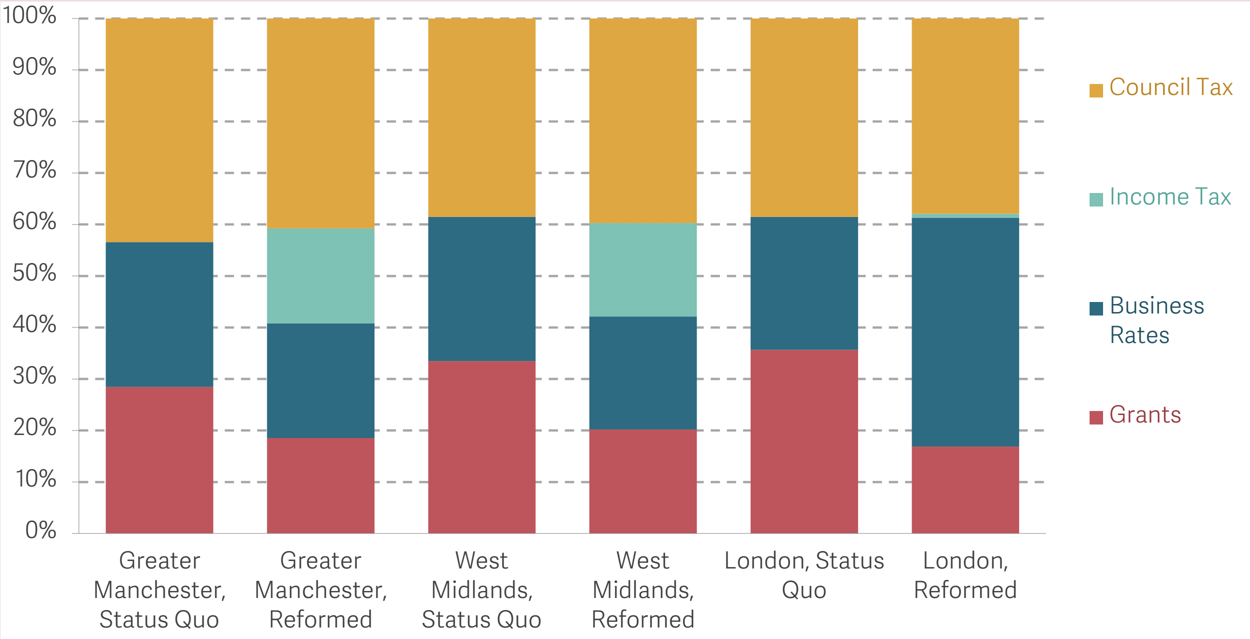
To keep the report simple, these assumptions are sustained throughout the report, but obviously this funding mix is up for negotiation. To show just how flexible the new model can be, an alternative funding mix with less fiscal devolution is presented in Box 6.

BOX 6: **An alternative funding mix**

The distinction between the funding model and the funding mix means that a shift to fiscal devolution still leaves plenty of things for politicians to decide themselves in the negotiations. An alternative funding mix with less fiscal devolution is presented in Figure 3.

FIGURE 3: **There are other ways of doing fiscal devolution**

A possible local government finance settlement for the triple deal: 'Funding Mix B', 2022-23



SOURCE: Analysis of: DHLUC 2023, Business rates revaluation adjustment top-up and tariff calculator, Council Tax levels set by local authorities in England 2023 to 2024 Table 3, National Non-Domestic Rates Returns NNDR1 Tables, Revenue Account Outrun Returns; GLA 2023, Statement of Accounts; GMCA 2023, Statement of Accounts; HM Land Registry 2022, Price Paid Data; ONS 2018, Admin-based income statistics, England and Wales: tax year ending 2018 - Gross individual income by Local Authority (LA); ONS 2023, Country and regional public sector finances revenue tables; WMCA 2023, Statement of Accounts; WMCPP 2023, Statement of Accounts; WMFS 2023, Statement of Accounts; VOA 2023, Council Tax Stock of Properties Tables CTSOP1.0

In this different scenario, the central assumptions are:

- The grant for every mayoralty is cut to £333 per person, amounting to £944 million for Greater Manchester, £975 million for the West Midlands, and £3 billion for London;
- Greater Manchester and West Midlands' retained share of local income tax is 13 per cent (raising £940 million and £877 million, respectively), and London's retained share of local income tax is 0.3 per cent (raising £137 million);
- as with Funding Model A in Figure 2, this includes complete retention of business rates receipts without any changes to bills, and greater flexibility over council tax without any

changes to total revenues.

In this approach, local government in Greater Manchester would see their total funding increase by 12 per cent to £3 billion; in the West Midlands total funding would decrease by 5 per cent to £2.9 billion; and London would see an increase in funding by 3 per cent to £11 billion. In total this would cost the HM Treasury £447 million in the first year.

The proposals differ from the UK's recent experience with fiscal devolution in Scotland, as Box 7 discusses. Delivering fiscal devolution will therefore require a different set of choices to recent experience either within England or Scotland, especially if it is to focus on improving local and national growth.

BOX 7: **Why has fiscal devolution in Scotland not led to improved economic growth?**

Unlike devolution within England, devolution in Scotland is primarily concerned with achieving constitutional aspirations rather than driving economic growth.

At the time of the Smith Commission in 2014, which set the post-referendum trajectory of devolution in Scotland, only 7 per cent of Scottish Government revenues were raised and retained in Scotland. This then increased to 36 per cent in 2019, and the aim of this phase of devolution is to increase it to 50 per cent.[45]

In return for large cuts in the block grant from Westminster, devolution in Scotland will eventually include an assigned slice of VAT (£5.5 billion in 2019 values), minor taxes such as the air departures levy (£286 million) and aggregates levy (£57 million), and currently includes the equivalent of stamp duty (£588 million), the Scottish landfill tax (£106 million), business rates (£2.6 million), and most importantly income tax (£12.1 billion).

Initially, the Scottish Government had the Scottish Variable Rate to income tax, which allowed Scotland to vary the income tax rate by 3p in the pound. This power was never used. The new Scottish Rate of Income Tax, established in 2012 and given greater flexibility in 2016, has been used by the Scottish Government to establish different allowances, create two new bands, and set different rates to income tax as paid in the rest of the UK. Scotland's example shows it is possible to release control over income tax to fund subnational government, and that greater devolution of powers will encourage their use.

However, it is not obvious that Scotland's economic performance or its growth rates have increased since fiscal devolution has been extended to Scotland.[46] Why might this be, and what does this mean for fiscal devolution in England? One reason is that the Barnett Formula remains in place, giving Scotland a proportionally generous amount of central grant. By softening Scotland's budget constraint, the incentive to grow is weakened, as it means Scotland relies less on local economic growth and local tax revenues to fund its services. Another is it indicates that fiscal devolution alone is not enough. For growth to occur, the economy has to change. Governments need to use their powers and resources to facilitate positive economic change, and although fiscal devolution can encourage this, good policy is ultimately how governance delivers long-run improvements to living standards.

As council tax is the most contentious part of the local government funding system and separate to the interactions between grant, business rates, and income tax, the next section describes how

45 Audit Scotland, Scotland's new financial powers: Operation of the Fiscal Framework 2018/19, October 2019.
46 P McCann & P Yuan, The Productivity Performance of Different Types of UK Regions and the Challenges of Levelling Up, National Institute Economic Review, 261, 2022.

council tax is reformed before moving on to the rest of the funding model.[47]

Fixing council tax with fiscal devolution

Many proposals for reforms to council tax exist, but few start from the question of how reforming council tax could improve economic growth.[48] From this perspective, there are two problems for council tax and fiscal devolution.

- First, council tax lacks buoyancy – revenues do not grow as local economic activity expands or land values rise – so it does not provide good economic incentives. Neither councils nor mayors are rewarded with higher council tax receipts if they successfully improve the performance of the local economy.[49]
- Second, council tax is highly regressive – in that those with lower-priced homes pay a higher share of the value of their property as council tax than those in more expensive properties – both locally and nationally. As a result, council tax is unpopular. The public considers council tax to be the joint-second most unfair tax (along with fuel duty and behind inheritance tax), the second most prioritised for tax cuts after the basic rate of income tax, and the joint-last least popular choice for increases.[50]

These issues are connected. The regressive nature of council tax means that homes which are expensive by local standards – and therefore tend to be occupied by the local authority's more affluent residents – do not provide an outsize share of council tax revenues. Councils therefore find it difficult to finance local services from growing the local population, as the increase in demand for services and the political cost of increasing housebuilding are not clearly outweighed by higher council tax revenues.

In addition, the severity of the local government funding crisis now makes the unpopularity and inefficiency of council tax a particularly acute problem. Increasing local resource to fund necessary services for some of the most vulnerable in society is now needed (even before local government services for the wider community are considered) but is made politically challenging when the tax burden falls hardest upon those on low incomes.

Unwinding council tax's regressive nature is important for improving the economic incentives of the wider local tax system as it is necessary for securing political support for a greater role for it in funding local services. Different places will make different choices about how progressive they want council tax to be, but they are currently unable to do so because council tax is so centrally controlled.

The barriers to reforming council tax

There are four distinct problems with council tax that need to be fixed for the economic incentives of

47 It is not completely separate: the level of grant is in part determined by central government's definitions of local need, which in turn depends in part on what council tax can raise. As will be seen, this report argues these should be disconnected.
48 See, for example: S Adam et al, Revaluation and reform: bringing council tax in England into the 21st century, Institute for Fiscal Studies, March 2020; M Broome, A Corlett & G Thwaites, Tax planning: How to match higher taxes with better taxes, Resolution Foundation, June 2023.
49 Local authorities and the mayors of Greater Manchester and London collect council tax, subject to extensive control by central government. The mayor of the West Midlands does not, but fire and police precepts are levied locally that function in a similar way: these should be collected by the mayor instead, and are modelled as if they will be.
50 K Pedley, Inheritance tax seen as an unfair tax but others are prioritised for cuts, Ipsos, July 2023.

council tax to improve without it becoming more regressive.

Council tax's 1991 valuations

First, council tax bands in England have not been revalued since their introduction in 1993, at a historic dip for house prices. However, as previous research has noted, a revaluation today without any other changes would entail large shifts in the distribution of council tax burdens, primarily coming at the expense of households in London and the wider South East.[51]

Insufficient council tax bands

Second, the variation in house prices across the country is now much greater than it was in 1991. The lack of bands makes revaluations more challenging as dwellings with what are now very different prices and with households of different incomes are squeezed into the same bands.

Anchoring around Band D

Third, council tax's regressive nature is baked into its design. Council tax bills are calculated according to a fixed fraction of the bill set by the local authority for a Band D property. For example, Band B properties pay a bill that is seven-ninths of the local authority's Band D properties, and Band F properties face a bill of thirteen-ninths of local Band D properties. Local authorities are therefore unable to vary the 'slope' in tax rates that council tax sets for each band, even though the 'slope' of house prices has changed locally and nationally since 1991. This 'anchoring' is why council tax and any increases to it are regressive.

Capping by central government

And finally, central government granted itself the power to control increases – 'cap' – domestic rates under the Thatcher Government, and this was retained under both the poll tax and subsequently council tax. Capping has limited council tax increases and is a key cause of the funding crisis in local government.

How fiscal devolution can fix council tax

As highlighted above, fixing any of the above problems one-by-one enters into immediate difficulties. But by addressing all four problems at once, council tax becomes much easier to reform.

This can be shown with a new model for council tax that makes the following changes:

- revaluing council tax;
- two additional bands at the top of the distribution;
- local government setting their own proportional property tax rates for every band; and,
- no dwelling paying a higher average rate than the current highest average rate in that billing authority.

These changes are discussed more below:

Revaluing council tax.

51 S Adam et al, Revaluation and reform: bringing council tax in England into the 21st century, Institute for Fiscal Studies, March 2020.

By increasing the thresholds for all the bands by the national increase in house prices between 1991 and 2022 – 388 per cent – every property in Greater Manchester, the West Midlands, and London can be revalued. If the existing bands are kept, then the new valuations are:

- A: Under £155,000
- B: Between £155,001 and £200,000
- C: Between £200,001 and £265,000
- D: Between £265,001 and £340,000
- E: Between £340,001 and £465,000
- F: Between £465,001 and £620,000
- G: Between £620,001 and £1,250,000
- H: Between £1,250,001 and £2,500,000

We estimate that half of all properties in Greater Manchester and West Midlands would stay in the same band, with roughly 44 per cent in Greater Manchester and 53 per cent in West Midlands moving up at least one band. 1 per cent in both move down a band.

In London, nearly every property moves up multiple bands, due to the rapid increase in London house prices since 1991. An estimated 74 per cent of properties move up at least two bands, 30 per cent move up at least three, and 10 per cent move up by four bands.

After this large one-off revaluation, annual revaluations would not be anywhere near as disruptive – only a very small percentage of properties would change bands year-to-year.

Two additional bands at the top of the distribution.

Bands I and J, corresponding to properties worth between £2.5 million and £5 million, and over £5 million respectively, are added to the council tax bands in England. These are a smaller share of dwellings than the current G and H bands, with I and J together estimated to correspond to less than 1 per cent of properties in Greater Manchester and the West Midlands, and 2 per cent and 0.5 per cent of stock in London respectively.

Local government sets their own proportional property tax rates for every band.

Mayors and the boroughs would have the freedom to set the property tax rate for each band as a proportion of each property's value. This would end both the capping and the anchoring of council tax.

No household paying a higher average rate than the current highest average rate in that billing authority.

A principle applied is that no household will face a higher tax rate from either the mayor or the borough than the rate of council tax currently paid by occupiers of the average Band A property.

With these changes, council tax becomes much more buoyant. More high-quality dwellings would automatically translate into higher council tax revenues, as would increases in property values from local economic success or improved amenity.

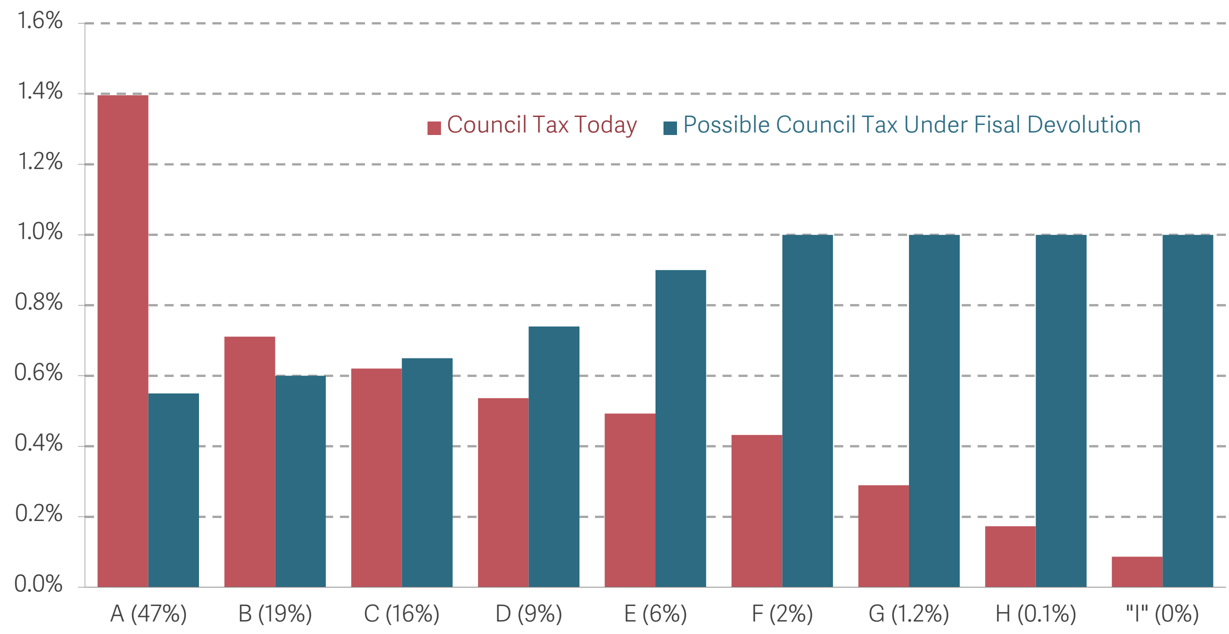
It can also be shown that fiscal devolution along these lines could turn council tax into a progressive tax, with a revenue-neutral budget. The hypothetical scenario outlined below, with methodology described in the annex, is not a recommendation, but a demonstration of how fiscal devolution of council tax increases the growth incentive while making it less regressive. [52]

Poorer places and poorer households benefit from fiscal devolution

As an illustration of how these reforms could work, consider Bolton - a less affluent local authority with relatively low house prices that sees little change in its banding from a revaluation. As a result, fiscal devolution of council tax may initially be expected to increase growth incentives for Bolton, but also generate regressive outcomes.

Figure 4 shows the current council tax rate set by Bolton borough council – omitting the mayoral precept – for each band as a percentage of the average tax rate. It also shows a hypothetical set of council tax rates for Bolton after fiscal devolution. As revaluation does not change the banding of 92 per cent of properties, the share of households within each band after revaluation is included in the horizontal axis. As can be seen, the higher rates under fiscal devolution mean the tax base is broader – increases in housebuilding of properties across the distribution would therefore provide more funding for Bolton council than they would now.

FIGURE 4: Fiscal devolution of council tax could allow most households in Bolton to get a cut in council tax
Bolton's council tax rates before and after fiscal devolution by council tax band: 2022-23



SOURCE: Analysis of: Land Registry 2022, Price Paid Data; DHLUC 2023, Council Tax Stock of Properties Tables CTSOP1.0 and Band D Council Tax Live Tables, England

Council tax would be fairer too. Roughly half of Bolton is in Band A before and after revaluation, and

52 This proposal differs from one made in an earlier Economy 2030 report, which was for a flat, proportional property tax set by local authorities (M Broome, A Corlett & G Thwaites, Tax planning: How to match higher taxes with better taxes, Resolution Foundation, June 2023). Flat property taxes do exist in other countries, but no requirement for either a flat or a progressive tax is necessary to deliver reform of council tax. A progressive approach, as outlined here, would mitigate the impact on inequalities, but entail higher tax bills for higher banded properties

their average council tax rate would fall from 1.4 to 0.5 per cent. This translates into their average council tax bill falling from £1,082 to £426 a year – ensuring that residents of the half of dwellings with the lowest values in Bolton could be, on average, £656 a year better-off. Residents of Band B properties, comprising a further 19 per cent of the population after revaluation, could see their average council tax rate fall from 0.71 per cent a year to 0.6 per cent, and see their average council tax bill fall from £1,262 to £1,065 a year, leaving them £197 a year better off.

These potential tax cuts would be financed by the broadening of the council tax base and the switch from regressive to progressive taxation. Households in Band E – after revaluation, this would include the 6 per cent of houses in Bolton worth between £340,000 to £465,000 – could see their council tax increase from an average of 0.49 per cent to an average of 0.9 per cent, or from £1,984 a year to £3,623 a year.

Bolton therefore gets a greater reward if new Band E houses are built within the borough after fiscal devolution of council tax than it does today. This increases the rewards for local government if it pursues growth, as a rising population in larger and higher quality properties will help fund services for existing residents.

The annual council tax rate in Bolton for revalued Band H properties – the top 0.14 per cent most expensive homes in Bolton worth between £1,250,000 and £2,500,000 increases in this hypothetical scenario from 0.17 per cent to 1 per cent. If the rates were this progressive, it would see Bolton's annual council tax bill for Band H increase from an average of £3,246 to £18,750.

This may sound like a large increase. But a 1 per cent tax rate is a much lower rate than the 1.4 per cent rate that the poorest half of households in Bolton in Band A are currently paying in council tax under the existing system. And as these changes are revenue neutral, boroughs like Bolton could use their new flexibility with council tax to phase in a transition over several years to mitigate the impact on households.

As the council tax system has become so regressive and so disconnected from local property values over the past three decade, the increase on the very highest banded properties reflects the fact that any solution to the problems in local government finance that grants relief to most households will see council tax bills rise for the most expensive dwellings in every borough. There is no way around this problem. For example, even a flat tax of 0.7 per cent on all properties – the lowest that can be set in Bolton while removing the tax's regressive nature and achieving revenue neutrality – still increases Bolton's Band H council tax bills to £13,500.

None of this is to say that Figure 4 shows the 'correct' rates of council tax for Bolton. It is straightforward for Bolton to choose a lower tax rate for the higher bands and thereby reduce the council tax discount for Band A and B and still achieve a revenue-neutral budget that is more progressive and gives greater rewards for growth. Bolton can even choose to retain the current regressive structure if it wishes, at a cost to growth and inequality.

Rather, it illustrates that fiscal devolution is a progressive reform for council tax, even in less affluent boroughs. Returning council tax to the control of councils sees their economic incentives improve, and households see their council tax bills fall.

Most households in every borough could see a tax cut from fiscal devolution of council tax

One possible response to the proposal, even if it increases growth and local government resource, is to ask about council tax bills in London. As property values in London are higher than those in Bolton, concerns that council tax reform – and especially revaluation – will increase most Londoners' bills are understandable. Other proposals to reform council tax often finance significant changes out of higher levies on most Londoners and residents of South East England.[53]

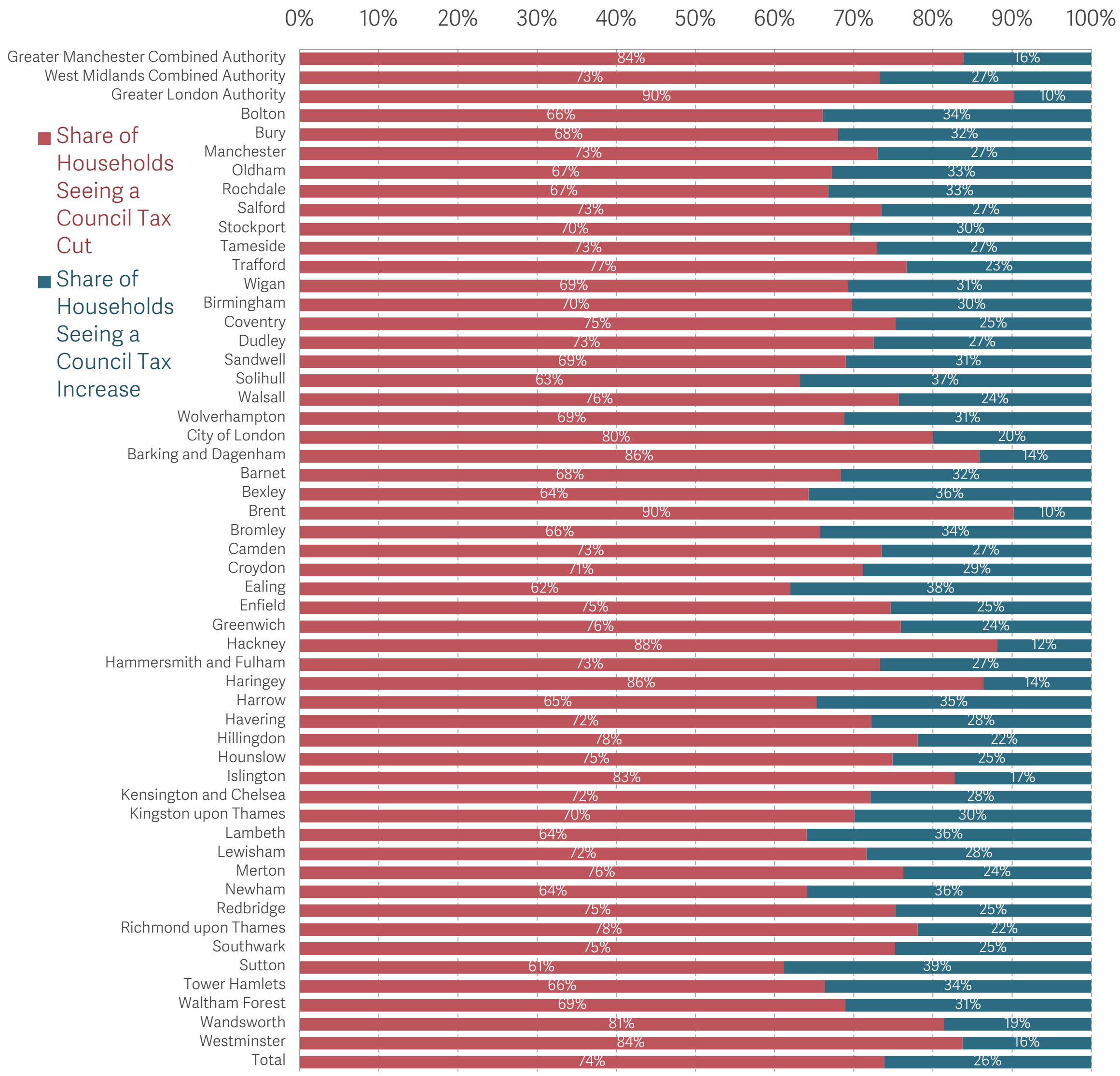
But these concerns can be dispelled. Fiscal devolution of council tax makes it possible to reduce council tax bills for a large majority of households in every borough in the triple deal, including in London. Indeed, in places that are more prosperous than Bolton, it is even more straightforward for fiscal devolution to achieve this.

To see this, Figure 5 shows the share of households paying council tax to their borough and their mayoral precept who could be expected to receive tax cuts and increases from fiscal devolution of council tax. Each billing authority has had a hypothetical council tax rate set for each band as in the Bolton example in Figure 4 – some have consciously been set to be more or less progressive than others to reflect the variation that would emerge after devolution. Including both the local authority and the mayoral precept, 74 per cent of households can be shown to potentially expect a tax cut, with the average household receiving a cut seeing a tax cut of £637. These tax cuts go towards households in the cheapest 60 to 90 per cent of dwellings within each borough, varying according to how progressive council tax rates are within each borough. Therefore, the stronger growth incentives and the flexibility over resource from making council tax more progressive shown in Bolton are scalable across the triple deal.

53 For example, the Fairer Share proposal for council tax and stamp duty reform of a flat 0.48 per cent rate on all property: https://fairershare.org.uk/. This is discussed more in S Adam et al, Revaluation and reform: bringing council tax in England into the 21st century, Institute for Fiscal Studies, March 2020.

FIGURE 5: A majority of households in every borough see a council tax cut from fiscal devolution

Share of properties seeing council tax cuts and increases from fiscal devolution by billing authority, 2022/23 values



SOURCE: Analysis of: Land Registry 2022, Price Paid Data; DHLUC 2023, Council Tax Stock of Properties Tables CTSOP1.0 and Band D Council Tax Live Tables, England.

These hypothetical cuts would be financed by council tax increases on the remaining 26 per cent of the population, with an average tax increase of £1,729. The size of the increase varies by borough and depends on how progressive the democratically elected council decides council tax should be. As discussed above in the Bolton example, a shift towards this distribution can be phased in over time by local authorities and mayors to mitigate the impact on households.

Fiscal devolution makes these council tax cuts possible, even though most households see their property revalued. Although three quarters of London properties move up multiple bands after revaluation, the new flexibility afforded by fiscal devolution means that councils can counteract the revaluation for most affected households by cutting their council tax rates.

For example, 23 per cent of properties in the London borough of Richmond worth between £620,000 and £1,250,000 a year are currently Band E and would under reform be revalued up to the new Band G. Normally, this would be expected to result in higher council tax – but the flexibility that Richmond council would gain over council tax from devolution means that their average council tax bill for the borough can be reduced from £1,987 to £1,590, saving these households £397 a year.

But in order to give tax cuts to so many people while improving incentives and flexibility over resource, council tax rates need to set with respect to local house prices, not national house prices. This is because the banding of properties after revaluation is driven by national land values, which are much higher in London and need to be counteracted to provide Londoners with tax cuts. Therefore, properties in the same band will therefore pay quite different bills depending on which borough they are in.

For example, Figure 4 showed a scenario after revaluation where a Band H property in Bolton – the top 0.14 per cent of local properties worth between £1.25 million and £2.5 million – would face an average council tax bill from the borough of £18,750. A similar progressive council tax structure for the London Borough of Barnet would see revalued Band H properties – 8.7 per cent of local households in Barnet, below the top 2.3 per cent of local households in higher bands I and J – face an average council tax bill for the borough of £3,938.

Allowing Barnet's Band H bills to be lower than Bolton's is what makes it possible for most people in every borough to get a tax cut and the reforms to be revenue neutral. If their bills were forced by central government to be similar, either Bolton (and every Greater Manchester and West Midlands borough) would see large cuts to funding, or Barnet (and every London borough) would need to increase council tax bills for most residents due to the revaluation.

Fiscal devolution therefore reforms council tax and sharpens its economic incentives by turning it into a tool of local redistribution. Other taxes collected by national government raise more revenue at higher rates from London and other affluent areas, and these fund services and redistribution across the country through the welfare state and grants to local government.

This can also be seen in how the mayoral precepts – which are much smaller than local authority bills – mean that council tax becomes a tool of redistribution between different boroughs in the same city. The most affluent boroughs – places like Westminster and Solihull – tend to have lower need and as a result can set low council tax rates for their residents, including for the disproportionate share of the highest banded properties in each city.

As the mayoral precept is set at a metropolitan level, properties in the same band pay the same council tax to the mayor whichever borough they are in. When set progressively, this means that the low council taxes faced by the most expensive properties in the most affluent boroughs are balanced by higher rates paid to the mayor – making it so that affluent boroughs make relatively larger contributions to each mayor's council tax receipts than poorer boroughs. This will encourage the mayors to grow their wider urban economies and absorb more responsibilities for local redistribution.

Additional steps for reforming council tax

Along with the reforms highlighted above, there are smaller problems with council tax that fiscal devolution provides an opportunity to resolve. The triple deal should therefore consider:

Annual Revaluations.

The triple deal should introduce automatic annual revaluations of the bands and residential properties – this is critical to both maintain the buoyancy of any residential tax system and therefore its growth incentives, while sustaining fairness for households. With annual revaluations, the impact of rising house prices on bills can be managed by the boroughs and mayors by cutting council tax rates.

Adding more than two new bands.

The scenario added two bands at the top of the banding for ease of illustration and modelling. But some local authorities have more than a third of dwellings 'bunched' in one particular band, making it harder to set revenue-neutral tax rates that also leave most households better off– the most challenging instance of this is Barking and Dagenham, which has 47 per cent of dwellings in the revalued Band E. Several more additional bands within the distribution of house prices would solve this problem.

Discretionary deferrals for local authorities and mayors.

The case of low-income residents of expensive houses – often referred to as the 'poor widow problem' – is an emotive and significant political barrier to local taxation reform. Alongside locally decided transitional periods to phase in new rates over several years, the solution to this is that local authorities and the mayors should have the power to admit applications on the bands of their choice for discretionary deferrals on bills until transaction of the property. This allows local leaders to make arrangements for sympathetic cases without being overwhelmed by applications.

Council tax should be paid by the owner, not the occupier.

One legacy of the poll tax is that council tax is paid by the occupiers, reflecting the poll tax's logic of being a 'charge' for users of local government services. If the rationale instead shifts towards council tax being a tax on property, then it makes little sense to bill the users of an asset instead of its owners. Taxing the owners would simplify collection by removing mobile private renters from the funding system, and broaden the tax base to include student accommodation and other dwellings currently outside the council tax system.

Rename the mayoral precept.

The concept of the mayors levying a 'precept' is a holdover from the language of domestic rates and the manner it was collected. If the mayors are to be setting their own rates of council taxation, then accountability for their performance could be improved by making clear it is distinct to the tax collected by local authorities. Renaming it as a 'metropolitan tax' or similar would be the simplest way of achieving this, even if boroughs remain the billing authority for administrative reasons.

Devolution of business rates, grants, and income tax

The second half of the triple deal's proposals for fiscal devolution are for a combination of changes to business rates, grant, and the introduction of a local share of income tax due to the interactions between them.

Reforming business rates for the troika cities is more complicated than devolving council tax, as the current tax sharing elements of business rates mean there are consequences for local authorities outside the deal. These mean any changes to business rates must be balanced with changes to grant or other forms of tax sharing to achieve revenue neutrality.

Business rates

Until the Thatcher Government, business ('non-domestic') rates were collected by local authorities in a similar manner to domestic rates. The 1988 Local Government Act nationalised business rates, but unlike the abolished poll tax, this was retained after the fall of Thatcher, and the revenues (set by a single national tax rate, or 'multiplier' combined with a complex set of reliefs) were used by national government to finance grants to local authorities.

The removal of business rates as a funding source for local government has previously been identified as a major reason behind the high cost of commercial space in British cities, as it weakened economic incentives for councils to permit new commercial space.[54]

Undoing this penalty to local growth has motivated a number of reforms over the past decade in the name of 'business rates retention'. These tax sharing elements have made the system more complex. Only half of business rates revenue is now retained by central government ('the central share') to be redistributed to local authorities in the form of grant, and the other half is nominally retained by local authorities. However, a portion of the half retained by local authorities is also redistributed between local authorities in the form of 'tariffs' and 'top ups'. Councils are also allowed to keep a portion of the growth in local business rates, condition on 'resets' decided by national government.

Further complexity is added by the fact that case-by-case devolution until now has resulted in different places having different deals. Local authorities in Greater Manchester and West Midlands have no central share and retain 99 per cent of business rates and send 1 per cent to the metro mayor, but still participate in the tariff and top-up system, with most boroughs being net beneficiaries. London also participates in the tariff and top-up system, with most councils being net contributors, but in 2022-3, the boroughs kept 30 per cent of local bills, the GLA kept 37 per cent, and the central share was 33 per cent.[55]

The barriers to devolving business rates

For the purposes of fiscal devolution, there are three major barriers:[56]

Local authorities are the billing authorities, not the mayors

First, the mayors do not collect business rates, as boroughs do instead. This creates a problem as business rates revenue is 'spiky' and varies between local authorities in the same local economy – local authorities with city centres have higher revenues than suburban local authorities for example.

54 P Cheshire & C Hilber, Office space supply restrictions in Britain: the political economy of market revenge, Economic Journal, 118 (529), June 2008.
55 DLUHC, The Local Government Finance Report (England) 2022 to 2023, February 2022.
56 The business rates system has numerous other problems, such as excessive reliefs, disincentives for investment, and infrequent revaluations, which Centre for Cities has previously discussed and recommended Treasury resolve. See: L McGough & H Bessis Beyond Business Rates, Centre for Cities, December 2015; H Bessis, Business rates: maximising the growth incentive across the country, Centre for Cities, December 2017; K Enenkel, T Aubrey & T Sells, Reforming business rates: Fixing a broken system, Centre for Cities, October 2020.

Full devolution to the current billing authorities will therefore create inequities between and within places that do not improve economic incentives.

Business rates devolution must go beyond allocation

Second, the experiments around business rates retention have not been enough to advance fiscal devolution. The tax sharing of business rates has been implemented – through the top-up/tariffs system – to give strong incentives to local authorities to add new commercial space by concentrating the revenue benefits on the margin. Therefore, further devolution of the rest of business rates will not have much of an effect on economic behaviour of councils, unless either more autonomy is granted to places to vary their multiplier, or if business rates is reformed into a proper commercial property tax.

Third, there are currently vastly different revenues between cities. London is the largest contributor to the business rates system, while Greater Manchester and the West Midlands are net beneficiaries. Without adjustments, London will gain at the expense of Manchester, the West Midlands, and the Exchequer.

How to devolve business rates

Our triple deal proposes overcoming these barriers with the following changes:

- local business rates should be devolved exclusively to the mayors;
- mayors should have control over the multiplier; and,
- the changes to business rates should be compensated with changes to grant and tax sharing.

We discuss these more below.

Local business rates should be devolved to the mayors

The metro mayors and the Mayor of London should become the billing authorities for business rates, retain 100 per cent of business rates and be removed from the top-up and tariff system. The result is that each city's commercial property tax revenues – including high city centre revenues – will be shared across the entire city by a politician accountable to the entire city-region. This will have consequences for the funding of local authorities, and it should be up to the mayors and the boroughs in negotiation to decide how to allocate funding so councils can meet their obligations.

Mayors should have control over the multiplier

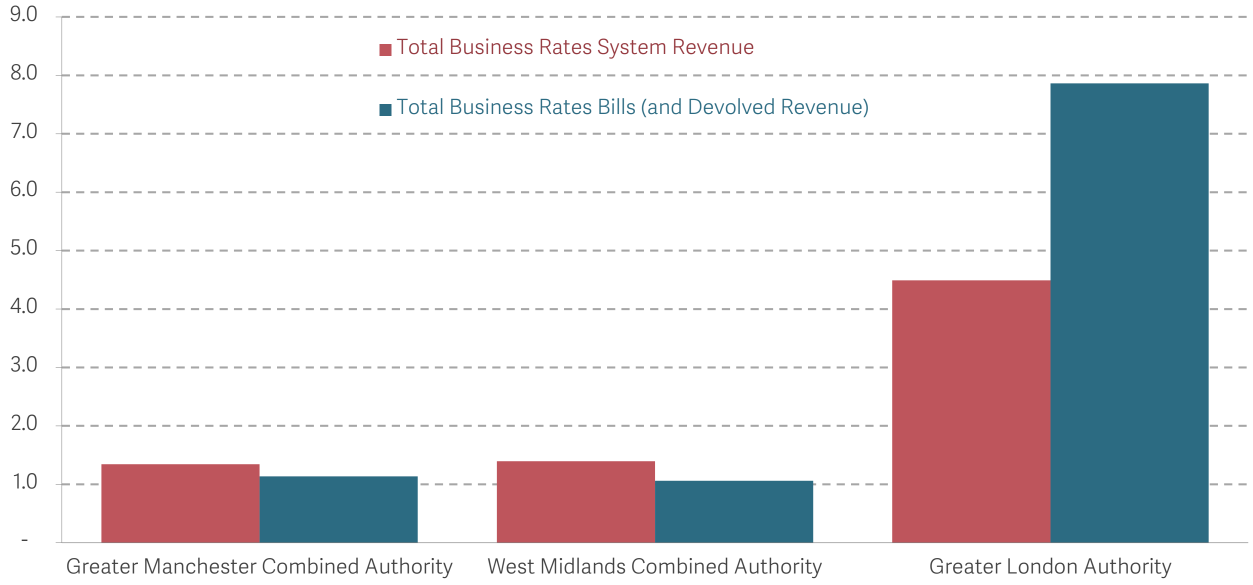
Introducing an entirely new form of commercial property tax for the three city-regions to run in parallel to business rates in the rest of England will be too complex. As this means there is still a need to increase economic incentives beyond what business rates retention already provides, the mayors should be given control over the multiplier, but should not yet have powers to make more radical changes to business rates.

Compensate the changes to business rates with changes to grant and tax sharing

The changes to revenue that these entail are set out below in Figure 6: this compares the total amount of revenue each city-region receives from the business rates system after changes from top-ups and tariffs and London's contribution to central government, to the total amount of business rates bills actually collected in each city-region (the annex explains the methodology used to produce these estimates).

FIGURE 6: **Business rates devolution would see London gain, and central government, Greater Manchester, and West Midlands lose out**

Business rates revenues and bills, £ billions: 2022-23



SOURCE: Analysis of: DHLUC 2023, Business rates revaluation adjustment top-up and tariff calculator, National Non-Domestic Rates Returns NNDR1 Tables, Revenue Account Outrun Returns.

London would be the big winner from business rates devolution, seeing its income increase from £4.5 billion to £7.9 billion. In contrast, Greater Manchester and the West Midlands would see income decline from £1.3 or 1.4 billion to £1.1 billion. Central government is a net loser from business rates devolution – to the tune of £2.8 billion – and would need to find new revenues to replace what is in effect currently a contribution from London to the rest of England.

However, it is unreasonable to expect that these fiscal gaps should be closed solely from local changes to the multiplier: this would be forcing Greater Manchester and the West Midlands to increase business rates, while London could reduce them. In addition, devolution of business rates would still cost the Exchequer money: that can only be cleared by a reduction in the grant to the troika, which we discuss below.

The grant system

Grants have two legitimate functions in a system of strong local self-government.

First, they finance responsibilities that local government has been mandated to provide by Parliament, as unfunded mandates are both unreasonable and particularly damaging to growth.[57] For this reason, the amount of resource in the modern local government funding system depends largely upon how much grant is fed into it by central government.

57 A Rodríguez-Pose & M Vidal-Bover, Unfunded Mandates and the Economic Impact of Decentralisation. When Finance Does Not Follow Function, Political Studies, November 2022.

Second, grants are also a tool of Parliament in its mandate to pursue national redistribution. Less affluent areas with smaller tax bases and higher need help from central grant to provide services that lower income households depend upon, especially because so much of the welfare state is financed through taxes that are unsuitable for devolution (such as VAT and corporation tax).

The combination of these effects explain why, combining both revenue and capital spending, London local government received more grant per person (about £693) in 2021-22 than either Greater Manchester (about £480) or the West Midlands (about £569). Although London is more affluent, it still has considerable deprivation and its local government has more responsibilities – for example, the Metropolitan Police has special national police duties and a much higher spend per person than Greater Manchester Police, and Greater Manchester does not receive a public health grant.[58]

However, grants do damage the economic incentives of councils. As funding is guaranteed regardless of how well the economy performs, the budget constraint of local authorities is softened. Grants allocated to places with greater deprivation could also be seen as a tax on the local authority if it pursues growth and reduces poverty.

In addition, an important priority of the grant system in England is reduction of differences in council tax bills between different places. The distinction between this and other forms of redistribution is subtle but important. Instead of redistributing towards lower-income households or to fund local services, the intention is to reduce variation in local taxation. This is not obviously progressive, and harms local self-government.

Grants have become much more important to local government finance since the 1960s.[59] They then grew very large during the New Labour era, and cuts to grant since 2010 are a key factor behind the current local government resource crisis, but they have also become more difficult for both local and national government to control.[60]

The barriers to reforming grant

For the purposes of fiscal devolution, there are two major problems with the grant system:

Grants redistribute both between and within local economies.

As boroughs provide the lion's share of local government services, central government currently dispenses grants to both the mayors and the boroughs. Although this is understandable for historic and practical reasons (as the boroughs provide most local services), it creates problems for fiscal devolution as it means that central government is making choices about the distribution of funding within each place, when under devolution its responsibilities should be limited to redistributing between places.

This is not just a theoretical problem. The incentives of leaders to pursue economic growth are weakened, as the resources that boroughs receive to fund services come from central government, not the metropolitan government. If the city's entire local economy becomes more prosperous, a borough will find that its grant from central government declines, even if its relative need compared to

58 S Bridgett, The trailblazer devolution deals will widen disparities between mayors – but this is a good thing, Centre for Cities, June 2022.
59 T Burgess & T Travers, Ten Billion Pounds: Whitehall's Takeover of the Town Halls, Grant McIntyre, 1980.
60 Centre for Cities, Cities Outlook 2019: A Decade of Austerity, January 2019.

other boroughs in the same city remains unchanged.

For central government, the role of boroughs as recipients of grant makes the job of central government harder, as the grant system must distinguish between the responsibilities of the boroughs and the mayors. Instead of deciding the level of support each local economy should have and allowing local government to decide its own priorities, Whitehall funds services and economic affairs separately, weakening local accountability and reinforcing the notion that central government is ultimately responsible for local services.

Central government determines local needs

One aspect of centralisation is that central government decides local priorities for individual authorities across a vast range of policy areas and dispenses distinct grant allocations to fund each of them.

A proliferation of 'competitive pots' has made the funding system more complex over the past decade, with local government now spending significant resource navigating an arbitrary funding system for uncertain promises of funding. The UK Government has said that it recognises this has spiralled out of control, and is committed to a systemic simplification in the manner of the Trailblazers' Single Settlement.[61]

However, the complexity of the funding system predates the pots. The wider local government finance settlement depends on central government deciding what the 'core spending power' of each local authority is adjusting grants between councils based upon this calculation to reduce the differences in council tax bills between places. In effect, places with what national government determines to be greater need – often places with more deprivation or weaker local economies, although the relationship is not as

This is why the local funding settlement is still centralised despite large cuts to grant and increases to council tax. Local taxes struggle to replace the lost grant because central government continues to define local need and uses the grant system, capping of council tax, and the nationalisation of business rates to control local taxation accordingly.

How to reform grants

Within the triple deal, these barriers can be overcome by changing the grant system in two ways:

- all grant should go the mayors, and then be redistributed to the boroughs; and,
- the grant should be smaller, and it can be distributed to each mayor as a flat payment per head of population.

We discuss these more below.

All grant should go to the mayors, and then be redistributed to the boroughs

A new 'metropolitan funding settlement' should build on the Single Settlements agreed in Trailblazer deals.

Grants from central government should no longer be given to each borough, but should be dispensed

61 S Bridgett, Pot Luck: What government needs to do to streamline local government funding, Centre for Cities, June 2023.

exclusively to the three mayors, who then combine them with their other funding sources (business rates, the mayoral precept of council tax, income tax sharing) to allocate grants to the boroughs in accordance with locally-defined local need. This new approach would have three benefits.

First, it will improve both flexibility and security for the boroughs. Instead of a funding settlement being imposed upon the boroughs by the Secretary of State – in recent times varying from year-to-year – the metropolitan funding settlements will be agreed in partnership with the mayors and the other boroughs.

Second, it allows the mayors to fulfil their role in redistributing across their local economy, while central government also fulfils their role in redistributing across the country. By making mayors responsible, it means each city can make different decisions about the desired level of internal redistribution, and each borough can make different choices on council tax, without worrying that this entails a reduction in support from central government.

And third, it reduces administrative workload for everyone. Boroughs will no longer have to bid for 'pots' from Whitehall from one of hundreds of authorities, but simply negotiate directly with their mayor in city hall.

Similarly, for national politicians and civil servants the job of providing support to the troika cities is made much easier. Funding will flow to three offices instead of fifty-eight, and the mayors will be more easily held to account for either their own or a borough's waste of public money than today.

The grant should be distributed to each mayor as a flat payment per head of population.

If fiscal devolution is to advance, grants must become a less important part of the funding mix. As this report has already shown, for fiscal devolution in the triple deal to be revenue neutral, and with the funding gap for the Exchequer created by devolution of business rates, grant for each of the three cities therefore will need to reduce by the start of the new system.

The model here shows that the triple deal would distribute the replacement grant to each mayor as a flat payment per head of population. This per head distribution of national grant to each city can then be combined with each city's metropolitan funding settlement agreed between the mayor and the boroughs to distribute grants to the individual boroughs based upon need.

This may seem like an oversimplification, but a per head distribution has been proposed previously as a model.[62] As total spend by councils is correlated with population, a single per head grant ensures that each mayor is given resources scaled to their responsibilities. A per head distribution maximises the growth incentive, as it means that as the population and local economy grows, funding from central government increases without reducing the incentives to grow.

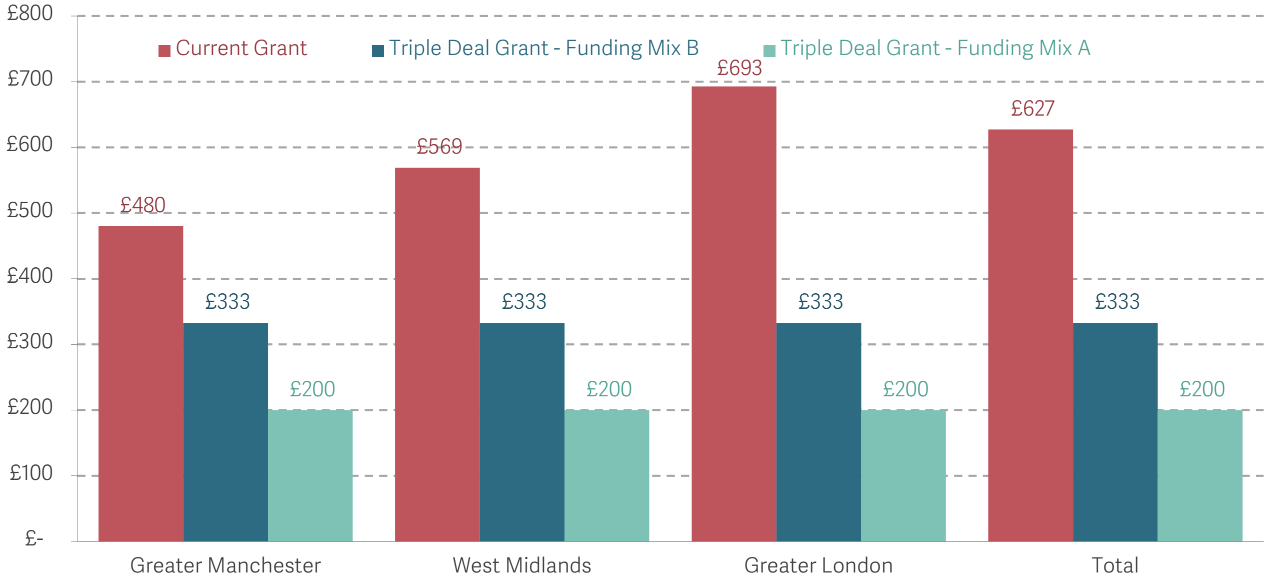
When financed by national taxation – which is disproportionately raised from more affluent areas – the net effect of a single per head grant is still progressive. Furthermore, with fiscal devolution the mayors and boroughs will be allowed to redistribute as much as they like when they agree their own metropolitan funding settlements. Government and the mayors may of course choose to instead weight the grant by deprivation or other metrics in their eventual settlement of the triple deal. But this will come at the cost of penalising Greater Manchester and the West Midlands if their economies

62 T Burgess & T Travers, Ten Billion Pounds: Whitehall's Takeover of the Town Halls, Grant McIntyre, 1980.

grow and therefore efforts they make on the margin to pursue it, while providing few savings for central government.

Figure 7 and Figure 8 show how grant funding changes under Funding Mix A, where the various grants received by the boroughs, mayors, and fire and police authorities are replaced with a single payment per head of £200. An option with less devolution, Funding Mix B, as shown in Figure 3 in Box 6 would have a grant per head of £333.[63]

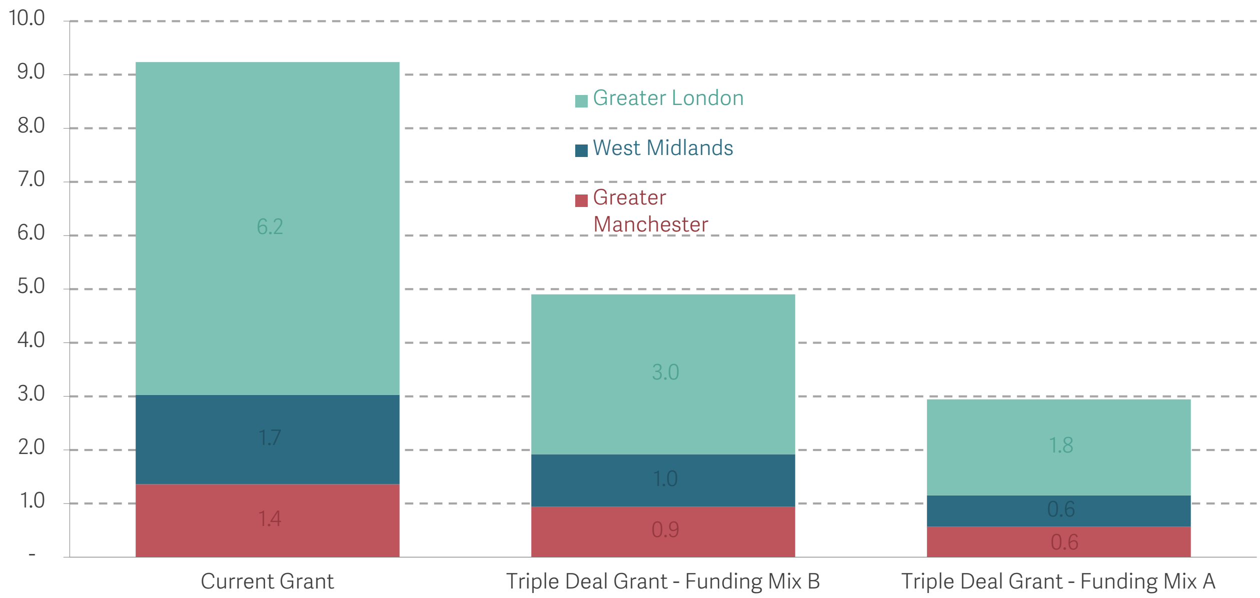
FIGURE 7: **London sees the biggest reduction in grant under fiscal devolution**
Revenue and capital funding per head, 2022-23



SOURCE: Analysis of: GLA 2023, Statement of Accounts; GMCA 2023, Statement of Accounts; Ogden et. al 2023, How much public spending does each area receive? Local authority level estimates of health, police, school and local government spending, IFS Report R269; WMCA 2023, Statement of Accounts; WMCPP 2023, Statement of Accounts; WMFS 2023, Statement of Accounts

63 The Annex explains how this report has defined grants – in summary, it includes both 'pots' and long-term funding streams for the mayoral authorities, and only the long-term funding streams for the boroughs.

FIGURE 8: **London sees the biggest reduction in grant under fiscal devolution**
Revenue and capital funding in total (£ billions), 2022-23



SOURCE: Analysis of: GLA 2023, Statement of Accounts; GMCA 2023, Statement of Accounts; Ogden et. al 2023, How much public spending does each area receive? Local authority level estimates of health, police, school and local government spending, IFS Report R269; WMCA 2023, Statement of Accounts; WMCPP 2023, Statement of Accounts; WMFS 2023, Statement of Accounts

As can be seen in Figure 7, London receives the most grant not just in absolute but also per head terms. This reflects the high level of grant received for the GLA's greater responsibilities and the significant level of deprivation in the capital. As a result, the reduction in grant for London under Funding Mix A is the largest in both per head (from £693 to £200) and absolute terms (£6.2 billion to £1.8 billion). But in our model, London's lower grant is compensated for by the increase in revenues from the retention of business rates as shown in Figure 6. Greater Manchester and West Midlands also see declines in grant per head (from £480 and £569 to £200, respectively) and in totality (£1.3 billion to £567 million, and £1.7 billion to £585 million, respectively).

So, although both London and HM Treasury are now almost compensated in revenue terms, the devolution of business rates and the shift to a flat per head grant still leave Greater Manchester and West Midlands facing a significant reduction in their revenues. The final funding element that closes the gap and advances fiscal devolution is income tax sharing.

Income tax

Local income tax is commonly used to finance local government in unitary states abroad, but it has never been used in the UK, despite being the central recommendation of the 1976 Layfield Report.[64] Devolving income tax would broaden the local tax base, provide strong economic incentives due to its buoyancy, and can be delivered through tax sharing.

However, as discussed above, a decision to be taken when devolving taxes is the choice between tax autonomy and tax sharing. Granting full autonomy to the three areas to vary the rates of local income tax would substantially advance local self-government. It would enhance economic incentives further,

64 F Layfield et al., Local Government Finance: Report of the Committee of Enquiry, HMSO, 1976.

reduce the burden on other parts of the local government finance system to flex to achieve national redistribution, and make it easier for national government to vary income tax without implications for local finance. Granting county councils and metropolitan boroughs the power to levy additional pennies on income tax bands was recommended by the Layfield Report in 1976.

However, the impact upon HMRC and the PAYE system will be substantially more complicated than allowing the mayors to retain an agreed share of local income tax. It is difficult to justify the initial and ongoing expense required to establish a parallel system of income taxation for only some local governments. Furthermore, in a country as centralised and regionally unequal as England, reform of local income tax must move carefully. Allowing places to share income tax is would be a large advance in fiscal devolution; the impacts of allowing places to vary the rate should arguably be considered as part of a wider fiscal settlement and reorganisation of local government in England.

The alternative – a degree of sharing of locally-levied income tax – would still mean that city-regions that successfully grew their local economies would boost their own (as well as the HM Treasury's) income tax revenues. The logic is therefore similar to business rates retention: giving places the ownership over local tax revenue could improve both local and national growth and revenues. However, while income tax sharing does advance fiscal autonomy, it does not do so by as much as a full local income tax would.[65] Central government would continue to be determining the tax base and tax rate for the mayors.

The sharing of income tax still presents numerous technical challenges, such as the interaction with HM Revenue and Customs and the Pay As You Earn (PAYE) system, the treatment of investment income, determining residence, and so on. But Scotland's experience with income tax devolution will be valuable here, as will the Layfield Report's discussions of how these would be applied to local government.[66]

The barriers to devolving income tax

For the purposes of fiscal devolution, there are two major problems with local income tax.

Variation in revenues

First, as average incomes are so different across the country, a move towards fiscal devolution of equal shares of income tax would exacerbate inequality between different parts of England, especially between London and the rest of the country. London's role as the country's most successful local economy means it has a special role to play as a source of national tax revenues, and fiscal devolution needs to account for this.

Volatility of revenues

Second, although income tax has a broad tax base, it is still sensitive to the earnings of the very highest earners. The top 1 per cent of earners paid 28 per cent of income tax liabilities in 2022-23.[67] This is a significant problem for devolving income tax as where top earners decide to live will have a significant impact on local revenues, especially if higher rates of council tax on the highest banded

65 In turn, the mayors would need to agree formulas to share some of these revenues (along with grant and business rates) with their boroughs to help them provide local services.
66 F Layfield et al., Local Government Finance: Report of the Committee of Enquiry, HMSO, 1976.
67 HM Treasury, Income Tax Factsheet, The Growth Plan 2022, September 2022.

properties cause some displacement.

How to devolve income tax

Within the triple deal, we propose that income tax can be devolved if it :

- gives a much larger share of local income tax to Greater Manchester and West Midlands than London; and,
- shares a constant amount from each income tax band.

We discuss these more below.

Greater Manchester and West Midlands should retain a much larger share of local income tax than London.

This has several benefits.

First, it compensates Greater Manchester and the West Midlands for the reductions in grant and full business rates retention while still advancing fiscal devolution. To maintain a level playing field between them, the share should be the same for both cities, and for other metro mayors who wish to opt-in to the triple deal after it is agreed.

Second, it means that the political choices about redistribution across the country shift from grant to income tax sharing. It therefore helps make a simple per head distribution of grant viable as a transfer from all the mayors from national government for mandated responsibilities.

And third, it encourages Greater Manchester and the West Midlands to pursue growth more than London. As income tax is a more buoyant tax than business rates – revenues rise faster when economic activity increases – greater reliance on income tax increases the rewards from growth.

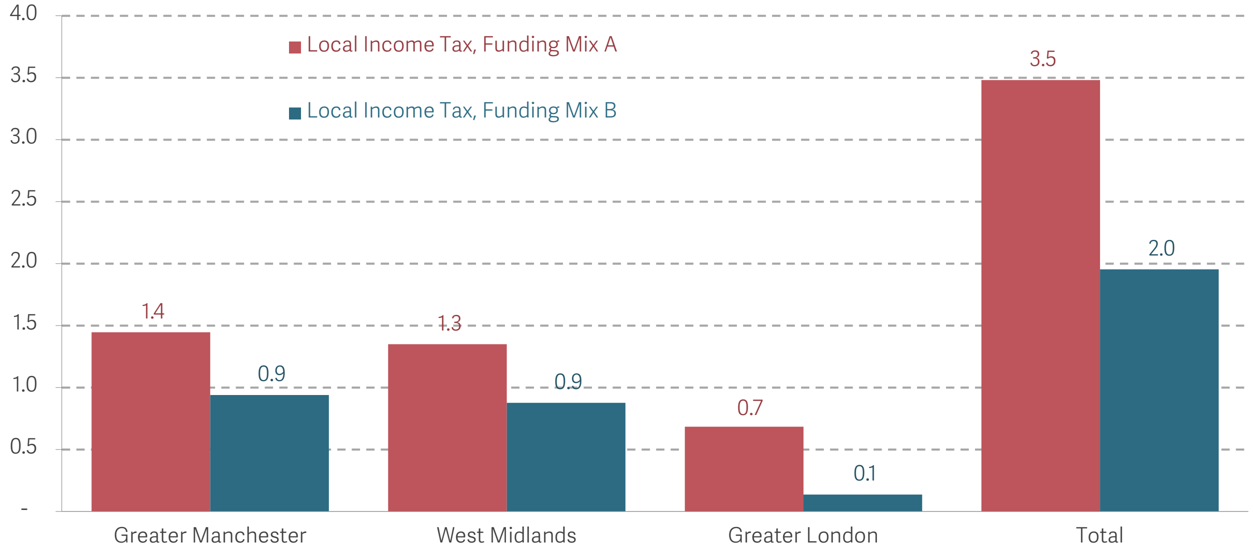
The funding mix of the triple deal therefore helps solve the central problem of Britain's economic geography identified by Centre for Cities and the Economy 2030 Inquiry – that Manchester and Birmingham need to grow for the country to grow.

Share a constant amount from each income tax band.

Importantly, rather than sharing a percentage from the total amount of revenues raised from each mayoralty, the mayors should receive a share of each income tax band. This would provide more stability in local income tax revenues by reducing reliance on the top earners. It would also give an incentive to the mayors to pursue inclusive growth, by pushing for increases in income growth and employment across the entire income distribution.

The share of income tax that should be devolved depends on the nature of the triple deal agreed, as shown in Figure 9 (the annex describes the model used to estimate current and income tax revenues in each city in Figure 9 and Figure 10). Under the model with greater fiscal devolution – Funding Mix A – the mayors are compensated for a lower per head grant of £200 with 20 per cent of local income tax revenues for Greater Manchester (£1.45 billion) and West Midlands (£1.35 billion), and 1.5 per cent in London (£685 million). Under Funding Mix B with less fiscal devolution, the mayors receive a higher per head grant of £333, and so retain 13 per cent of local income tax revenues for Greater Manchester (£940 million) and West Midlands (£877 million), and 0.3 per cent in London (£137 million).

FIGURE 9: **Greater Manchester and West Midlands benefit more from income tax**
Amount and share of locally generated income tax revenues retained, £ billions, 2022/23



SOURCE: Analysis of: ONS 2018, Admin-based income statistics, England and Wales: tax year ending 2018 - Gross individual income by Local Authority (LA); ONS 2023, Country and regional public sector finances revenue tables, Population Estimates

Economic growth will grow local and national income tax revenues

As the triple deal does not give any flexibility to the mayors to vary the rate of income tax, it is possible to estimate future income tax revenues for the mayors and central government under different growth scenarios and funding mixes. By using the Economy 2030's Inquiry's objective of closing the gap between Manchester with Lyon and Birmingham with Toulouse by 2038 as the goal, it can be shown that a local share of income tax encourages the mayors to pursue growth.

Figure 10 shows the net increases in income tax annual revenues shared out between the mayors and central government in 2037 in a range of scenarios where the triple deal has increased local economic growth in each city every year from 2027 to 2038, and different shares of income tax have been devolved in Funding Mix A and B.

FIGURE 10: **Under sharing of locally-raised income tax revenues, central government and the mayors could all share in higher income tax revenues by 2038**
Estimates of income tax revenues in triple deal funding mixes by authority in 2038 (2023 prices)

Funding Mix A				
Share of Income Tax		High Growth	Medium Growth	Low Growth
20%	Greater Manchester	229,533,505	152,210,005	75,655,678
20%	West Midlands	186,504,407	121,032,122	61,370,015
1.5%	London	27,419,475	18,189,604	9,050,045
	Treasury	489,223,387	323,980,562	161,393,527
Funding Mix B				
Share of Income Tax		High Growth	Medium Growth	Low Growth
13%	Greater Manchester	149,196,778	98,936,503	49,176,191
13%	West Midlands	121,227,864	78,670,879	39,890,510
0.3%	London	5,483,895	3,637,921	1,810,009
	Treasury	504,908,002	334,336,311	166,563,458

SOURCE: Analysis of: ONS 2018, Admin-based income statistics, England and Wales: tax year ending 2018 - Gross individual income by Local Authority (LA); ONS 2023, Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted; Country and regional public sector finances revenue tables

Higher growth in the triple deal cities would translate into higher annual tax revenues for the mayors beyond their current level of funding. By 2038, Greater Manchester could raise between £49 million and £230 million; the West Midlands could raise £40 million and £187 million, and London between £2 million and £27 million from keeping a slice of local income tax receipts and more prosperous local economies above their current funding settlement every year, depending on the level of growth and the level of fiscal devolution. National government would benefit too. Between £161 million and £505 million additional receipts in income tax could be raised for HM Treasury by 2038 every year from the triple deal, again depending on the level of growth and the level of fiscal devolution in the three city-regions.

These growth assumptions depend in part on achieving the priorities the Economy 2030 Inquiry set out in Greater Manchester and the West Midlands in their 'Tale of Two Cities' duology, including a large increase in the graduate population, an expansion of the city centre, higher rates of housebuilding, and investment in the transport network and social housing. The Economy 2030 Inquiry has previously estimated that reaching the estimated growth potential of Manchester and Birmingham would take an investment of £3.55 billion through to 2040.[68]

There are two major lessons to draw from Figure 10. First, a greater degree of fiscal devolution should encourage the mayors to take decisions that increase economic growth. In Funding Mix A, the difference in income tax revenues between the high and the low growth scenarios for Greater Manchester and West Midlands are £153 million and £125 million respectively – more than the entire

68 The Economy 2030 Inquiry has previously estimated that reaching the estimated growth potential of Manchester and Birmingham would take an investment of £3.55 billion through to 2040. See: P Brandily et al, A tale of two cities (part 1): A plausible strategy for productivity growth in Birmingham and beyond, Resolution Foundation, September 2023, and: P Brandily et al., A tale of two cities (part 2): A plausible strategy for productivity growth in Greater Manchester and beyond, Resolution Foundation, September 2023.

uplift achieved in the high growth scenario in Funding Mix B. London also benefits from a similar effect, albeit smaller due to its lower share of income tax retention. London's growth incentive works mostly through council tax and business rates.

Second, central government revenues depend much more on the level of growth achieved than the degree of fiscal devolution. This is because displacement effects – how salaries change from moving between different local economies in the UK – swamp the marginal changes in the share of income tax retained by each mayor. But in a high growth scenario for the troika cities, HM Treasury would have roughly £500 million extra income tax revenues to spend on national priorities by 2038 compared to the baseline scenario. Roughly three quarters of these revenues would be from London, reflecting the continued importance of the capital to the national economy.

Together, these two lessons present a trade-off. A lower per head grant today in return for a higher share of income tax means higher future revenues for each of the cities and for HM Treasury, because the mayors get greater rewards for pursuing local economic development. However, the challenge facing HM Treasury is that due to differing levels of economic performance between places, higher shares of local income tax – and lower amounts of grant funding – likely make it harder to roll out the triple deal model to other metro mayors, and fiscal devolution to the rest of England, as the next section discusses in more detail.

Fiscal devolution beyond the triple deal

The triple deal's fiscal reforms would set a major precedent and substantially improve the resources, incentives, and fairness of the tax system for the three big cities. Even if devolution came to a stop after it was implemented, devolution and national economic growth would be much more advanced than they are today.

England's system of taxation in the rest of the country would however remain centralised, and there would be additional factors to consider when trying to extend fiscal devolution more broadly.

We discuss four below:

Local government resource

In the medium-to-long term, extending fiscal devolution to the rest of England is critical to put all local authorities and services on a firm financial footing while also advancing their growth incentive and local self-government. But even if fiscal devolution may bring immediate relief to some places with high tax bases and low need, it will not immediately help those local authorities with the opposite characteristics.

There are therefore two steps to extend fiscal devolution more broadly. First, local government has to be reformed around economic geographies. This will reduce the mismatches between existing needs and funds from shifting grant funding towards per head distribution, both making it easier for fiscal devolution to conduct local redistribution and council funding more buoyant. As discussed in the principles in this section, many local authorities in England cannot currently absorb a big increase in fiscal autonomy, as their small size means local need and resource varies too much for an advance in fiscal devolution to occur without an increase in inequality.

Second, the mismatches between resource and need that would emerge with fiscal devolution across England due to its regional inequalities mean that grant funding to all councils may need to increase to narrow any funding gaps in the most deprived parts of the country. In the short-term, an increase in grant is probably already necessary to prevent further bankruptcies even without reform of the funding settlement.

Capital spending

Fiscal devolution will also see the borrowing capacity of the mayors increase, which will necessitate oversight by the HM Treasury. Local authority borrowing has come under increasing scrutiny in recent years, as the centralised system of granting cheap government debt to councils from the Public Works Loan Board (PWLB) struggles to price risk or hold councils to hard budget constraints.

But increased buoyancy of local government finance would mean that local government is both more exposed to the boom-and-bust phases of the economic cycle. Therefore, borrowing will become more important to smooth out local government finances under fiscal devolution. In addition, higher levels of investment – both public and private – are necessary to tackle the UK's lack of capital stock. The volatility of central government capital spending, with major projects such as HS2 cancelled with little notice, suggests that diffusing capital spending out to local governments could under the right circumstances permanently increase public investment in a sustainable manner.

A reformed system of capital financing would see mayoral and local authorities borrow from capital markets instead of the PWLB. This would impose tighter oversight and accurately price risk, further increasing the incentive for local government to pursue growth. A shift of this kind would depend on either the UK household or corporate sectors increasing their savings rate to increase investment without a further deterioration in the current account deficit.[69] For local public investment to increase under this constraint, central government will need to build demand for municipal bonds among households and capital markets. In turn, confidence in these assets will depend on creating a deep market for English municipal bonds to allow accurate pricing and sharing of risk, and a much-reduced role for the PWLB.

Replacing business rates with a commercial property tax

The rates are an archaic and flawed form of taxation.[70] The case for replacement with a normal commercial property tax is strong, especially to maintain accountability for residents in comparisons with a reformed council tax.

However, as it currently has a role in financing the wider local government system, it is impossible to replace without a reform of that local government system. The reforms introduced over the past decade have been substantial and attracted little controversy, indicating that the politics of comprehensive reform are likely favourable.

Getting commercial property taxation right is a matter of the highest importance for local self-government because distributing its highly localised revenues across the local economies that determine the value of local commercial property enhances both the economic incentives facing local

69 P Brandily et al., Beyond Boosterism: Realigning the policy ecosystem to unleash private investment for sustainable growth, Resolution Foundation, 2023
70 M Broome, A Corlett & G Thwaites, Tax planning: How to match higher taxes with better taxes, Resolution Foundation, June 2023.

government and internal redistribution. It will make it easier to deliver other necessary reforms to local government which are more politically challenging.

Hypothecating a share of national taxation for the per head grant

To reinforce the link between national redistribution and grant funding, the triple deal could consider financing the per head grant out of a committed share of national taxation, with the percentage set at the Spending Review. An example of this hypothecation working abroad is the Local Allocation Tax in Japan, which includes 33 per cent of nationally collected income tax and corporation tax, 50 per cent of liquor tax, and 21 per cent of consumption tax.[71]

This would have three distinct benefits. First, it would make explicit that grant funding should not come from local taxes, as currently happens with business rates. Second, it would mean that local government would have to be explicit that asking for more grant means taking a larger share of national tax revenues. And third, it would retain the benefits of stability from a 'formula' for grant while avoiding the temptation to allocate grant according to Whitehall's definition of local need.

However, hypothecation would entail some trade-offs and a review by HM Treasury. It means that changes to the hypothecated taxes by national government would have consequences for the funding of local government, and introduce economic cyclicality into grant funding. But taxes with stable revenues that are unsuitable for fiscal devolution – such as VAT and corporation tax – are the most promising for a tax-sharing grant arrangement of this kind.

Fiscal devolution depends on the other two legs of the stool

This section has set out the principles that should guide fiscal devolution, and proposed one possible funding model for the triple deal.

Although it may seem tempting, fiscal devolution cannot be extended to places outside of the three troika cites without the other two legs of the stool, with additional powers and reform of geography and governance. Most of the other metro mayors are well-placed to absorb these fiscal freedoms alongside the other changes in this devolution deal, but the fragmentation of local government in the rest of England risks fiscal devolution unnecessarily increasing inequality without a comprehensive reorganisation of local government. We must remember that fiscal devolution is a means, not an end. It does not mean much without the other legs of the stool to ensure additional responsibilities for the three mayors to deliver for their local economies, and stronger accountability to voters and central government. The next section describes what powers the mayors should receive as part of the triple deal.

71 A Breach & S Bridgett, Centralisation Nation: Britain's system of local government and its impact on the national economy, The Resolution Foundation, September 2022.

Responsibilities and powers

Decades of centralisation have left local government with few economic powers that are rarely exercised at the level of the local economy. For the mayors to deliver higher growth in their cities, they need to be able to shape the transport network, the built environment through control of a reformed planning system, and the 'strategic' services for which it makes sense to deliver at the metropolitan scale.

As discussed in Section 1, the second leg of the stool is the mix of powers and services that should be a responsibility of the mayors. Despite the advance of devolution over the past decade, local government in England still has few powers to shape the local economy. Alongside a change in how local government is funded, a shift towards local self-government will require powers to be transferred from Whitehall to mayors and councils.

This does not mean unlimited devolution, but the correct, clear, and protected division of competencies between local and national government. National government will always have a role managing the national economy and providing oversight of local government. Local government, meanwhile, has always been first and foremost the provider of local services. This will remain a crucial duty of councils, and in each of the three cities it will be the primary responsibility of borough councils which are closet to households. But precisely because they are closer to the neighbourhood scale, boroughs are less suitable to exercise powers that pertain to the wider city economy.

The responsibilities transferred to the mayors should be practical and primarily economic. In the triple deal, there should be a reason to expect the powers the mayors receive to either improve the performance of the local economy or service delivery, while still being relatively easy to transfer (ruling out large operational responsibilities, such as schools or the NHS).

The priority responsibilities to be transferred are therefore the planning system and transport. The two complement each other, as urban development shapes patterns of urban mobility – new housing will require transport infrastructure, and denser urban cores will make it easier to deliver improvements to public transport. Delivering change across both policy areas is important if the triple deal is to maximise growth. How these economic levers should be exercised are discussed in more detail in other Economy 2030 Inquiry report and Centre for Cities research, but a focus on city centre development, tradable services, increased housebuilding through densification and outwards expansion, and graduate training and attraction are common to all three cities.[72]

Other services, such as policing or waste collection, do not have quite the same economic role, but there are plausible economies of scale that can be achieved by aligning governance and accountability at the metropolitan level.

Below we discuss what powers the mayor should be empowered with.[73]

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72 G Rodrigues & A Breach, Measuring Up: Comparing public transport in the UK and Europe's biggest cities, Centre for Cities, November 2021; P Brandily et al, A tale of two cities (part 1): A plausible strategy for productivity growth in Birmingham and beyond, Resolution Foundation, September 2023, and: P Brandily et al., A tale of two cities (part 2): A plausible strategy for productivity growth in Greater Manchester and beyond, Resolution Foundation, September 2023.
73 The responsibilities below entail funding commitments and changes. These have not been explicitly modelled in the fiscal devolution section, for two reasons. First, many of the responsibilities are being moved from the boroughs to the mayors, and the internal funding settlement in each city is best placed to divide up resource accordingly. Second, other responsibilities are coming either from central government and can be funded through negotiation concerning the per head grant or will have revenue streams attached (e.g. transport fares).

Planning reform

A big challenge to building the homes, offices and factories that the UK will need to facilitate future prosperity is the current discretionary, case-by-case nature of the planning system, which injects uncertainty into the development process and reduces investment. While this ultimately should be solved at the national level, the troika deals offer the opportunity to at least fix the system in the three cities and show what benefits wider reform can bring.

The scale of the challenge to improve Greater Manchester's and the West Midlands' economies requires the planning system to deliver considerably more homes and commercial space than it currently does.[74] Improving living standards through lower housing costs also depends on big increases in housebuilding, especially in London, which can only be delivered through planning reform.

This should entail three changes:

The creation of a new 'flexible zoning' system for the three cities

The Economy 2030 Inquiry has previously called for planning reform and a shift from discretionary decision-making towards a rules-based zoning system.[75] Centre for Cities has also called for replacing the current planning system with a new 'flexible zoning' system.[76] This spatial approach to planning would see local leaders making strategic choices on how to achieve orderly urban growth across their city, and contrasts to the current discretionary process where each planning application is considered case-by-case.

Under zoning, the planning system would assign different 'zones' to different urban neighbourhoods. The zones would be defined in a national rulebook, and zones would set out the multiple uses allowed and the maximum density of each structure. For example, skyscrapers would be suitable in a city centre zone and polluting industrial activity in industrial zones, but neither would be allowed in a suburban living zone alongside homes, small apartment buildings, light commercial uses and public buildings and similar.

If builders proposed a project which complied with the rules set out by the zoning and national building regulations on sites not subject to protections (such as Conservation Areas or listed status), then planning permission would be guaranteed. Public consultation would be frontloaded into the creation of metropolitan plans (see below) rather than on campaigns to block individual new developments and homes.

Local plans should be merged with local transport plans to create a 'metropolitan plan'

A zoning system would see different urban neighbourhoods be given distinct rules for lawful development depending on how the land is zoned. Zoning would, compared to the current case-by-case planning system, have more certainty, make choices at a neighbourhood scale rather than site-by-site, and be more spatial.

74 P Brandily et al, A tale of two cities (part 1): A plausible strategy for productivity growth in Birmingham and beyond, Resolution Foundation, September 2023, and: P Brandily et al., A tale of two cities (part 2): A plausible strategy for productivity growth in Greater Manchester and beyond, Resolution Foundation, September 2023.
75 P Brandily et al., Beyond Boosterism: Realigning the policy ecosystem to unleash private investment for sustainable growth, Resolution Foundation, 2023
76 A Breach, A Very Short Guide to Planning Reform, Centre for Cities, 2022

Yet there is more to planning than just permitting buildings – infrastructure matters too. But at present this is unnecessarily difficult, as it is done separately across different tiers of local government to planning for the built environment, with local plans (written by the boroughs/unitary councils) deciding where development occurs and local transport plans (written by the combined authorities/ county councils) determining where new transport infrastructure is built. Merging local plans with local transport plans with a zoning system would therefore increase growth not just by making it easier to build new buildings, but by making it easier to deliver new infrastructure with an integrated planning process.

In turn, this raises the question of which tier the new 'metropolitan plan' should sit at. Some boroughs such as Manchester and Brent have delivered considerable changes to their built environment, while many others have not, such as Croydon's short-lived experiment at suburban densification from 2019-2022. To have the biggest impact on economic performance, the mayors should write the metropolitan plan, in consultation with the borough as providers of social infrastructure and representatives of community input. For this spatial planning approach to improve the economy by integrating planning for the built environment and transport, it needs to be at the scale of the local economy and transport network.[77]

Introduce a Builder's Remedy for the Mayors

A barrier to growth within the current planning process is that there is no penalty for failing to agree a local plan. As of early 2022, only 42 per cent of local planning authorities have an up-to-date local plan.[78] As the development process depends on local plans being in place to deliver development at scale, investment and construction can slow to a crawl if an authority fails to agree a local plan, whether due to delays or design. Although the incentives to pursue growth would be improved by fiscal devolution, this risk would remain without reform. There are already deterrent mechanisms in the English planning system to encourage councils to agree local plans, but they are currently not working well.

The plan-making process could be made more effective if a Builder's Remedy was introduced into the triple deal, as recently introduced in California.[79] Under the Builder's Remedy, a mayor that failed to agree a metropolitan plan would lose the ability to use their planning powers to manage development at all.

The Builder's Remedy is not intended to be a route under which new development is delivered. Instead, the rationale is that if a mayor is unwilling to use the powers given to them by the planning system to plan for growth, then they should not be able to use those powers to block rule-abiding development. Indeed, the Builder's Remedy would ideally never be invoked. Instead, it would provide a strong incentive for the mayors to agree a lawful metropolitan plan that matches the importance of the economic role they are assuming. This is how the Builder's Remedy was intended to work and is working in California.

77 Other local planning authorities that exist either to protect specific areas from economic development or to deliver complex regeneration schemes, such as national parks or development corporations, should retain their status.
78 R Clements, Ten years of the NPPF: What do we have to show for a decade of plan making?, Lichfields, May 2022.
79 A Breach, Can California's Builder's Remedy help solve England's housing crisis?, Centre for Cities, October 2022.

Transport

Urban mobility expands the size of the labour market available to workers and firms, deepening agglomeration effects and thereby local and national economic performance.[80] Additional social benefits that come with successful transport policy – climate, air quality, social inclusion – are all important but depend on a successful economic case.

London already has an extensive transport network, but it is congested, and its funding model has experienced challenges since the Covid-19 pandemic. As Centre for Cities research and the Economy 2030 deep dives have established, Greater Manchester and the West Midlands face severe congestion due to both a lack of infrastructure and a low-rise urban form.[81]

To shape this the mayors should be given more powers, which we discuss below. These changes will have fiscal implications for the mayors, particularly taking on the rail infrastructure and the new maintenance costs that come with being a highway authority, but these have been excluded from the report's modelling in the fiscal devolution chapter because the internal funding settlement within each mayoralty will adjust funding accordingly to match the greater responsibilities that are passed down. Of course, transport investment will make little difference to the economy if the cities' built environment does not change. The planning reforms from the preceding section will be needed alongside transport devolution if growth is to increase.

Mayors should be given control of suburban heavy rail lines and all stations

For mayors are to be accountable for the urban transport system, they will need to operate the city commuter rail services, with control of the farebox, ticketing, and timetabling, similar to either the Overground or the Elizabeth Line in London or the evolving arrangements in the Liverpool City Region.

As the urban rail networks are tangled within the national rail network, different lines are easier or more challenging to devolve. The West Midlands Rail Executive already has a role in running the commuter lines into Birmingham, and further devolution to this body might be the easiest way to advance rail devolution in the short-term locally.

Within the other two city-regions, the lines that can most easily be handed over to mayoral control are:

- Greater Manchester: The one-in-five rail services mentioned in Greater Manchester's trailblazer devolution bid, including:[82]
    - Wigan – Manchester Victoria
    - Stalybridge – Southport
    - Glossop – Hadfield – Manchester Piccadilly
    - Rose Hill – Manchester Piccadilly
    - Buxton – Manchester Piccadilly
    - Alderley Edge – Manchester Piccadilly

80 A Bertaud, Order Without Design: How Markets Shape Cities, MIT Press, 2018.
81 P Brandily et al, A tale of two cities (part 1): A plausible strategy for productivity growth in Birmingham and beyond, Resolution Foundation, September 2023, and: P Brandily et al., A tale of two cities (part 2): A plausible strategy for productivity growth in Greater Manchester and beyond, Resolution Foundation, September 2023.
82 Transport for Greater Manchester, Local accountability at centre of new bus network as operators appointed to run first franchised services outside of London for almost 40 years, December 2022.

- London: the 'Metroisation' proposals that would take much of the rail network of South and Southeast London under TfL control, with improved frequencies and development of transport corridors.[83]

In addition, the Mayors should receive control of all the stations – or at least all intra-urban stations – within their boundaries. This will make it easier for the mayors to deliver on integrated transport strategies for their cities, and redevelop stations and their neighbourhoods to finance enhanced transport services.

The mayors should become the highway authority for all A and B Roads and roads near stations

If the mayors are to oversee their transport network, then they need to be responsible for the road journeys between different boroughs for both commuting and freight. This has three distinct elements – managing traffic, providing new highways, and maintaining existing highways.

Historically, the latter was the responsibility of more strategic levels of local government. Classified roads – A and B roads – that were not nationally-significant 'trunk' roads were the responsibility of London County Council, the Greater London Council, and the Metropolitan Counties. 'Unclassified' local roads only of significance to residents remained under the control of the boroughs.[84] A and B roads are therefore a good starting base for negotiations about transferring control of roads back to a metropolitan level of local government. This would mean going beyond the consulted changes to the Key Route Network and transferring greater responsibilities for inter-borough travel from the boroughs to the mayors.

There are two potential additions to this. One would be to make the mayoral authority the highway authority for roads in the immediate vicinity of tube, tram, and railway stations too. This would enable the mayors to proceed with redevelopment of the stations and the neighbourhoods around them without requiring a Section 8 agreement under the Highways Act from the borough council for any works pertaining to the roads. The other would be to also make the city-region authority the highway authority of all roads within a defined city centre. As the city centres are economic assets of urban and national significance, this would ensure that changes to their road networks are accountable to the wider metropolitan system of governance, rather than purely particular local interests that borough councils are rightly sensitive towards.

The mayors should have the power to set workplace parking levies and responsibility for micromobility

As the mayors outside London do not currently have the power to set workplace parking levies to manage traffic, this power would need to be transferred from the boroughs by affirmative order from the Secretary of State for Transport, subject to section 87(1) of the Local Transport Act 2008. Whether the mayors then use this power is up to them.

Whenever national legislation progresses on micromobility and e-scooters, mayors should be the responsible authority for managing micromobility across their urban area. This will make it possible to integrate micromobility into the wider transport strategy, so that it used safely and without

83 Transport for London, Strategic Case for Metroisation in south and south east London, March 2019.
84 Royal Commission on Local Government in Greater London, Cmnd 1164, 1960, HMSO; M Smith Highway Authorities over Sixty Years, Chartered Institute of Highways and Transportation: North Eastern Branch, 2012

cannibalising fares revenue that the city depends upon. The West Midlands in its trailblazer deal is

already assuming responsibilities for micromobillity, and these could be extended to the other mayors too.

Services

Most services provided by boroughs differ from the preceding responsibilities and fiscal powers already discussed in that they have no direct economic benefits. The case for devolving them – or granting them to the mayor – must therefore be distinct. There must be obvious misalignments between how services are currently provided and the evolving structure of devolved, urban government in the mayors, or there must be clear efficiencies to provide services at a metropolitan scale.

Many services currently provided by the boroughs will be best provided by the boroughs. 'Personal' services, with one-to-one interaction between individuals and the providers, are unlikely to benefit from economies of scale and could potentially be affected by diseconomies.

In contrast, services that are more 'strategic' in nature sometimes present more obvious mismatches between the evolving structure of local governance in each city, and their arrangements pre-date the creation of the metro mayors. The negotiations for the triple deal should consider whether they could be better delivered by the mayors in light of their growing economic responsibilities and strong electoral mandates.

Services that should be considered are as follows:

Making the Mayor for the West Midlands responsible for policing, and potentially nationalising the Metropolitan Police's national responsibilities

The Mayor for the West Midlands has recently asked under the Levelling Up and Regeneration Act to be given Police and Crime Commissioner powers. This should happen – it will place the mayor on a level playing field with the other mayors and make fiscal devolution to the West Midlands possible by transferring the police and fire and rescue precepts to the mayor.

In addition, a fair funding settlement for London may depend on the Metropolitan Police losing some of their national responsibilities. These have already been raised as a possibility by the Casey Review, but any action on this will have to wait until a consensus has emerged on the future of policing in London.[85]

Giving the mayors powers for licensing in their city centres.

Within a defined city centre zone – such as London's Central Activities Zone – the mayors should take on the power to grant or deny licenses to premises for the trade in alcohol and entertainment. Unlike suburban locations where boroughs should keep their licensing powers, city centres have a metropolitan, national and international economic role as places of amenity and consumption.

As the licensing authority and police authority of their city centres (including West Midlands after the merger of the Police and Crime Commissioner role), the Mayors will also collect 100 per cent of the

85 L Casey, An independent review into the standards of behaviour and internal culture of the Metropolitan Police Service, 2023

late night levy paid by licensed businesses open after 00:00 to pay for policing costs.

Making the city-region authorities the Waste Disposal Authorities (WDAs).

Waste collection is a personal service – for residents, once it is out-of-sight it is out-of-mind. But disposing of a city's waste is a strategic problem as it requires land and sites for processing. Yet despite this, there are severe mismatches between the Waste Disposal Authorities and metropolitan governance, especially outside Greater Manchester. These should be aligned to allow the mayors to better manage and reduce waste across their cities. The negotiations should also give serious consideration to the city-region authorities also becoming Waste Collection Authorities.

Providing a Department of Education Regional Director for each mayoralty.

Although London currently has its own Regional Director, neither of the other two mayors has a comparable connection to the Department of Education.

Despite the challenges associated with them, fiscal devolution and more powers to shape the local economy are arguably the easier parts of the devolution deal. The final leg of the stool – governance and geography reforms – and the barriers they will face are the subject of the final section.

Governance and Geography

The powers over taxation and policy that the troika deal will transfer mean local leadership of local economies will matter more for the three cities and the national economy. A tighter link between voters, leaders, decisions, and outcomes is necessary if the stronger economic incentives the deal provides are to be incorporated into stronger political incentives. This requires Greater Manchester and the West Midlands to be put on a level playing-field with London with the re-establishment of a governing structure that is separated from the structures of their boroughs.

Geography is less important for the triple deal than it is to extending local self-government to the rest of England, as the city-region authorities already approximate the economic geography of their cities. Changing the boundaries of these cities at this stage would be challenging, deliver few immediate benefits, but is ultimately necessary to deliver devolution across England. The triple deal should instead commit the city-region authorities to support boundary changes that would align political and economic geographies in a future reorganisation of local government across England.

Devolution across the other two legs of the stool – funding and responsibilities – should improve outcomes by increasing the ability of local leaders to change their local economies. Yet if local politicians in the places benefitting from the triple deal are to get more powers to shape the local economy and set local taxes, both voters and central government need to know that they can hold specific people accountable for the performance of the local economy and services. Achieving this balance between leadership and accountability in the design of local institutions is a crucial question for central government.

So is the geography of local government. Local government needs to be meaningfully local and not 'regional' if it is to represent distinct local economies. But it cannot be so local as to divide different parts of the same local economy from each other, as that would make it harder to manage local economies and deepen inequalities.

Below, we discuss these both and how they pertain to the triple deal both for its cities and as a stepping stone to further devolution.

Governance

The underlying problem with local governance in England is that local government is too weak and too fragmented to manage the local economy well. If greater local self-government is to improve the performance of the national economy, then there needs to be a stronger connection between local elections, the behaviour of local governments, and local economic outcomes.

Reflecting the diminished authority of local government, turnout in local elections is low. Despite the huge variation in places across England, local elections – sometimes occurring three out of every four years – are often seen as national polls, and have little impact on local outcomes. They are either predictably safe or unpredictably volatile, and councillors have little ability to win support based on a proven track record.[86]

The metro mayors and Mayor of London are popular institutions, but are only a small part of the structure of local government, even in the big cities. Outside of London, the mayors are slim

86 A Breach & S Bridgett, Centralisation Nation: Britain's system of local government and its impact on the national economy, The Resolution Foundation, September 2022.

institutions with bespoke arrangements and an awkward statutory basis as 'confederations' of boroughs, unlike the metropolitan counties they replaced. This is largely because the legislation that created the combined authorities pre-dated the first elections for the metro mayors. An enhanced role for the mayors in local government will therefore require a relative shift in authority from the boroughs towards metropolitan government, even if the autonomy of the boroughs is also enhanced through fiscal devolution.

The 'combined' model of governance has worked well in Greater Manchester, but it has been less successful in other parts of England. Calls from other parts of the country, including other city-regions, for different arrangements and the lukewarm reaction to the proposed 'County Deals' indicates it struggles in parts of the country without the same history of decades of co-operation or urban geography.[87]

However, the advanced nature of devolution in the three cities makes it challenging to create a new set of arrangements from scratch. Government and the mayors will have to start from the shared position that the current model of governance cannot serve as a stepping-stone to devolution across the rest of England.

The triple deal can help address these problems by enacting the following changes.

London-style devolution for Greater Manchester and the West Midlands

The metro mayors of Greater Manchester and West Midlands should be put on a new statutory basis that separates their city-region authorities from their boroughs, as is the case with the mayor of London and the Greater London Authority. By recreating the structure of the metropolitan counties, it would untangle the responsibilities of the local boroughs and the mayors, put places outside the capital on a level playing field with London, and make it much easier to extend the triple deal's model outside of the initial cities while expecting improvements to growth.

Metropolitan assemblies for the city-region authorities

Alongside the separation of the city-region authorities from the boroughs within them, a new assembly should be established on a city-wide basis to hold the mayors to account with questioning, drafting reports, and passage of the mayors' budget with a link to the voters.

There are at least two ways this could be done, each with their own advantages and limitations. One option would be a directly elected assembly, effectively extending the London Assembly model to Greater Manchester and the West Midlands. Such a model has been suggested before within Greater Manchester.[88] The other option would be an indirectly elected assembly composed of councillors directly elected to each borough, set in proportion to their party's representation in each borough. This would likely require reform of how boroughs are elected to improve proportionality in the boroughs and the city-region authority (as set out below), but the indirect approach is for example how the Metropolitan Area of Barcelona is scrutinised across its 36 separate municipalities.[89]

87 S Calkin, Metro mayor: Combined authority model doesn't work, Local Government Chronicle 2023; D Turner et al., Why hasn't UK Regional Policy worked? The views of leading practitioners, M-RCBG Associate Working Paper Series | No. 216, 2023
88 N Jackson, Calls for London-style assembly which would hold Greater Manchester Mayor to account denied, Manchester Evening News, 2023; Manchester City Council 12th July, Agenda Item 57 https://democracy.manchester.gov.uk/ieListDocuments.aspx?CId=135&MID=4354#AI12376
89 https://www.amb.cat/en/web/amb/la-institucio

Furthermore, the parliamentary scrutiny committees for Greater Manchester and the West Midlands established by the trailblazer deals should be abolished.

Electoral reform for metropolitan and local authorities

Alongside the changes to the institutions above, the triple deal should consider electoral reforms to improve accountability of all local representatives. This is the other side of the coin to taking on a greater local responsibility for local economies that become more important to the national economy – political competition needs to be focused on the record and promises of mayoral candidates, rather than being seen as proxies for national elections to Westminster.

The recent abolition of the Supplementary Vote for the mayors should be reversed. Either the Supplementary Vote could be reintroduced or the Alternative Vote could be introduced for the first time. The mixed approach of the Additional Members System (AMS), currently used in the London Assembly, could be used for the metropolitan assemblies. This would allow for both local representation of specific boroughs/neighbourhoods while avoiding one-party dominance on the scrutiny bodies.

For the borough councils, this becomes especially important if an indirect approach is taking to a mayoral assembly. Either AMS could be considered for borough elections, or a shift towards single member wards, reflecting national Government policy which is starting to encourage a shift towards single-ward councils.[90] At a minimum, the triple deal should see the boroughs cease to conduct elections in 'thirds', which are an artefact of medieval voting practices to approximate proportional outcomes before modern electoral systems,[91] and move to all-out elections like all London boroughs currently do.

Shifting councillors and assembly members from ward-based to 'at-large' elections across the entire authority is likely to increase growth, as evidence from the US suggests the latter is associated with higher levels of housebuilding as it incentivises local representatives to care about the prosperity of the entire city.[92]

Restore the abolished-heraldry of the Greater London Council and the Metropolitan Counties to the mayors

The temporary abolition of metropolitan governance in England's big cities saw their arms fell into abeyance. The triple deal should consider granting them back to the mayors.

Geography

For devolution to work, powers over the economy should match the geography the economy operates over. The political geography and the economic geography of a place should ideally align. Although not perfect, the existing geographies of Greater London, Greater Manchester, and the West Midlands are a close match to this.[93] Therefore, changing the political geography of the city-region authorities

90 M Caller, Liverpool City Council Best Value Inspection, 2022
91 J. Colomer, On the origins of electoral systems and political parties: The role of elections in multi-member districts, Electoral Studies 26, 2007, pp. 262-273
92 M Hankinson and A Magazinnik, The Supply-Equity Trade-Off: The Effect of Spatial Representation on the Local Housing Supply, The Journal of Politics, Vol. 85, No.3, 2023; L Fang et al., Homeowner politics and housing supply, Journal of Urban Economics, Vol. 138, 2023
93 That said, the political geographies of the troika cities were last set in 1963 for London and 1972 for Greater Manchester and the West Midlands. In the more than fifty years since, technology, commuting patterns, and the nature of the British economy have all changed.

– which is politically challenging – is not necessary for the triple deal to succeed. All of the modelling and recommendations set out in the rest of this report can be delivered without touching the current boundaries.

But this is not the case in many other parts of England. Box 8 discusses what will need to change if this model is rolled out beyond the troika. The triple deal needs to commit to devolution towards economic geography if it is help advance local self-government across England, even if the deal does not change any boundaries.

BOX 8: **Why does economic geography matter for local self-government?**

For wider devolution to be a success, the local government system will eventually have to be reorganised. Devolution to a flawed political geography disconnected from economic geography will fatally undermine the long-term success of any settlement and make inequality worse with minimal improvement to growth incentives, resource, or the quality of governance.

Economic geographies cover subregional areas that reflect commuting patterns – the geography over which people live, work, study and play in their day-to-day lives. The local needs of both workers and firms broadly overlap at this level, as improvements to local infrastructure, housing markets and commercial property, and education will have benefits across an entire economic geography.

Fragmenting a local economy between different authorities will damage the ability of leaders and voters to shape their local economy and exacerbate inequality. Conversely, too many local economies into a single authority risks either "jam-spreading" or conflict between different places with different needs. This is not necessarily a problem for the triple deal, but the fragmentation of local government outside the big cities presents the single biggest barrier to further devolution.

Given this, the triple deal should consider the following changes.

A memorandum of understanding on the economic geography of the city regions.

Instead of requiring the triple deal to deliver difficult reforms to political geography, a simpler approach would be to commit to future reform when comprehensive reorganisation of local government in England becomes possible and is on the agenda. A memorandum of understanding agreed between national government and the mayor alongside the triple deal would help advance longer-term reform if it included:

- a recognition by all parties that the political geography of the city-region authorities is currently incomplete;
- a shared definition for the economic geography of the big cities; and,
- a commitment by all parties to support future changes to the boundaries of the city-region authorities so they align more closely to the economic geographies of the big cities.

This would allow the triple deal to reassert the importance of economic geography to future reform without the difficulties of implementing it at this stage.

Other metro mayors who currently run combined authorities with misaligned political and economic geographies – for example, the West of England is currently missing North Somerset – should also be

This means that changing the boundaries to reflect these changes should be considered as part of future progression on devolution.

required to sign a similar memorandum of understanding prior to opting into the triple deal.

Use high skill Travel to Work Areas as the basis for economic geography

The standard approach to measure the geography of an economy is to use 'travel to work' areas (TTWAs). The issue with this approach is that they are influenced by the skills of the workers who live in them, as higher skilled workers are more likely to travel longer distances to commute. Therefore, TTWAs with more graduates – which typically perform better as skills are so closely linked with economic performance – are generally larger than those with a lower share of graduates.

For devolution, this causes two potential problems. First, as graduates are so important to economic performance it means devolution to TTWAs would not to be a consistent scale across England and would bake in misalignment between political and economic geographies. Second, the small size of TTWAs with fewer skilled workers would mean fiscal devolution risks making inequality worse, as poorer places with fewer graduates to start with would have a larger share of their graduates working in the local economy but living outside their boundaries. Devolving to TTWAs would therefore make local redistribution unnecessarily difficult by increasing the tax burden on low-income workers in poorer local economies.

To address this, local economies should instead be defined by high skill TTWAs (HS-TTWAs) instead, which are also produced by the ONS and University of Newcastle using 2011 Census data.[94] By using the commuting patterns of graduates to define economic geography, the political structures that devolution would establish could absorb more fiscal devolution and stronger growth incentives with less risk of increasing inequality. This would have implications for the next phase of devolution to the rest of England and the triple deal cities. For example, London and Greater Manchester are all split into two TTWAs, but contain one HS-TTWA each, while the West Midlands is currently four TTWAs but two HS-TTWAs.

94 ONS with M Coombes, Travel to work area analysis in Great Britain: 2016, University of Newcastle RR2016/04, September 2016.

Conclusion

Britain has been here before. Serious economic problems persist through multiple Parliaments due to institutions that have seemed impossible to reform. Both the diagnosis and the desire for change quickly become conventional wisdom, but opportunities for reform are missed. Eventually, a resolution is delivered in the national interest, but at great cost after decades of delays.

Yet the challenge facing the British economy today is greater than any it has previously faced. The worst period of economic performance since the Industrial Revolution has been combined with the hardest external constraints on the public finances in living memory, as pressures on the welfare state continue to rise without any obvious sources of extra revenue, such as defence after the Cold War.

Hard choices are now unavoidable. Either taxes must increase as living standards stagnate or fall, or previously untouchable institutions are finally reformed in pursuit of economic growth. And the three largest local economies in the UK – London, Manchester, and Birmingham – need to grow if the national economy is to grow.

Local government is part of the solution because it is part of the problem. Excessive centralisation, weak and fragmented governing structures, a funding framework for local services in England on the brink of collapse, and the underperformance of the big cities outside London are problems that touch us all. Even if the system sees the increase to funding it needs to meet its current responsibilities, there is no route to improved national economic performance without better local economic governance, which is impossible with devolution and comprehensive reform of local government.

But the scale of the challenge is great but can be overcome. England has reformed its system of local government in the past, as have other countries. This report has set out how devolution across all three legs of the stool is on a scale big enough to make a difference while still being achievable in the short term. London, Greater Manchester, and the West Midlands would gain with the triple deal the resources, incentives and powers to start changing their local economies and the national economy for the better.

The triple deal would not complete devolution. It would be a substantial stepping stone, but further changes would be required outside of the big cities to extend local self-government to the rest of England. It is perhaps possible to offer some of the benefits of the triple deal to local authorities that voluntarily align around economic geography, particularly those reforms concerning fiscal devolution due to the local funding crisis. Yet the devolution agenda will have to pursue wider reorganisation.

At this stage, getting fiscal devolution right is the priority. The details are complex and will depend on negotiations between the three mayors and central government. But it must be done to escape the local funding crisis without deepening centralisation. By combing fiscal devolution with greater powers and governance reforms, a solid base for local and national growth through local self-government can be established.

Centralisation is a choice. It is a recent development, and we can decide to undo it. It won't be easy, but rebuilding local self-government is part of how we will rebuild the British economy and enhance our democracy.