TRL Insight

Representation to

Spending Review and Autumn Budget 2021

About TRL Insight

TRL Insight is the trading name of Tom Lawrence. Tom has provided policy advice, analysis and other services to the public sector for over 20 years. Some of this has been delivered under the TRL Insight brand; some through associate and core staff posts, in a range of organisations in and supporting local authorities and schools and their partners. The contents of this response represent the views of TRL Insight only.

This policy advice and analysis has included:

- Two Excel tools commissioned by the Local Government Association (LGA) in relation to the Fair Funding Review of business rate redistribution;
- A report for the LGA on the fragmentation of funding to local authorities;
- A range of briefings on the financial and wider impact on local authorities of central government policies and decisions, including spending reviews and budgets;
- Briefings, longer guides and training sessions on the funding system for local authorities and best practice in investing to save and generating income, and briefings on schools grants;
- Case studies on the relationship between public health and inclusive growth;
- A well-received report on school funding pressures in England;
- Participation in the Capital Programmes Working Party run by HM Treasury and the Settlement Working Group run by DCLG (as it was then titled);
- Case studies on London authorities' innovative capital investment in infrastructure;
- Articles for the MJ and Room151 and contribution to a Guardian LiveChat on the future of public sector funding;
- Supporting a council group in a London Borough in relation to the full range of council service areas;

- Responses to many government consultations.

Tom also has experience in the tourism industry and experience with local organisations and campaigns, such as

- A campaign to reduce knife crime in inner South-East London;
- Raising awareness of community rights within the community and voluntary sector;
- Work with a social enterprise running a library and recycling service.

Overview of contents

This may be an unusual spending review submission, as it does not make representations on particular policies to spend more money on particular services.

Instead, it focuses on:

- Improving the Government's financial planning, analysis and accounting regimes, to unlock future growth, revenues and savings;

- Measures to provide local government with the financial autonomy it needs to invest in local communities and level up local economies.

There are four topics covered in this submission:

- **Investing to save**. This is about making greatest use of analysis, resources and structures developed in recent years to move public sector financial planning to a more long-term basis. It would enable the Government to identify future revenues and savings that could be far greater than the upfront costs. The text illustrates these principles with a commentary on four policy areas in which they may be particularly relevant, but these are just provided by way of illustration and readers of this submission are urged to focus on the overall principles. Due to the time pressures of running a small business, TRL Insight has not been able to exemplify any of the four examples financially in time for the submission deadline. But it seems almost certain that other representations will have done this, or at very least, exemplified the initial costs and returns of other interventions to which these considerations are relevant.

- **Reforming the public accounting regime to unlock local growth**. This is about technical changes which do not require extra spending by the Government. They would make investment mechanisms possible, including Tax Increment Financing. A sense of what this could achieve can be gained from the section on this in the report Building Freedom. The details of these changes may need to be worked through carefully. TRL Insight therefore urges the Government to commence this process immediately and operate to a timetable of being able to implement them in the next Spending Review at latest.

- **Local authority taxes that reflect ability to pay**. This is a plea for additional tax levers for local authorities, to reduce the need for more grant funding to remain financially viable and to begin to take the role the Prime Minister envisages for them. Any sums raised from these taxes would of course be used to fund local services. Any equalisation necessary would occur within the sector and would be revenue neutral. TRL Insight urges the Government to begin to develop options immediately and to commit to introducing at least one such tax power before the end of the Parliament, to tackle unsustainable budgetary pressures in local government.

- **Reforming the grant funding regime**. This is about improving the nature of grant funding to local government – for example, providing more certainty over future funding, providing a smaller proportion on the basis of competitive bidding and improving record-keeping by central government. Few figures are provided in this submission, but readers are referred to the report Fragmented Funding, which contains extensive financial and statistical analysis. TRL Insight urges the Government to begin to implement the report's recommendations immediately.

Investing to save

For the finances of the public sector as a whole, the most beneficial change that could be achieved in coming years would be a transition to a longer-term approach to policy-making. This would mean projecting all the knock-on implications of each policy on other service areas and, in particular, facilitating interventions which either generate greater tax revenues or create savings for the public service in the long term.

In the past, such long-term financial planning has tended to be limited to capital spend on infrastructure projects. However, to the external observer, there are now signs that HM Treasury's approach is starting to evolve. Furthermore, structures are now in place and analysis is being done which will allow such interventions to be identified far more readily. This has become possible largely because of greater collection of data and the growth of technology to analyse it.

Such structures and advances include:

- Setting up the What Works Centres and the analysis they have carried out;
- Tools for calculating the cost-benefit ratios and returns on investment from policy measures. These include the Cost Benefit Analysis (CBA) model developed by the Greater Manchester Combined Authority (GMCA), the Social Value Engine developed by Rose Regeneration and a series of tools developed by Public Health England;
- Publishing the Aqua Book and improvements to the Green Book;
- Setting up the Office of Budget Responsibility (OBR), and staffing it with those who have skills in long-term projection and an understanding of public policy in the round – alongside the Treasury Select Committee, the OBR can provide robust stress-testing and critical challenge to financial planning.

The limitation of long-term financial projections to infrastructure projects in past decades has even affected the language used in key fiscal documents – in spending reviews and budgets, it has at times been commonplace to use the phrases "investment" and "capital expenditure" almost interchangeably. On occasion, HM Treasury has also cited statistics that capital expenditure produces a far higher return on investment (ROI) than current (revenue) spending or welfare payments – as though all capital spend results in the same ROI and all revenue spending has the same ROI. This is far from the case. Some capital projects will never result in particularly high income or savings for the public purse but are instead carried out for to improve the quality of life of citizens. Conversely, there are many possible interventions where a relatively modest revenue investment by the public sector would produce considerable savings or increases in tax revenue downstream. These are often investments in some form of prevention or early intervention. Key areas for these include:

- **Investing in young people**. Spending consequent on worklessness is a major drain on public finances. Criminal behaviour results in even higher costs to the public purse. Naturally, if adults are gainfully employed, this results in significant tax revenues – from their own earnings taxes, sales taxes on what they spend their pay on, and multiplier effects. Once an individual has developed patterns of behaviour, this can last for decades – and is often passed on to succeeding generations. Such patterns of behaviour are usually developed in childhood. Thus, investments for a few years in a person's childhood, to ensure they start out on a successful path through life, can produce a very significant return. This requires the coordination of many policy areas, to ensure that children have academic skills, "soft" employability skills and life skills, and are healthy, happy, resilient and aspirational. This means ensuring that they have mental health support, access to physical health services, the time and opportunities to socialise, appropriate role models and guidance where necessary, as well as formal education;

- **Health and care**. The importance of treating health conditions early, before they have become acute or chronic, is well known. It is far better – and cheaper – for an individual to have their health and care issues addressed in primary care and social care settings than when they have become serious enough to require hospital treatment. Early intervention makes it easier to tackle both physical and mental health issues – and these are often deeply intertwined. Indeed, public health interventions can help to prevent people becoming ill in the first place, reducing the overall cost to the public sector even further. The nature of these can vary very widely, from sexual health policies, to treating drug and alcohol abuse, to improving air quality, to improving leisure facilities, parks and other public amenities, to improving housing quality and providing employment support (see below).

- **Helping people obtain and retain work which suits them**. The key challenge for the public finances is ensuring that costs are covered by income, especially from taxes. This is becoming harder as social care expenditure rises – both for the elderly and for working age adults. The best way of maximising revenues is to ensure as many people are in work as possible. But in general, if people see work which appeals to them and they are able to do it, they will. The NHS has been very successful at keeping people alive longer. The challenge now is to keep people healthy enough to work – and to ensure work which they are willing and able to do is available, and to help them obtain and retain it. Again, there are a wide variety of policy interventions which can help with this. There may be barriers to work such as transport, childcare or having the appropriate skills and training. And there is a two-way interplay between health and employment: poor health can be a barrier to work, but also employment in suitable, satisfying, high quality work can improve an individual's mental and physical health, while conversely, unemployment can result in a downward spiral.

- **Policies to reduce reoffending**. Where an individual does engage in criminal behaviour, it is vital to break the cycle of offending before it becomes entrenched. For those sent to prison, policies to facilitate this may relate to their time in prison, the time around their release, or to their life after prison – or very possibly, this timeline as a whole. Relatively small outlays could prove of great value to society and to the public purse. In developing policies in this area, it is important not to focus on whether the policies are "tough" or "soft" on criminals, but on what works. It is not in society's interest to treat offenders in a way that leads to more frequent re-offending. As long as they are accorded basic human rights, policies should be acceptable to the public but also, crucially, evidence-based. TRL Insight urges the Government to build up an evidence base on which interventions are successful in reducing reoffending, and to build policy from this foundation.

There are two points in the above commentary which it is worth going into a little more detail.

The economic and financial dimensions

Firstly, much of the work done in this space in recent years has been based on the concepts of Social Value and Social Return on Investment (SROI). For example, the New Economics Foundation (NEF) developed techniques for measuring SROI and their work was complemented by that by the Centre for Local Economic Studies. Social Value UK has also played a key role in supporting the development of analysis on this subject and in supporting social value more widely.

However, the Green Book distinguishes between the "economic dimension" (based on social value) and the "financial dimension" of a proposal for public spending. The case made above deliberately stresses the **financial return** to public sector budgets of interventions.

TRL Insight therefore urges the Government to do the following. Firstly, review the existing tools for analysing the return on investment from policy interventions. Secondly, adapt them where necessary to make them suitable for use in its own procedures on the appraisal of policies, projects and programmes – or develop its own tools which will do the same – consulting with the OBR to ensure their robustness. Thirdly, explore the interventions contained in these tools and other policy proposals made in other Spending Review and Budget representations and ensure that there is a route by which these can be considered as options in departmental policy-making.

Such a course of action could improve the health of the public finances and increase the efficiency of Government spending, and would decrease the chance of prudent proposals inadvertently being excluded from the decision-making process.

Savings generated for central government by local government

Secondly, it is clear from the above examples that often a policy executed by one part of the public sector will result in financial benefits for another part of the sector. In particular, many of the measures that could save money or bring in increased tax revenues for central government fall within the responsibilities of local government.

TRL Insight urges the Government to explore these with local authorities, inviting them to co-design and implement appropriate policies in a genuine and engaged partnership.

This could involve an arrangement in which the tax revenues or savings are shared with the local authorities.

The difficulty for local authorities, however, in investing in prevention and early intervention is that, unlike central government, they are unable to borrow for revenue purposes. The one instance in recent years in which local authorities could use capital funding for revenue purposes was the provision of capitalisation directions for major service transformation projects; even then, they had to be funded from capital receipts, rather than borrowing.

To unleash the full power of local government to generate savings and tax revenues for central government, two components are needed. One is a structure for making arrangements to share these savings and revenues, and the other is the extension of the prudential system to cover councils' revenue expenditure on invest-to-save projects. TRL Insight urges the Government to extend make these changes, with the extension of the prudential system to cover invest-to-save project which generate savings or income for any part of the public sector.

Reforming the public accounting regime to unlock local growth

The last section of this response closed by allowing local authorities to borrow for specific savings- or tax-generating revenue purposes.

There is a long-standing related issue about how the public sector accounting regime may be improved to unlock greater investment in capital projects for local growth. This starts from the following observation. If a local authority spends money on a capital project which is financed by borrowing from a bank, or raising bonds through the UK Municipal Bonds Agency (UKMBA), this expenditure is included in the Government's fiscal documents in a way which makes it appear as though it is the Government's own spending. This seems preposterous and is a presentation peculiar to the UK.

But it has real consequences. This strange presentation led to a severe limitation on England's only brief experiment with Tax Increment Financing. It meant that it took seven years and the shortage in housing to reach crisis proportions for the cap on Housing Revenue Account borrowing to be lifted. It also meant that capitalisation, which allowed councils to treat one-off revenue costs that were otherwise unaffordable and incurred for reasons beyond the authority's control as capital costs, was first subject to a national limit, then docked from council funding, then ended altogether.

This issue is thoroughly explored in TRL Insight's report Building Freedom. The report examines other countries' measures of deficit and debt, such as Denmark, Sweden and Canada, but also the wider context for these, such as the presentation of fiscal documents and the country's local government finance system.

It recommends that:

- Spending Review and Budget documents should be reformed to reflect the financial autonomy of local government:
    - These documents should focus primarily on the finances of central government and bodies which are answerable to it (such as the NHS and Non-Departmental Public Bodies);
    - Corresponding statistics should be presented for expenditure, income, in-year balance and debt – excluding local government;
    - Financial and fiscal data estimates or projections relating to local government should only be included in these documents in a separate section providing a reconciliation for the whole public sector. These should be agreed through consultation with representatives of local government;
- The Government should immediately set up a panel of experts, as described in this report, to consult on the details of these changes. As part of their deliberations, they should consider the presentation of public finances in other countries.
- In future, the Government should not impose any constraints on borrowing or investment on local government other than those contained within the prudential system. Neither should the Government reduce revenue funding for local government as a "cost" of greater borrowing or investment by local authorities.

The report concludes that

> *"to grow local economies and help them thrive in the long run, investment is needed in local authority assets. With the current accounting system, these will have to be on the public sector balance sheet if a re-run of the misuse of PFI is to be avoided. Any mechanisms developed to increase investment during times of difficulty for the UK economy will be hampered by limits put in to prevent the public sector deficit increasing. Therefore reforms to the public sector accounting system itself are necessary to grow sustainable communities".*

TRL Insight notes that the Government lists among its priorities for the Spending Review:

- *"Levelling up across the UK to increase and spread opportunity; unleash the potential of places by improving outcomes UK-wide where they lag and working closely with local leaders; and strengthen the private sector where it is weak;"* and

- *"Delivering our Plan for Growth - delivering on our ambitious plans for an infrastructure and innovation revolution and cementing the UK as a scientific superpower, working in close partnership with the private sector"*.

To unleash this potential of places and deliver an infrastructure and innovation revolution, TRL Insight urges the Government to implement the recommendations listed above.

Local authority taxes that reflect ability to pay

The Prime Minister, in a speech on levelling up in Coventry on 15 July, described devolution as the "crux of the argument" and spoke of local authorities "taking the lead" in levelling up economies and communities across the country.

However, over the last decade, many councils have increasingly found themselves unable to afford to fund anything more than basic minimum services. They would certainly struggle to lead a revolution in levelling up. While demand for their services keeps rising, the funding for them is often failing to keep pace. In this situation, councils often call for more grant funding from central government. This largely happens because councils are highly constrained in how they can raise their own money, but the Government keeps on introducing new grants for local authorities to spend on specific new projects and services. This is therefore the most familiar way of getting extra cash for the services they are so keen to provide to their citizens.

But there is a problem with this. It makes the councils increasingly dependent on the Government for funding – and dependent on following the rules attached to that funding. This makes it hard for councils to come up with genuinely innovative policies and programmes, based on the strengths and unique characteristics of the localities they serve – especially those which cut across service areas.

Councils will only be free to “take the lead” and “unleash the potential of places” when they have sufficient financial autonomy to do so. This means raising funding locally and within the local government sector and having a range of levers they can pull to do this.

However, the two main sources of local funding, business rates and council tax, are not well suited to a flexible fiscal policy. This is because these two taxes are based on the continuing ownership of property, rather than any ability to pay. This makes it very difficult to change the rates at which they are charged without putting unsustainable pressure on taxpayers.

Council Tax, for example, places a high burden on those who are “asset rich, cash poor”, making it politically difficult to raise rates. The unpopularity of increasing this tax has led to the Government introducing various measures over the years to limit its rise – capping, referenda and the Council Tax Freeze Grant. The revaluation of Council Tax properties in Wales made this procedure so unpopular that it has never occurred in England or Scotland, where council tax bands are still based on 1991 values. This has led to Council Tax becoming discredited as a reasonable basis for taxation.

Similarly, Business Rates are especially onerous for businesses which depend upon having high Rateable Value properties, while completely exempting businesses which operate entirely online. The financial pressure placed on small businesses by Business Rates has led to the Government introducing new discounts and reliefs on a regular basis.

Taxes which reflect ability to pay need to be considered as part of the funding mix for local government. These could be new taxes or supplements to existing national taxes; they could be based on levels of profit (such as stamp duty and corporation tax) or on income (such as income tax). The LGA's proposals for a “basket of taxes” are worth considering in this context. The precise funding mix used in a given locality should be a matter for local discretion, but a common basis for equalisation between local authority areas is needed.

The yield from such taxes will fluctuate with the economic cycle. If they are a small part of the mix, local authorities may be able to manage these fluctuations in income. However, if they form a significant proportion of the mix, there will need to be mechanisms to handle the fluctuations in yield, which should be developed through a partnership between local and central government.

Reforming the grant funding regime

Apart from the way that grant funding to local authorities hampers their financial autonomy and constrains much of what they can spend their money on, there are other problems with it.

When the Coalition Government came to power in 2010, there was a cull of local authority grants. Some were simply ended, while others were merged or rolled into Formula Funding. For those which were not simply ended, it was helpful that the ringfences on the ways they could be spend were removed. However, rolling grants into other funding streams is not necessarily helpful, as it can cause distributional issues. (Indeed, those which were rolled into Formula Funding became part of the baseline for the Business Rate Retention system in 2013/14.)

Since then, the number of grants to local authorities has crept up. TRL Insight's analysis for the LGA identified 250 separate grants paid to local authorities in 2017-18. Many of these are only awarded after a competitive bidding process, which can be onerous for the authorities involved, with short timescales and no certainty of success. Many grants also have a short lifetime. Our analysis is summarised here, but TRL Insight urges each department issuing grants to read the relevant section of the full report, which is available here. In particular, the subsections titled "Interviews with senior officers" dramatically capture the difficulties that these problematic issues with the grants cause for delivering services.

TRL Insight urges the Government to implement the recommendations in Section 15 of this report, highlighted using bullet points.