

Independent Commission on Local Government Finance Wales

Published March 2016

Table of Contents

Executive Summary.....	1
The rationale for change	
The Commission's vision	
Approach to reform	
Aims of the reforms	
Reforms	
Benefits for the Welsh Government	
Recommendations	
About the Commission	
Foreword.....	12
Introduction	15
Context to this review	17
The purposes of local government	
Demographic and economic characteristics of Welsh local authorities	
Local government in the context of Welsh public services	
Local taxes - an international perspective	
The existing system of local government finance in Wales	23
Revenue expenditure	
Income	
Revenue Support Grant (RSG)	
Specific grants	
European grants	
Council tax	
Non-domestic rates	
Capital expenditure	

Our approach.....	34
Process and principles	
Our deliberations	
Reforms – our recommendations	37
Summary points	
Local government reforms	
Performance and accountability framework	
Expected benefits of our recommendations	
Summary of recommendations	54
Appendices	56
Appendix 1 – Analysis of revenue expenditure by service 2014-15	
Appendix 2 – Analysis of revenue financing by authority 2014-15	
Appendix 3 – Specific and general grants over the last 10 years	
Appendix 4 – Analysis of council tax income by authority 2014-15	
Appendix 5 – Analysis of NDR income by authority 2014-15	
Appendix 6 – List of organisations and individuals providing oral evidence	
Appendix 7 - Responses received to the Written Call for Evidence	
Appendix 8 - Summary of evidence received	
Appendix 9 – Changes in local authority Non-Domestic Rates receipts 2002-03 to 2014-15	
Appendix 10 – Specific grants 2014-15 and 2015-16	

Executive Summary

The rationale for change

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

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

The Welsh financial settlement has to some extent protected local authorities in Wales from the levels of cuts seen in English local authorities. However, funding reductions have nevertheless been unprecedented and have drawn into sharp relief a financial regime that is hindering the ambition of Welsh local authorities, constraining the innovative instincts of the local government workforce and holding back innovation which could make a substantial contribution to economic growth. On average, local government in Wales is dependent on the Welsh Government for 83% of its income¹ (45% from the Revenue Support Grant, 26% Specific grants and 12% redistributed business rates), with only 15% being raised locally through council tax (the remaining 2% being made up through appropriations and adjustments), leading to a deficit in democracy. Local Leaders are faced with decisions that have implications that are almost universally unpopular whilst having little flexibility over the quantum of finance available to allow for other scenarios or options.

There is a unique opportunity within Wales to grasp and embrace changes to the financial system. As plans are made for local government reorganisation, so too plans should be made for strengthening the

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

finance of local government, whatever the shape of local authorities in the future, allowing for greater freedoms and flexibilities for local decision making, enabling local authorities to grow their tax base and reinvest in their areas to boost both the local and national economies.

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

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

The Commission's vision

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

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

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

Approach to reform

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

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

Aims of the reforms

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

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

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

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

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

Reforms

Taxation

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

- The Welsh Government introduce legislation to make it possible for city regions, or other sub-national groupings of authorities, to reform bandings and the ratio of council tax payable from band to band
- Existing council tax discounts be reviewed with the objective of giving individual local authorities discretion over their use
- The Welsh Government legislates to introduce a permissive list of small local revenues for local authorities to use
- As Welsh Government achieves greater fiscal devolution this should flow through to the local level
- The merit of a locally-retained share of Welsh Government income tax should be considered again in the next five years

Fees and charges

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

Grants

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

Multi-Year funding

- Indicative rolling three yearly grant settlements are introduced

Capital expenditure

- De-hypothecation of capital funding streams

New independent bodies

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

Performance management

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

Benefits for the Welsh Government

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

Recommendations

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

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

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

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

The Commission recommends authorities be given a suite of permissive powers that can be introduced locally, depending on local circumstances. Examples of powers to be conferred would be the introduction of a tourism tax. There should be a logic in choosing to levy these taxes, with money raised to be utilised

according to related priorities, so tourism tax to assist with local development/ regeneration which would aid the tourism industry.

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

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

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

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

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

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

The Commission has received a great deal of evidence about the formula for the RSG being based on outdated data, complex and lacking in transparency. The Commission therefore recommends the existing grant regime is frozen and, for the immediate future, used as the basis for the rolling three year settlements proposed above. This change would provide temporary stability and predictability, allowing

councils to plan effectively and assist planning with partner organisations. To improve the system in the longer term, an Independent Grants Commission should be set up to commence work on a more effective and fairer formula for the future. The Commission also believe the Grants Commission should be asked to comment on the use of local authority grants by the Welsh Government and to undertake a periodic review of specific grants. As the Grants Commission would be independent, it would be possible to separate the legitimate role of the Welsh Government in setting the quantum of grant from decisions about grant distribution.

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

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

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

About the Commission

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

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

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

Professor Tony Travers - Chair

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

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

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

Chris Hurst

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

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

Professor George Boyne

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

Professor Boyne's main research interest is the explanation and evaluation of organizational performance in the public sector. Professor Boyne founded the Public Management Research Group at Cardiff Business School in 1995. In 2014, the quality of research in Public Management at Cardiff University was ranked third in the world.

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

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

Gill Lewis

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

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

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

Harry Thomas

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

Lynn Pamment

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

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

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

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

Simon Parker

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

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

Foreword



Local government is important to everyone in Wales. The quality of schools, social care, streets, waste management and many other services depends on the decisions made by councillors and the delivery by officers. During a prolonged period of public expenditure constraint, the way resources are raised and used is of even greater importance.

Councils pre-date the Welsh Government. Nevertheless, the institutions which have evolved in the 17 years since 1999 are instrumental in determining the future of local authorities today. It is important that the different spheres of Welsh Government operate in ways that recognise the roles and responsibilities of each of the others. The United Kingdom does not have a codified constitution, so the relationship between institutions at the local, Wales and UK levels is one that will change over time. Precedent and evolutionary reform are important in guiding constitutional development.

The National Assembly for Wales and Welsh Government are now the legislative starting-point for councils' powers and funding arrangements. But the UK government is still influential because of its control of the Chancellor's annual budget, periodic spending reviews, the Barnett Formula and its power to devolve tax-raising powers. Stamp Duty, landfill tax and, eventually, income tax powers are being transferred to Wales.

This report considers the position of local government in Wales and its need for appropriate funding arrangements. As the post-1999 reforms mature and develop, it is surely right to look at the way existing arrangements affect autonomy and accountability at the sub-national level. The 2016 council finance system in Wales is broadly the one inherited from the "England & Wales" arrangements operated by the UK government in the years prior to devolution.

Successive UK and sub-national administrations have, to put it mildly, struggled with the reform of local government finance. Today, councils in Wales, England, Scotland and Northern Ireland operate on the basis of a single, small, inflexible, local tax. There is no buoyancy in the system. Revaluation of the tax base has proved virtually impossible in England and Scotland, though the Welsh and Northern Ireland governments have performed rather better. Non-domestic rates remain largely or wholly nationalised. Councils have few incentives to strengthen their tax base. The relationship between tax raised and public expenditure is currently weak at the Wales and local levels.

The Independent Commission on Local Government Finance in Wales was appointed by the Welsh Local Government Association, with support from CIPFA, to review the situation. The Commission has taken evidence from public, private and voluntary organisations and undertook its own research. There was little evidence of pressure for a revolutionary reform of the system of local authority finance, nor was there contentment with the current arrangements.

The operation of the grant system, in particular, attracted criticism, as did the erratic path of the local government funding total. But there were also concerns about the fairness of local domestic taxation and about the limited scale of the local tax base. A number of witnesses pointed to recent reforms in England as evidence of a more enlightened approach to issues such as specific grants, incentives, the predictability of change and a willingness to innovate.

We also heard ministerial concerns about the quality of some local provision and also about the Government's preference for a possible move to a smaller number of councils, although structural reform on its own may not have the desired impact. Such issues are beyond our terms of reference. However, structural reform should not be relied upon in isolation to improve performance. During our work, the Minister for Public Services set up a Finance Futures Panel to *"to share and test innovative ideas in relation to the future finance system"*. We agree that there needs to be innovation in considering the future of local government funding in Wales.

But there is little demand for a major upheaval. The Commission has therefore concluded that it should consider options for evolutionary improvements to the finance arrangements that can be commenced within the next Assembly term. It would be a waste of time to make bold proposals which had virtually no chance of implementation. Rather, we have considered the evidence presented to us and evolved a series of proposals to improve the working not only of local government finance but also, over time, to strengthen the Welsh economy.

Even in as centralised a democracy as Britain, it is possible to deliver changes to the system of sub-national taxation, grants and public expenditure planning. Devolution to Wales and Scotland has shown how political authority can operate at different levels. The logic of the successful reforms of 1999 is that further devolution of power can now be considered. The challenge for policy-makers is how to ensure that sub-national institutions have the resources and powers to operate effectively. This report makes proposals to improve the sub-national government of Wales, to the benefit of its people.

In undertaking our work, the Commission has benefited from the evidence submitted both orally and in writing. Politicians and officials at the local and Wales level have been supportive and collaborative. We were welcomed to meetings or evidence sessions in Swansea, Conwy, Llandrindod Wells, Carmarthen and Cardiff. Our secretariat, provided by the WLGA, notably Nathan Gardner, Mari Thomas and Jon Rae have been immensely patient during our deliberations and have been responsible for the management of what has been a large project. Although it is invidious to single out a single commissioner, Chris Hurst's skills in

the creation of elegant documents was of huge help to the Commission as a whole in the latter weeks of our work.

Tony Travers

Chair of the Commission

London School of Economics & Political Science

March 2016

Introduction

1. A review of local government finance in Wales must be set against the backdrop of wider changes to public finance across the United Kingdom. The devolution of power to Wales and Scotland has continued to evolve since 1999. From 2013, the UK Government has initiated a process of reform to local government finance in England. The Welsh Government is in the position of receiving additional taxation powers while, in parallel, considering the future structure of local authorities in Wales. In this context, an examination of the strengths and weaknesses of council funding would seem a reasonable step within the wider framework of the economy and governance of the country. Indeed, the Welsh Government is conducting its own review of the subject.
2. In addition, in the White Paper – **Power to Local People 2015**, the Welsh Government itself made a clear statement of intent on this subject: *“...we intend to consult on and bring forward further legislation to effect more fundamental changes to the Local Government finance system. The longer-term approach will enable us to design a system which takes account of wider changes to the powers and fiscal responsibilities of the Assembly, and could allow Local Authorities to raise more of their finance themselves.”*
3. This Commission is concerned with the way the system of council finance in Wales supports (or impedes) the purposes of local government. Until 1999, Wales was run as part of “England and Wales”, largely from London, though with significant autonomy given to the Welsh Office. The structure of local government was reformed in 1974 and again in 1996 and the potential for reorganisation of councils in Wales is currently under consideration. It appears likely that government in Wales may soon operate on the basis of the Welsh Government and, by international standards, a relatively small number of all-purpose authorities.
4. The operation of local authority finance in Wales fell within the terms of the Layfield Report (1976) and, indirectly, the Lyons Inquiry (2007). The community charge (1990) and subsequently council tax (1993) were introduced across Wales, England and Scotland. Since devolution in 1999, the operation of Welsh local government has been the responsibility of the Welsh Government. For this reason, developments affecting the funding of the Welsh Government cannot be fully isolated from consideration of the operation and improvement of the arrangements for funding councils in Wales.
5. Total Managed Expenditure in Wales in 2015-16 is £30.1bn, of which in excess of £8.6bn (28%) is the responsibility of local government, including education.

6. Devolved government in Wales is 17 years old and, compared to councils and their predecessors, a relatively modern institution. In establishing itself and its role, the Welsh Government relationship with councils has inevitably changed over this period. The transfer of tax-raising powers and the government's interest in further structural reorganisation suggest that it is now an appropriate time to consider the role of local government and its underpinning financial base.
7. The Commission did not undertake a detailed study of the funding of individual services. Housing finance and the Housing Revenue Account were not within our Terms of Reference.

Context to this review

The purposes of local government

8. Local authorities in Wales serve a number of important purposes. Firstly, they enable citizens to influence the shape of their local community and the delivery of local services. For example, the demands of people in Conwy can be expected to differ in a number of respects from those of citizens in Newport and there are legitimate democratic reasons for expressing such difference. Secondly, there are constitutional arguments for local government, most obviously the avoidance of over-concentrated political power and greater local accountability. Thirdly, there are benefits from delivering services at the local level: taxpayers can better understand and influence how resources are used, as local people better understand the needs of their own communities. Finally, running government at the local and town level strengthens the underpinning of democracy by allowing more people to be engaged and involved in local decision making. It is important that the arrangements for funding local government finance are supportive of and congruent with these objectives.
9. The current system allows some shaping of local communities, but probably less than would be the case in many other countries. The system (as is also the case in England and Scotland) provides the government with significant opportunities to intervene in the operation and delivery of local services, with power effectively concentrated at the centre. Accountability benefits are almost certainly undermined by a lack of clarity in the minds of the citizens as to which tier of government is responsible for the tax impacts of local spending.
10. Another purpose of local government is in providing opportunities for significant numbers of local people to take part in local political institutions and engage in decision making. This advantage could be further strengthened if councillors had more direct control and accountability over local taxation and for the quality of local public services.
11. Our deliberations and proposals should be seen against this backdrop. In considering the evidence and in making our recommendations, we have sought to identify improvements which will not only help to strengthen the financial base of Welsh local government but also help to make a contribution to the improved economic outlook of Wales.

Demographic and economic characteristics of Welsh local authorities

12. In common with councils in other UK nations, Welsh councils vary significantly in terms of their economic output per head, population density/change, levels of deprivation, employment rates and revenue expenditure. **Figure 1** (below) brings together a number of statistics to provide a high level picture of the differential economic and social attributes of 22 Welsh local authorities.

Figure 1

AUTHORITY	POPULATION		DEPRIVATION	ECONOMIC OUTPUT	EMPLOYMENT			LA EXPENDITURE	
	Density	Change			Employment rate	Median gross annual pay		Revenue expenditure per head	
	per sq km	between 2001-2014 %			%	£	index (max=100)	£	index (max=100)
Isle of Anglesey	99	▲ +3.5	2.3	53.5	69.5	£20,941	86	£2,235	87
Gwynedd	48	▲ +4.6	4.1	75.6	69.4	£17,409	71	£2,357	92
Conwy	103	▲ +6.0	5.6	62.5	71.2	£19,346	79	£2,303	90
Denbighshire	113	▲ +1.8	13.8		70.1	£18,091	74	£2,495	97
Carmarthenshire	78	▲ +6.5	4.5		68.5	£19,449	80	£2,289	89
Ceredigion	42	▲ +0.0	2.2	64.0	63.8	£18,988	78	£2,282	89
Pembrokeshire	76	▲ +9.4	5.6		70.7	£17,742	73	£2,163	84
Merthyr Tydfil	530	▲ +5.1	22.2	62.8	66.3	£20,196	83	£2,522	98
Rhondda Cynon Taff	559	▲ +2.1	16.9		69.3	£19,543	80	£2,500	98
Blaenau Gwent	641	▼ -0.5	23.4		64.7	£18,702	77	£2,524	99
Caerphilly	649	▲ +6.1	12.7	54.8	68.3	£19,742	81	£2,299	90
Torfaen	729	▲ +0.8	5.0		67.3	£21,275	87	£2,481	97
Bridgend	563	▲ +9.7	10.2	66.0	69.6	£19,817	81	£2,308	90
Neath Port Talbot	318	▲ +4.5	13.2		68.0	£20,143	83	£2,562	100
Swansea	636	▲ +8.0	12.2	74.4	67.7	£20,466	84	£2,339	91
Monmouthshire	109	▲ +8.7	0.0	80.4	74.6	£24,391	100	£1,977	77
Newport	771	▲ +6.7	14.7		68.8	£19,060	78	£2,399	94
Cardiff	2,524	▲ +14.3	17.8	89.8	69.0	£21,420	88	£2,248	88
Vale of Glamorgan	386	▲ +7.0	5.1		71.4	£21,262	87	£2,163	84
Flintshire	352	▲ +3.5	2.2	86.0	70.7	£21,513	88	£2,072	81
Wrexham	271	▲ +6.4	5.9		72.2	£20,518	84	£2,152	84
Powys	26	▲ +5.0	1.3	65.1	77.3	£19,095	78	£2,256	88
WALES	149	▲ +6.2	10.0	71.4	69.5	£20,032	82	£2,309	90
UK	265	▲ +9.3	n/a	100.0	72.1	£22,069		n/a	

Note - the highest values in each column are denoted by **red text**

Sources:

1. Population density: persons per square kilometre, by local authority and year - StatsWales, 2014
2. Population change: Population estimates by local authority and year, StatsWales, 2014
3. % LSOA in most-deprived 10%: Welsh Index of Multiple Deprivation (WIMD) 2014, Revised, Welsh Government, 2014
4. GVA (Gross Value Added) per head: Regional Gross Value Added (Income Approach) 1997 to 2014, ONS, Table 3
5. Employment rate: Employment rate by Welsh local area and year, StatsWales, 2015
6. Median Gross Annual Pay: Annual Survey of Hours and Earnings (ASHE) 2014 Table 8.7a Place of Residence by Local Authority, ONS
7. Expenditure per head: Revenue outturn expenditure, by authority, 2014, StatsWales

13. Key points to note from this analysis include:

Population

- Cardiff has the highest population density of any authority; with Newport, Torfaen, Caerphilly, Blaenau Gwent, and Swansea also having relatively densely-populated areas
- Gwynedd, Ceredigion and, particularly, Powys are among the most sparsely populated authorities in Britain
- Cardiff has seen the strongest population growth in the period since 2001, the Census closest to the creation of the devolved government arrangements for Wales. Bridgend, Pembrokeshire, Monmouthshire and Swansea have also experienced significant increases. In North Wales, Wrexham and Conwy have experienced the greatest rises in population.

Deprivation

- Using the Welsh Index of Multiple deprivation, the greatest concentrations of deprivation are found in Blaenau Gwent and Merthyr Tydfil, followed by Cardiff, Newport and Rhondda Cynon Taff
- Councils in much of North and West Wales and in Powys are assessed to have significantly lower concentrations of deprivation.

Economic output

- Cardiff/ Vale of Glamorgan has the highest GVA (economic output) per head, followed by Flintshire and Newport/ Monmouthshire
- The lowest levels are in Anglesey and Caerphilly/ Torfaen, where GVA per head is 35 to 40 points lower than the highest.

Employment

- Employment rates tend to be highest in North and West Wales (apart from Ceredigion, where students affect the number) and lowest in the South Wales Valleys. Indeed, there is a clear correlation between deprivation and employment rates.

14. The Welsh Government's grant funding arrangements to local government are designed to take account of social and demographic differences and to compensate councils for differences in needs and resources. However, it is not possible to produce a grant system which is universally

accepted as *fair*. In all needs-equalising grants of this kind, there is room for discretion in setting the formula and there will always be active debate about the results of any formula. This was certainly true in England in the years before needs equalisation was, in effect, frozen at a point in time. Subsequently, arguments about the fairness or otherwise of grant distribution have largely evaporated.

15. The scale of the differences shown in **Figure 1** raises a question which goes beyond the scope of our inquiry - *is the system of local government funding simply intended to equalise for differences in expenditure need and taxable capacity, or does it have a function in encouraging convergence between areas?* Generally, British grant systems have simply equalised and provided national taxpayers' support for council services. But in recent years, concern has grown about the persistence from place to place of differences in income, wealth, economic development and other characteristics. In England, the local authority funding arrangements are being radically overhauled in an attempt to incentivise higher levels of growth in places where the economy has traditionally lagged.
16. In considering the future arrangements for financing local government in Wales it is important to reflect on the development of the Welsh Government itself - in particular its increasing taxation raising powers and fiscal autonomy. Wales will find itself increasingly self-dependent in the years ahead and this reality will create pressure on politicians at all levels to ensure that all parts of the Welsh economy are playing to their relative strengths and maximising the overall economic foundation of Wales.

Local government in the context of Welsh public services

17. **Figure 2** (overleaf) summarises the principal components of identifiable public sector expenditure in Wales. This data is taken from the UK Government's *Public Spending Statistics for 2013-14*, which include the Country and Regional Analysis 2015. It provides an analysis of public spending by country, region, and function. The analysis is limited to identifiable expenditure for Wales.
18. The expenditure has been classified in ten broad categories, as defined by HM Treasury in its public spending statistics. Using the HM Treasury figures as a baseline for Wales, the data has been used to cross-reference information from Welsh Government's *Revenue Outturn (RO) data for 2013-14*. Where the amount of total expenditure is higher than that recorded by Welsh local government, the remaining spend has been attributed to Welsh Government. A full reconciliation between these individual returns and HM Treasury statistics has not been possible but these figures do illustrate, in broad terms, the level of expenditure across the various tiers of government in Wales and where it is spent. All figures are rounded to the nearest £1m.

Figure 2

2013-14	SPENDING AUTHORITY			Total identifiable public expenditure in Wales
	UK government depts ¹	Welsh Government	Welsh local government ²	
	£m	£m	£m	
Expenditure				
1. General public services	63	354	242	659
2. Defence			5	5
3. Public order and safety	562	1	873	1,436
4. Economic affairs	604	1,187	525	2,316
5. Environment protection	98	189	370	657
6. Housing and community amenities	4	94	513	611
7. Health	16	6,125		6,141
8. Recreation, culture and religion	143	98	323	564
9. Education	101	1,696	2,890	4,687
10. Social protection	10,608	90	2,816	13,514
Total expenditure on services 2013-14	12,199	9,834	8,557	30,590
	40%	32%	28%	100%
Financing				
Net council tax			1,179	1,179
Non-domestic rates			1,032	1,032
General taxation	12,199	9,834	6,346	28,379
Total funding	12,199	9,834	8,557	30,590
Total expenditure on services 2003-04	8,021	6,555	5,701	20,277
	40%	32%	28%	100%

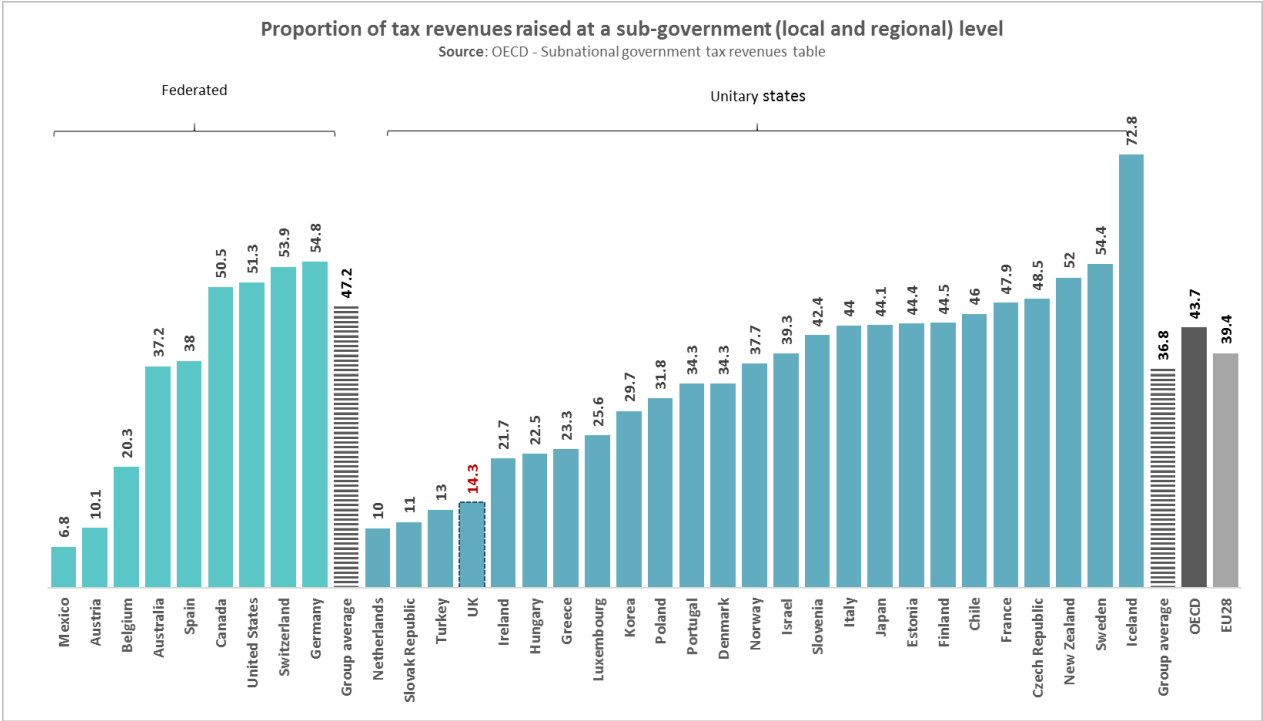
Notes:¹ Includes Wales Office² Includes LG public corporations**Source:** PESA and StatsWales

19. **Figure 2** confirms that £8.6bn (28%) of the total £30.6bn spent on public services (including elements of social protection) in Wales in 2013-14 was the responsibility of local authorities. However, as stated earlier, local government has certainty of around a quarter of its own income.

Local taxes - an international perspective

20. How does Wales compare to other countries in terms of the proportion of tax revenues it raises at a sub-UK level? The Organisation for European Co-operation and Development (OECD) publishes data on the proportion of income raised from local and regional taxes for sub-national government for all of its member countries. Wales is not separately identified in these statistics but a comparison of the UK’s relative position is of interest. These data are summarised in **Figure 3**.

Figure 3



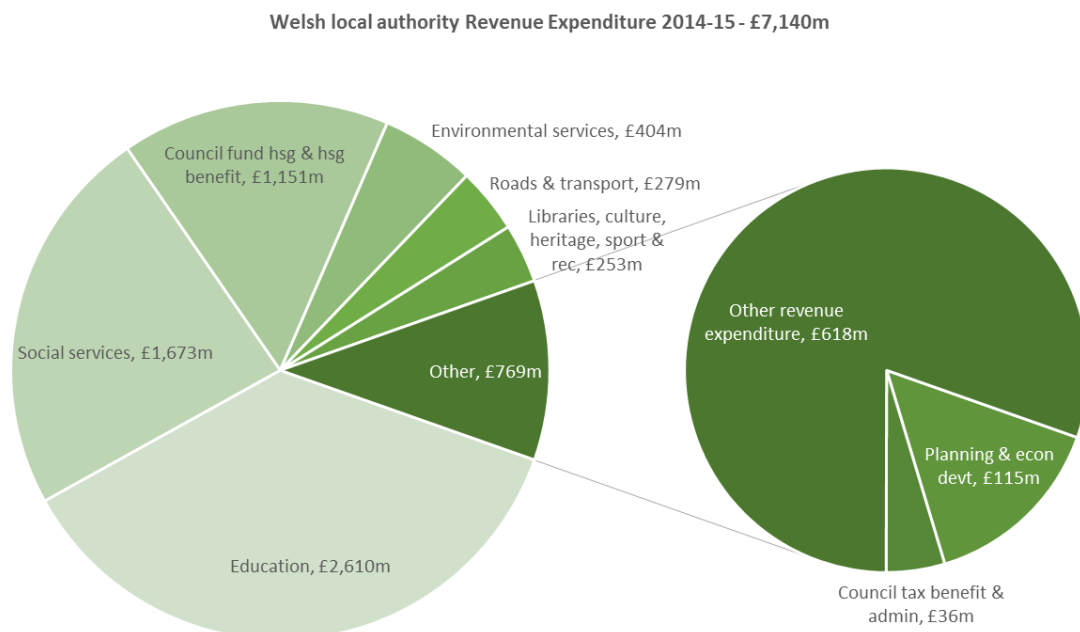
21. Across the member states of the OECD, taxes raised at local or regional level account equate to 44% of total revenues. For federated (and quasi-federated) states, the proportion of income raised regionally or locally is higher (at 47%) compared to unitary states (at 37%). However, these group averages conceal significant variation at a country level.
22. The UK can be seen to be one of the most centralised states in the developed world, with its local and regional taxes accounting for only 14% of total revenues, being the 6th lowest of the 34 OECD member states. Wales reflects this degree of centralisation.

The existing system of local government finance in Wales

Revenue expenditure

23. Revenue expenditure is the day-to-day running costs of services, costs of administration and financing costs. Revenue expenditures include:
- Staff salaries and wages
 - Property and transport running costs
 - Payments to suppliers and service providers; and
 - Capital financing costs in respect of the money borrowed or otherwise raised to finance new buildings and the acquisition of other assets, including major equipment.
24. In 2014-15 (after offsetting service fees and charges of £616m and net of social protection) Welsh local authorities Revenue Expenditure totalled £7.1bn. **Figure 4** summaries this spending by broad service area, with a more detailed analysis of this expenditure, by individual authority, set out in **Appendix 1**.

Figure 4



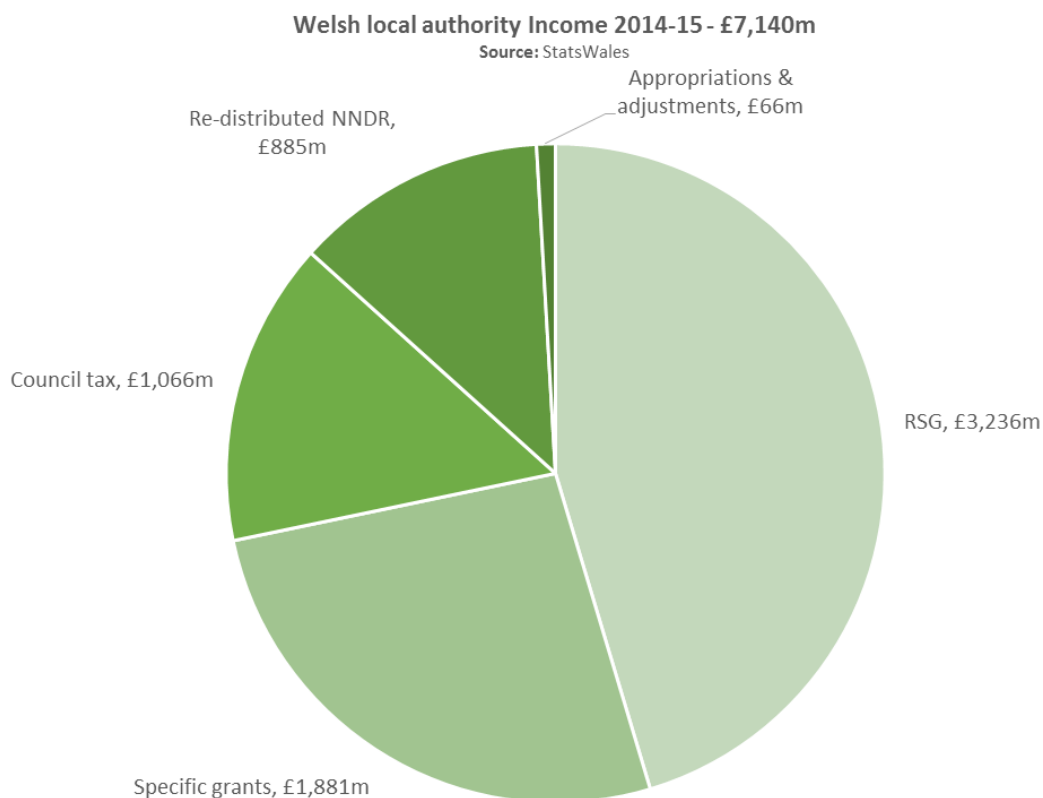
25. As would be expected, the largest single component local authority total operating costs is staffing, with £3.4bn (48% of the total £7.1bn expenditure) accounted for by employee related costs. From a service perspective, spending on Education accounted for the largest element of expenditure in 2014-15 (i.e. 37% of the total), with spending on Social Services representing nearly a quarter of total LA revenue spending (23%). If spending on Education is excluded, Social Services costs account for over a third (37%) of LA revenue expenditure.
26. Education and Social Services are both largely protected services and in 2014-15 these services accounted for 60% of total local government expenditure. As a consequence, pressures to reduce overall council spending - in response to LA funding pressures - have fallen disproportionately on other services (including management and administration) which, in aggregate, only account for 40% of total expenditure. This creates a gearing effect, with every 1% reduction in total income requiring a 2.5% reduction in expenditure concentrated on the 40% of expenditure where there is most discretion.

Income

27. Councils receive income from three main sources: council tax, non-domestic rates and government grant. In addition, though excluded from this analysis of expenditure and income, authorities fund some provision (such as leisure services and parking) from fees and charges. But the majority of spending is funded by the sources listed above.
28. Council tax was introduced in 1993 to replace the community charge (better known as the “poll tax”) which itself had only existed since 1990 when it replaced domestic rates, a property tax. Non-domestic rates originally operated alongside domestic rates as local government’s main income source. But the growth within local government of larger welfare services such as education and social care led to a position where rate income had to be supported by central government grants. From 1945 onwards, councils received increasing amounts of grant funding. As a result, local taxation became a smaller share of total income.
29. The total of council tax, non-domestic rates and grant in Wales will, in any particular year, broadly be equal to overall expenditure. Grant allocations, determined by the Welsh Government, are made in such a way as to reflect differences in two characteristics of an authority: its relative need to spend and the size of its tax base. Grant distribution starts with an assumed total of expenditure, known as the Standard Spending Assessment (effectively the total to be funded from council tax, NDR and grant) and uses a formula to attribute the national total between individual councils.

30. Each authority's SSA is the sum of a number of Indicator-Based Assessments (IBAs) for particular services. Thus, for example, there are IBAs for primary and secondary education. These assessments use pupil numbers and weightings for deprivation and sparsity to determine a relative need to spend figure for each council. A similar exercise is undertaken for all services. The SSA for a council is the total of all these IBAs. Grant distribution then reflects differences in SSA per capita. This *so-called* Revenue Support Grant is paid to local authorities as general support - that is, it is not ring-fenced for particular purposes by the Welsh Government.
31. In addition to the RSG, the Government pays a number of ring-fenced, specific, grants to councils. Local authorities are required to use these (often small) funding streams for particular purposes. Some of these specific grants are audited separately to assure ministers they have been properly used.
32. Total local authority income in 2014-15 – excluding service Fees & Charges which are offset against Gross Expenditure – was £7.1bn. A breakdown of this income is shown in **Figure 5**. A more detailed analysis of funding, at authority level, is set out in **Appendix 2**. [Note - the figures shown for council tax and NDR are net of reliefs granted to taxpayers].

Figure 5



2014-15	RSG	Specific grants	Council tax	Re-distributed NNDR	Appropriations & adjustments	Total
All authorities	£3,236m	£1,881m	£1,066m	£885m	£66m	£7,135m
	45%	26%	15%	12%	1%	100%

Source: StatsWales - Revenue outturn (RO) data collection 2014-15, Welsh Government

- 33.** Revenue Support Grant from the Welsh Government funded 45% of authority total expenditure in 2014-15; with Specific Grants from the Government (including those related to housing services) accounting for a further 26% of total funding. In aggregate 71% (£5.1bn) of total local authority funding is provided via grants from the Welsh Government. When redistributed NNDR is added to this, the total amount of funding controlled by Welsh Government is over £6bn or 84%. This creates a second gearing effect for Welsh local authorities. For example, a 1% reduction in total government grant income would require council tax revenues to increase by 5.3%. However, as the authority's first obligation will normally be to reduce expenditure in response to a reduction in grant income, the pressure to reduce costs will fall disproportionately on unprotected services (as described earlier in this section).

Revenue Support Grant (RSG)

- 34.** The revenue support grant remains a significant part of the annual funding of local government in Wales. 45% of the income to local authorities is via the RSG route, which is a higher proportion of total income than other parts of the UK although comparability with the English system is made difficult because of the direct funding for schools. Planning for the future by local government could be more effective in an environment when there is transparency and predictability in the determination of Welsh Government block funding.
- 35.** The Commission is mindful of the fact that no formula exists or could be devised that allocates money in a way which leaves everyone feeling satisfied and fairly treated. That said, we are acutely aware of the number of representations it has received stating that the existing distribution mechanism is based on outdated data and may once have been fit for purpose, but has had elements added to it over the last 15 years to render it into a state that is barely comprehensible even to experts in the field, let alone something whose rationale for allocation could be explained to members of the public.
- 36.** The formula for determining each local authority's quantum of RSG is complex and based on a standard spending assessment (SSA) for each authority. When RSG is considered alongside re-distributed NDR the sum is referred to as Aggregate External Finance (AEF). The SSA is the amount of revenue expenditure, funded from AEF and standard council tax, which the Minister for Public Services considers appropriate and reflective of the differing characteristics within each local

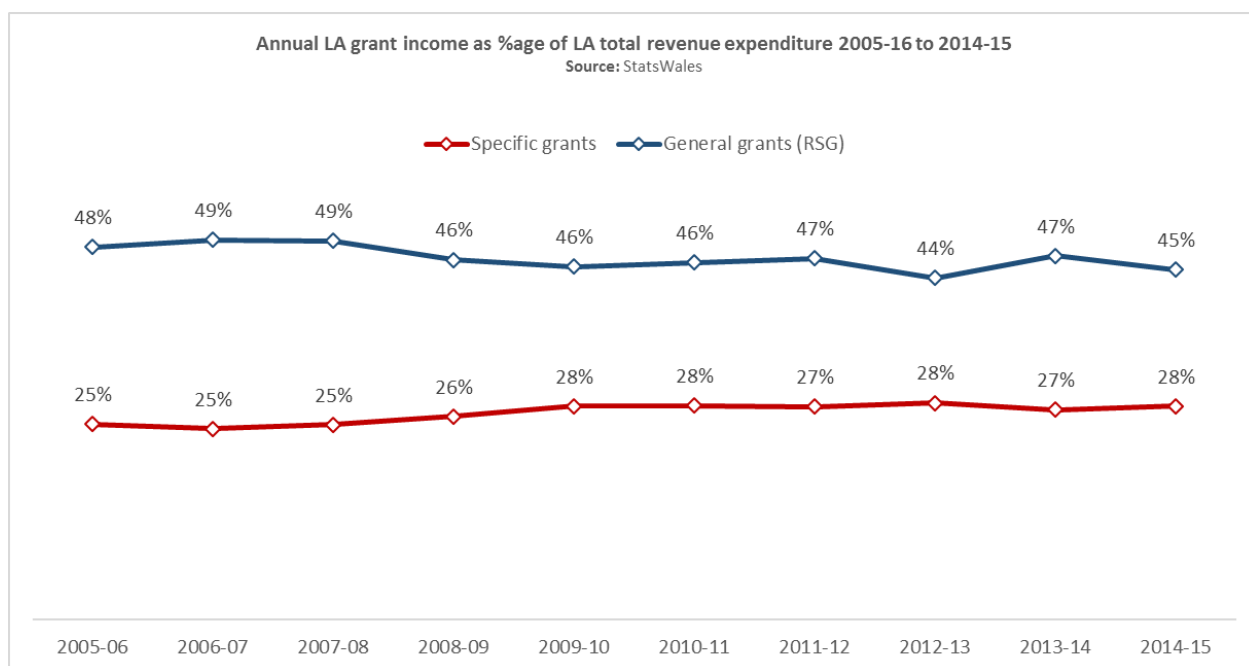
authority. This is intended to ensure that each local authority can provide a standard level of service.

37. The formulae to calculate SSAs makes use of information which is considered to reflect the differing characteristics of Welsh local authorities, taking account of factors such as:
- Population
 - The numbers of children and older adults
 - Length of roads
 - Deprivation
 - Rurality and sparsity.
38. The formulae used to calculate SSAs is set out in the annual *Local Government Finance Report (Wales)* which is laid before and debated by the Assembly at a plenary session. Background information on the formulae, data and assumptions used to calculate the SSAs is published in the annual publication *Welsh Local Government Settlement*.

Specific grants

39. Unlike the annual RSG, Specific Grants (also referred to as ring-fenced or earmarked grants) are hypothecated – that is, provided by the Welsh Government for a specific purpose. Consequently, these grants normally come with separate and individual accountability and reporting obligations; with authorities having minimal discretion over how the grants are used and over what period they can be spent.
40. In 2014-15 the total of Specific Grants provided to local authorities in Wales was almost £2bn. This total comprises two main types of grant:
- Ring-fenced grants; and
 - Grants to reimburse for expenditure they incur under agency arrangements on behalf of other bodies.
41. Within the first category the largest component relates to housing subsidies, which fall outside the scope of our work. In 2014-15, non-housing Specific Grants accounted for £0.9bn of the total Specific Grants of £2bn. We were unable to obtain separate figures for housing and non-housing Specific Grants for the 10 year period we have analysed – shown in **Figure 6** overleaf - but we consider the overall trend revealed by the chart to be revealing.

Figure 6



42. Over the last 10 years the percentage of total authority expenditure in Wales funded by Specific Grants has risen from 25% to 28%, while over this same period RSG has reduced as a percentage of total expenditure from 48% to 45%. The data underlying this analysis is included in **Appendix 3**.

European grants

43. In 2014-15 local authorities in Wales received £48.1m of EU funding. There is an administrative burden associated with the application for this funding and with compliance with funding requirements. Local authorities should have a clear view on how this funding enhances achievement of local objectives.

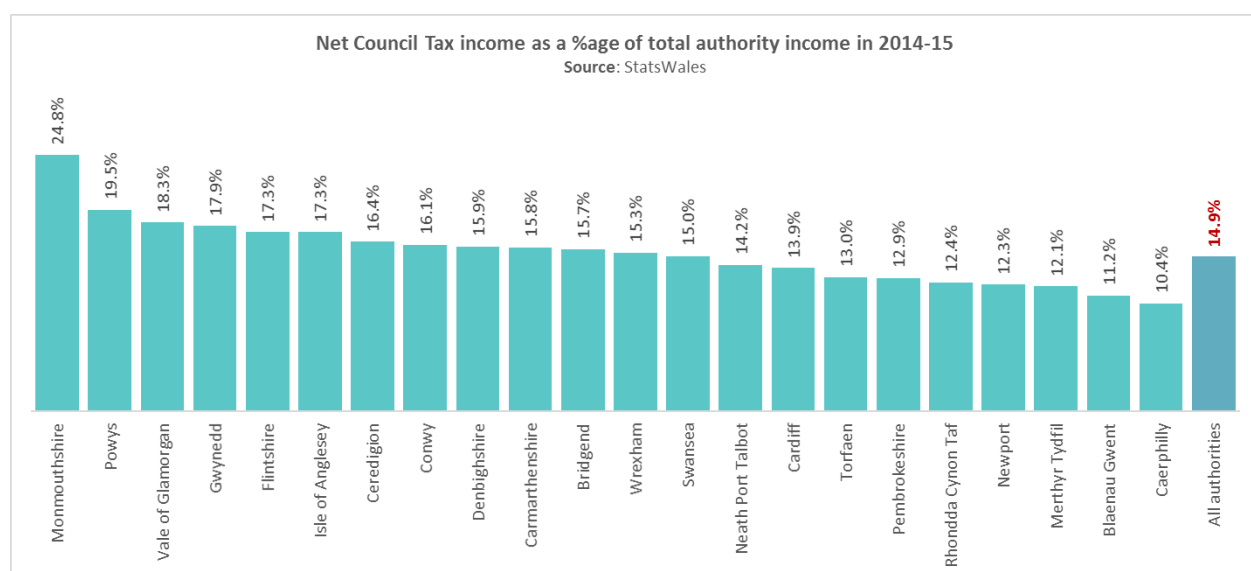
Council tax

44. Council tax was introduced on 1st April 1993 by the *Local Government Finance Act 1992*. The amount of the tax is set by local councils annually and charged according to valuation bands. The current council tax bands in Wales were set by the *Council Tax (Valuation Bands and Lists) (Wales) Order 2003* and came into effect on 1st April 2005.
45. In the *Spending Review 2010*, the UK Government announced it would abolish council tax benefit and give responsibility for developing replacement arrangements to local authorities in England and to the devolved administrations. Funding for future arrangements to provide council tax

support was cut by 10% from that time. A new Council Tax Reduction Scheme (CTRS) replaced council tax benefit in Wales from April 2013 and each local authority in Wales has had to adopt its own CTRS. These new regulations, now set by Welsh Government, were based on the previous council tax benefit rules but with local authorities being given some local discretion to take the needs and priorities of their local area into account.

46. In addition to council tax support, there are a range of discounts. The council tax is made up of two elements, the property and personal, and each element constitutes 50% of the council tax. In the main discounts are awarded in multiples of 25% which is reflective of the property/personal split of the council tax bill. For example, a property with no occupiers (an empty property) can receive a 50% discount (the property element), although this “long term empty” discount is subject to local decisions and can be reduced to 0%. Another example is the Single Person Discount, where 25% discount is allowed for properties occupied by only one person i.e. 50% of the personal element (25%), plus the 50% property element equates to a 75% council tax bill. Some classes of people are disregarded for council tax purposes and this can lead to a “disregard discount” of 25% i.e. students, apprentices, youth trainees and school leavers. This helps to maintain the single person discount of 25% where there are only 2 residents and one is a disregarded person. If both occupiers are disregarded people then the council tax is reduced by 50%. Discounts and Disregards are contained within *Section 12 Local Government Finance Act 1992, and The Council Tax (Discounts & Disregards) Order 1992* (as amended). Powers to vary these lie with the NAFW/WG.
47. In 2014-15 gross council tax income in Wales was £1.3bn before reliefs were applied and yielded net income of £1.1bn. For Wales as a whole, net council tax income represented 15% of total local authority income in 2014-15. However, at an individual authority level there was wide variation in this percentage – for example, Monmouthshire received 24.8% of its total income from net council tax income, while Caerphilly only received 10.4% of its total income coming from council tax – see **Figure 7** (overleaf).

Figure 7



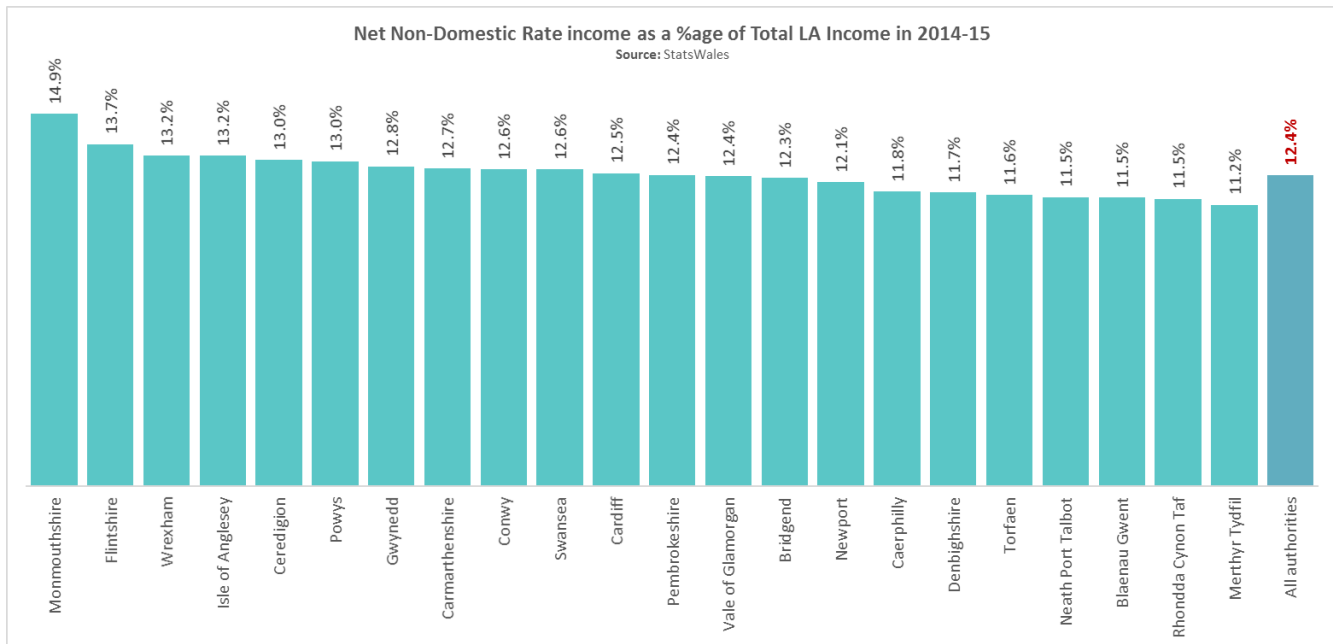
48. Further details of council tax income at individual authority level are set out in **Appendix 4**.

Non-domestic rates

49. Non-Domestic Rates (NDR) are calculated by taking the rateable value of a property and multiplying it by an NDR multiplier (or poundage). The Valuation Office Agency values properties for the purposes of charging NDR and assigns each a rateable value. The Welsh Government sets the multiplier each year.
50. Normally the multiplier is set according to the Retail Price Index (RPI) as at the September preceding the financial year to which the multiplier applies, and it cannot be increased by more than that figure. However, the *Non-Domestic Rating (Multiplier) (Wales) Order 2015* has capped the increase to 2%.
51. As is the case for council tax, there are a number of reliefs available to help reduce the rates bill for a business and for other non-domestic properties. The Welsh Government pays 100% of mandatory rate reliefs and a variable percentage of discretionary reliefs.
52. All NDR income is collected and paid into a Non-Domestic Rates (NDR) Pool held by the Welsh Government. These revenues are then redistributed to local authorities as part of the local government revenue settlement each year. In 2014-15 the gross income distributed to local authorities from the Welsh Government NDR Pool was £890m. Discretionary reliefs granted reduced this quantum by £3.6m.

53. For Wales as a whole, in 2014-15 net NDR income accounted for 12.4% of total local authority income. However, as can be seen from **Figure 8**, at an individual authority level there was wide variation, with Monmouthshire receiving 14.9% of its total income from net NDR and Merthyr Tydfil with only 11.2% of its total income coming from NDR.

Figure 8



54. Further details of NDR income at individual authority level are set out in **Appendix 5**.

Capital expenditure

55. Capital expenditure involves investment in assets such as buildings and roads. In general, such assets are used to deliver services and last more than one financial year. They are the identifiable public face of local government and include the schools, libraries, council housing, roads, parks and other local buildings which form part of local communities. Their relative state of repair can have a significant impact on service quality, accessibility and an influence on citizens' perceptions of the Council and the services they receive.

56. In 2014-15 total relevant² capital expenditure (capex) by Welsh local authorities spent was approaching £1bn – see **Figure 9**. In aggregate, 59% of this total related to Housing and Education services.

Figure 9

Service	Capex 2014-15	
	£m	%age
Education	246	25%
Housing Revenue Account	183	19%
Transport	168	17%
Council Fund Housing	77	8%
Planning and development	103	11%
Other environmental services	53	5%
General administration	42	4%
Sport and recreation	27	3%
Agriculture and fisheries	23	2%
Personal social services	23	2%
Libraries, arts activities and facilities	11	1%
Other transactions	10	1%
Total	966	100%

57. Annual capital expenditure is financed from a combination of sources, including:

- **Capital grants** - from government grants, European funding sources and other publicly sponsored bodies
- **Capital receipts** – the proceeds of local authority assets sales
- **Borrowing** – some of which is financially *supported* by the Welsh Government but with the majority falling to be funded from an authority's own resources (*prudential borrowing*)
- **Revenue funded capital expenditure** – paid for from local authority revenue funds.

² Excludes Law, Order & Protective Services

58. The funding of local authority capital expenditure in 2014-15 is summarised in **Figure 10**. This analysis shows that 41% (£394m) was financed by grants, of which c. 11% (£43m) coming from European sources. The second largest source of funding was borrowing and other credit arrangements which provided 33% (£317m) of total financing in 2014-15.

Figure 10

Source	Capex financing 2014-15		
	£m	£m	%age
Grants from Welsh and UK governments	316,343		
Grants from European Community Structural Funds (including ERDF)	42,856		
Contributions from private developers	22,270		
Grants from Welsh Government sponsored bodies	9,874		
Other grants (including National Lottery) (rounded down)	3,111	394,454	41%
Prudential borrowing and other credit arrangements	221,556		
Welsh Government supported borrowing	96,231	317,787	33%
Capital expenditure funded from LA revenue		148,656	15%
Major Repairs Allowance		60,400	6%
Capital receipts		44,651	5%
Total		965,947	100%

Source: Capital outturn (COR) data collection, Welsh Government

59. In recent years Welsh Government has provided additional revenue funding to local authorities in order to free up authority resources to service further borrowing for local highways improvement and for the *21st Century Schools Programme* in the form of the Local Government Borrowing Initiative.

Our approach

Process and principles

60. The Commission put out a call for evidence and commissioned a number of papers from WLGA officials. Oral hearings were held, as were meetings with Welsh Government ministers. This process used the Commission's terms of reference as a starting point and guided questioning accordingly. Once this process was complete, we considered the evidence in its entirety and started a process of deliberation.
61. We had a shared view about the principles that should underpin a healthy system of local government finance, taking account of the findings of previous commissions of enquiry and broader international experience. These principles included:
- Transparency and comprehensibility
 - Predictability
 - Fostering accountability to citizens
 - Promoting efficiency and effectiveness
 - Increased self-reliance and self-sufficiency, while protecting the most vulnerable
 - Incentivisation of economic growth and innovation
62. We did not, however, start with any pre-conceived or expected set of proposals.
63. The evidence we received pointed to a number of weaknesses in the current system of local government finance. The evidence and witnesses also suggested possible reforms. In our deliberations we considered the evidence put to us, using it as a starting-point to frame our discussions. A number of proposals were debated and accepted, others rejected. In the end, judgement was required about the points put to us. We also had to bear in mind the financial situation facing the Welsh Government and ministers' concerns in relation to service effectiveness. A list of the individuals and organisations that provided oral evidence to the Commission is included in **Appendix 6** and in **Appendix 7** a list of those organisations and individuals providing written evidence is also provided. A summary of the written evidence provided to the Commission is set out in **Appendix 8**.
64. The conclusions and recommendations that follow were thus derived following deliberations based on a particular set of questions, evidence received in response to those questions and analysis based partly on this evidence but also taking account of the long-evolved nature of

government in Britain. The Commission pursued improvements which could be implemented within the term of the next Assembly.

Our deliberations

65. The Commission concluded that the existing system has not failed, but believe that by making a series of alterations, it would work far better for both citizens and organisations of government. We are clear that by adopting our pragmatic recommendations, there are reasons for cautious optimism for the future whatever the future number of local authorities in Wales. Once these recommendations are implemented, they should lead to a system that:
- **Strengthens local accountability** – if a greater proportion of a council’s funding comes directly from its local tax base, it is more directly accountable to its citizens and businesses for the impact of decisions it makes.
 - **Supports and encourages innovation** – local councils in Wales should be free to respond to local issues flexibly and creatively. Greater freedom and acceptance that there is often not a *one size fits all* solution to problems that appear similar but often have differing factors at play due to demography and geography.
 - **Allows greater local discretion** to allow authorities to respond differently to local circumstances - with fewer constraints via grants there is an opportunity for expenditure decisions to become more localised, prioritising their needs to be met in the most appropriate way according to local knowledge.
 - **Reduces local government’s dependency** on the Welsh Government
 - **Incentivises growth in the local economy** - with a direct link between economic development and their own financial well-being through retention of business rates.
66. The Commission discussed in some depth more radical proposals such as local income tax or a land value tax to replace the existing regime for business rates. We were mindful of the timing of this report in that the Welsh Government itself is soon to take over wider responsibility for taxation such as income tax and feel that issues such as this should be looked at again in the future once the implications for Wales’s government can be more fully understood. The Commission also felt that the journey towards greater self-reliance and increased accountability should commence with smaller reforms, so while there may well be some benefits to more radical alterations such as land value tax, further research needs to be conducted with modelling beyond the scope of this Commission.

- 67.** We recognise that with greater local freedoms, there is a need for enhanced accountability for local performance and decision making. Recommending a new performance and accountability framework is outside the scope of our work. Welsh Government may wish to consider whether performance and accountability frameworks need to be enhanced if our recommendations are implemented.
- 68.** In summary, the Commission feel that the recommended package of reforms that follow will significantly enhance the ability of local government to better respond to the needs of its citizens whilst being low risk, logical, achievable and above all, practical. They will also be applicable regardless of the shape of local government in the future. Further reforms may well be required in the future, but the reforms below will start the journey towards greater self-sufficiency.

Reforms – our recommendations

Summary points

- 69.** Local government in Wales should raise a larger share of its income from local tax sources, as part of a wider series of reforms which also move the Welsh Government to a position of greater fiscal autonomy from the UK government.
- 70.** In looking at the funding of local government there were three key areas of concern:
- The proportion of government funding
 - The proportion of funding that is fettered through grant constraints; and
 - The high level of uncertainty surrounding the Revenue Support Grant and smaller associated grants.
- 71.** Currently Welsh local authorities (in aggregate) depend on 83% of their revenue funding on general and specific grants. We estimate that our recommendations would reduce grant dependency from its current level to around 58% over the next five years; and, if these changes incentivise authorities to grow their local tax base, they would help to further reduce grant dependency over time.

Local government reforms

Non-domestic Rates

- 72.** Non-domestic rates (NDR) were a local government revenue source until the reforms of 1990. Subsequently, NDR has been collected by councils but then, in effect, passed across to the government for re-distribution back to them as part of grant funding. Although many businesses probably think of their rate bill as a council revenue source it is, in reality, an “assigned revenue” from the Welsh Government to local authorities.
- 73.** A nationalised NDR system of this kind operates in such a way that councils do not benefit from any increase in their business rate base. Equally, a council which has a declining tax base does not lose resources. NDR income from all authorities is pooled. The grant system operates in a way that also equalises for variations in the council tax base. Councils in Wales find themselves in a position where there is no incentive to build up their tax base.

74. The Treasury and the Department for Communities & Local Government have made changes to the NDR in England, allowing councils to retain 50% of the yield since 2013-14. It is proposed to move to 100% retention by 2020. The rationale for these reforms is to increase local autonomy and to give councils greater incentives to develop and increase their tax base.
75. While taking evidence, the Commission discussed the possibility of local retention of the NDR in Wales. Many witnesses were in favour of such a reform and few, if any, were opposed. The changes in England were generally welcomed, particularly as they offered the chance of substantially increasing the fiscal autonomy of Welsh local government.
76. Moving to a system where councils are able to keep their NDR yield will boost the locally-determined share of income for every council in Wales. Some would gain more than others, and the continuing grant system would have to be adjusted to reflect the differences from authority to authority: there should be no losers or gainers on Day 1 of any new system. Overall, the transfer of the NDR to local control would increase the proportion of revenues raised locally from 15% to 27%.
77. We believe the transfer of the NDR from national to local control would:
- a. Give councils reasonable certainty over a greater proportion of their income, from year to year
 - b. Increase local autonomy, which would in turn have benefits for local democracy
 - c. Provide an incentive for every authority to build up its tax base; and
 - d. Strengthen the link between local businesses and councils and sharpen the voice of the private sector in decision-making.
78. In the longer term, a system which allows councils to retain the yield that comes with growth in the NDR base would be likely to produce winners and losers as compared with what might otherwise have occurred. We have examined past fluctuations in NDR income - **Appendix 9** shows movements in the yield of business rates by authority over the last 12 years. We have concluded that under the new arrangements we have proposed, local agreements to pool receipts at a city regional or sub-regional level could be put in place to smooth any significant fluctuations.
79. The Welsh Government will have a role in monitoring the impact of locally-controlled and retained business rates. If an authority found, though no fault of its own (for example an industrial closure such as that in Port Talbot), that they were falling significantly behind the average, the government could provide them with short-term support through a temporary grant. Such a grant would have the purpose of re-building the local economy so as to reduce longer-term dependency.

80. We do not consider this proposal inconsistent with the notion of a radical reduction in specific grants, as recommended elsewhere in this report. Any support for councils which found themselves with rapidly-declining resources should be paid outside the on-going structure of local taxation and general grant. Grants to rapidly-declining areas should have the precise objective of restoring growth in the local economy and tax-base. The Commission believes it would be sensible to separate the general operation of the local government finance system from temporary funding for authorities facing sharp economic decline.
81. We believe that as councils will have greater economic independence with this recommendation, so too they have the duty to assist the businesses in their areas by easing the process of collection. The Commission heard evidence from business bodies suggesting there should be a standardised form for the collection of business rates rather than have 22 different designs. The Commission sees no reason for local authorities not to standardise their processes in this way.

RECOMMENDATION

- 1 - *Non-domestic rates be retained in full by local authorities*
- 2 - *In the year of implementation measures be put in place – such as adjustments to grants receipts or pooling arrangements - to ensure that no authority is better or worse off financially than in the previous financial year*

Council tax and discounts

82. Council tax is the sole local government tax in Wales. Each home is placed, on the basis of selling prices (capital values), in one of eight bands. In Wales, this number has subsequently been increased to nine (from A to I). A home in Band I currently pays 3.5 times as much as a home in Band A, with other bands representing steps in between these outer bounds.
83. Councils are free to determine the rate of tax, though the Welsh Government is responsible for its structure, including the banding arrangements and the frequency of revaluations. There has been one revaluation in property values since 1993, which was implemented in 2005 and based on 2003 property values. Subsequently, there has been no up-rating of values. The England and Scottish governments have never held a revaluation.
84. Property prices change over time, with some homes increasing in value faster (and some more slowly than others) but these trends are only reflected in the council tax following a revaluation. Infrequent revaluations can lead to a substantial minority of properties being in the wrong valuation band. Moreover, changes in the distribution of the values of homes, in particular relative

increases affecting the most expensive ones, may make the existing bands implausibly narrow in reflecting changes in the full range of capital values.

85. Council tax, like the domestic rates system and the community charge, is highly visible to those who pay it. Unlike many other taxes, a bill is sent out to each householder each year. Annual changes are visible and sometimes unpopular. Year-on-year changes in Welsh Government grant will usually have a greater impact on the level of local taxation than locally-made spending decisions.
86. The Commission did not receive a substantive body of evidence to suggest that council tax was fatally flawed. Indeed, there were surprisingly few proposals from councils themselves or from official bodies to make radical changes to local domestic taxation. However, there was powerful evidence from the Institute for Fiscal Studies which argued that *“the existing council tax system is regressive with respect to property value”*.
87. Gerald Holtham, chair of a commission which previously reported on the broader issue of the funding of government in Wales, proposed that *“...the tax bands and associated rates should be reformed to be proportional to capital values”*.
88. It is interesting to note that these, more radical, tax proposals come from experts while local government itself is more concerned with the operation of the grant system. The Commission believes that the IFS and Gerald Holtham make an interesting case. The mechanics of council tax are frozen and, as a result, increasingly unfair (in its own terms) to many individual households. To its credit, the Welsh Government not only implemented revaluation in 2005, but also introduced an additional valuation band. Cardiff has been more radical in this regard than either the London or Edinburgh governments.
89. This Commission has concluded that Welsh local government should, as a priority, become less grant-dependent and more effectively incentivised to develop its local tax base. Against this backdrop it has asked itself the question *would a radical reform of council tax be an accelerator or an obstacle to change?*
90. There is little evidence of any public pressure for a significant change to the operation of council tax. Consequently, there is little political pressure to change these arrangements. Moreover, there is a risk that a struggle over relatively modest changes to local taxation would distract politicians and officials from implementing a more fundamental reform to the way Welsh local government is funded.
91. The Commission’s considers that local domestic taxation needs to be seen as part of the wider tax system in Wales and across the UK. Is the overall impact of income tax, VAT, excise duties and all

other taxation, including council tax, broadly fair? Once answered, it is possible to move on to the issue of whether council tax works well in its own terms. A number of examinations of the UK tax system, notably the Mirrlees Review, have been critical of the operation of property taxes. Mirrlees concluded, with commendable understatement that “[the] taxation of property in the UK is currently something of a mess”³.

92. Our review is concerned with local government finance. The wider operation of property taxation in Wales and across the UK is beyond our terms of reference but we agree with Mirrlees that there is a problem with the operation of the full suite of property taxation. We suggest that the Welsh Government, which is taking over Stamp Duty (another property tax) from the Treasury might wish to consider the combined impact of different property taxes, including UK inheritance tax, on the Welsh property market. Local government taxation is but one part of this wider system. If and when a wider review of all property taxes led to reform, it would be possible to devolve revenues from the full suite of such taxation to local government.
93. The Commission has also been mindful of the fact that other recent reviews of local government finance in the UK have made proposals in relation to council tax. The London Finance Commission (2013) concluded *“Council tax should be retained as a local tax but London government should be given the power and be required to hold periodic revaluations (undertaken by the Valuation Office, according to national practice), to determine the number of bands, to set the ratio of tax from band to band and to set the tax rate”*⁴. The CIPFA/Local Government Association commission on local government finance in England (2014) concluded *“sub-national Pioneer areas should be given the power to determine the number and value of council tax bands and when properties are revalued”*⁵.
94. Most recently, the Scottish Commission on Local Tax Reform’s report concluded that *“local tax now.... needs substantial reform”*. The Commission, which was jointly initiated by the Scottish government and COSLA, went on to observe: *“the present Council Tax system falls short. People in the most expensive homes pay no more than 3 times the tax on the lowest value homes, even though we estimate those homes, on average, are now worth around 15 times as much. That means people in less expensive homes are paying a higher proportion of their property’s value in Council Tax than those in the most expensive homes”*.

³ *The Taxation of Land and Property* in Tax by Design, Final report of the Mirrlees Review, Oxford: OUP, 2011, paragraph 16.4

⁴ *Raising the capital* - the report of the London Finance Commission, London: Greater London Authority, 2013, page 11

⁵ *Financing English Devolution* - Final Report of the Independent Commission on Local Government Finance, London: LGA/CIPFA, 2014, page 10

95. Having argued council tax is failing, the Commission concluded that “[the] present Council Tax system must end”. A reformed property tax, local income tax and a land value tax were all examined, though there was no agreed proposal about a preferred reform. Rather, the Commission suggested that a long-term period of further consideration would be required⁶.
96. The Scottish Commission’s caution is understandable, given the problems that attended the reform of local taxation in England and Wales in 1990 (and Scotland in 1989). Subsequently, the Scottish government decided to reform council tax to increase the amount paid by properties in higher bands.
97. We believe it would be possible to make a number of significant changes to the existing Welsh system which would improve it. We propose that a revaluation of council tax be undertaken as soon as possible and at least every five years thereafter. Modest transitional arrangements would be required because of the long period since the 2005 revaluation.
98. Banding reforms would also be justified, at least on grounds of fairness. Large homes in expensive areas of Cardiff and Swansea can sell for up to 30 or 40 times (or more) those of flats in many parts of Wales.⁷ Yet the range of council tax bills is from 1 to 3.5. It is the Commission’s view that to avoid a major redistribution of bills from one part of the country to another, any reform to banding should be at a sub-national level. Nevertheless, we can see the arguments for more bands and a wider range of bill between bands at least in some parts of the country. The Cardiff Capital region, for example, might be given the freedom to make changes to banding and the ratio of payments from the top to bottom band. The question of how to allow re-banding by city regions or possibly by individual authorities should be explored further. Whatever changes are made to the operation of council tax, we consider its rate should continue to be determined by local authorities.
99. We considered the question of the single person discount as it relates to council tax, having received some evidence that its retention or abolition could be at the discretion of individual local authorities. We agree that subject to a need for legislative change that discretion at the local level over this and other existing discounts would be consistent with our principles of local autonomy.

⁶ The Commission on Local Tax Reform, Volume 1 – Just Change: A New Approach to Local Taxation, Edinburgh: The Commission on Local Tax reform, 2015, paragraph 2.3

⁷ See *WalesOnline*, 22 December 2015, <http://www.walesonline.co.uk/lifestyle/welsh-homes/10-most-expensive-homes-sold-10634791>, which showed top value homes sold in 2015 to be in the range £1m to £2m. Flat and even small houses are available elsewhere in South Wales (and, indeed, in North Wales) for £25,000 to £35,000.

RECOMMENDATION

- 3 -** *A revaluation of council tax be undertaken as soon as possible and at least every five years thereafter*
- 4 -** *The Welsh Government introduce legislation to make it possible for city regions, or other sub-national groupings of authorities, to reform bandings and the ratio of council tax payable from band to band*
- 5 -** *Existing council tax discounts be reviewed with the objective of giving individual local authorities discretion over their use*

Capital

- 100.** The prudential system for capital accounting, based on providing local authorities with both the freedom and the responsibility for managing their assets and their capital investment, aligns well with the Commission's ambitions of greater local self-determination, reduced dependency and driving economic growth. There are some authorities that have exploited the freedoms within the system to provide the stimulus needed in the local economy (for example Newport City Council's investment in the Friar's Walk development in the city centre).
- 101.** Reductions in government support (whether through capital grants or revenue support for the costs of "supported" borrowing) for capital investment have shifted the balance of funding from 64% Government support (£682m)/ 29% Local Authority resources (£303m) in 2008-09, to 49% Government support (£473m)/ 43% Local Authority resources (£415m) in 2014-15, with the remainder being made up of European, Lottery and other grants. However, with such a large proportion of the Welsh Government support being directed through either specific capital grants or the Local Government Borrowing Initiative, the Commission recommends that these funding streams should also be de-hypothecated.

RECOMMENDATION

- 6 -** *De-hypothecation of capital funding streams*

Fees and Charges

- 102.** Councils in Wales have the legal power to charge for a wide range of the services they provide and to control how much they charge for these services. This allows them to raise income at a local level across a range of services from leisure and home care to parking and school meals. There are a number of areas where Welsh Government do control the level of charges including

a cap on charges for non-residential social care and planning fees. In line with the general direction of our report, the Commission recommends that decisions on what should be charged for and the level of those charges should be determined locally, within an overarching corporate approach to fees and charges that ensures income generating opportunities are maximised, while supporting the wider objectives and priorities of the local authority through clear governance arrangements.

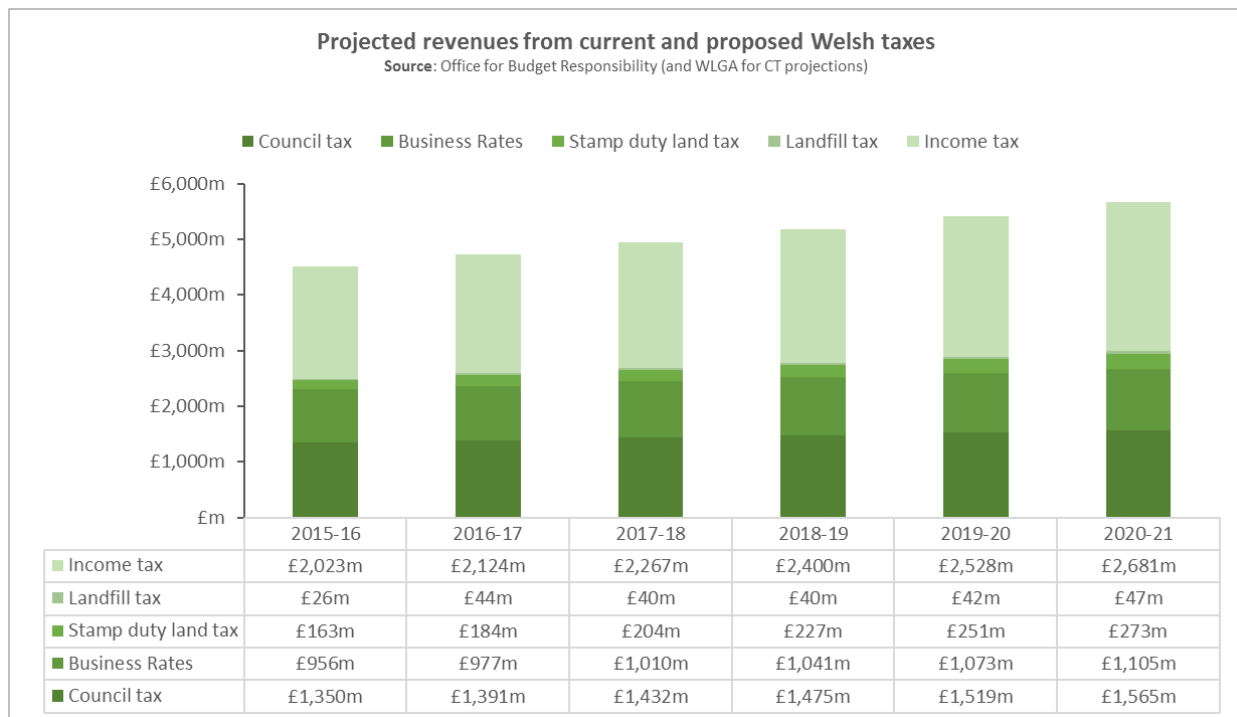
RECOMMENDATION

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

Devolved Taxes

- 103.** Currently, the only taxes raised within Wales are the council tax and non-Domestic rates. From April 2017, the Welsh Government will also assume responsibility for the replacements for Stamp Duty Land Tax and Landfill Tax with the proposal for partial Income Tax devolution by 2020. **Figure 11** below sets out projected income for these taxes from the Office for Budget Responsibility (OBR) along with WLGA projections for council tax.

Figure 11



- 104.** As Welsh Government achieves greater fiscal devolution from the UK Government the Commission recommends that this should flow through to the local level.

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

RECOMMENDATION

- 8 -** *As Welsh Government achieves greater fiscal devolution this should flow through to the local level*
- 9 -** *The merit of a locally-retained share of Welsh Government income tax should be considered again in the next five years*

Additional Specific Taxes

- 106.** The Commission received evidence about the possibility that smaller revenues, notably a tourism tax (a small charge per visitor night) might be introduced. Other minor revenues suggested include ones relating to public health objectives or to the environment. Taxation in relation to road use or off-street parking might also be possible, particularly in major urban areas. We believe there is scope for the Welsh Government to create a permissive list of possible smaller local revenues. Councils would not be required to use such sources, but would be free to do so. The objectives of such new resources might be linked directly to particular purposes such as tourism promotion (in the case of a visitor charge) or improved local amenities.
- 107.** Additionally, the Commission heard evidence from the CBI regarding the way the Crossrail scheme in London was funded and recommend that the City Regions are given the power to add a supplementary business rate whose sole purpose will be to assist in paying for large capital projects.

RECOMMENDATION

- 10 -** *The Welsh Government legislates to introduce a permissive list of small local revenues for local authorities to use*
- 11 -** *City Regions are given the power to add a supplementary business rate whose sole purpose would be to assist in paying for large capital projects. These powers should be available to other regions as they evolve*

Police and Fire Services

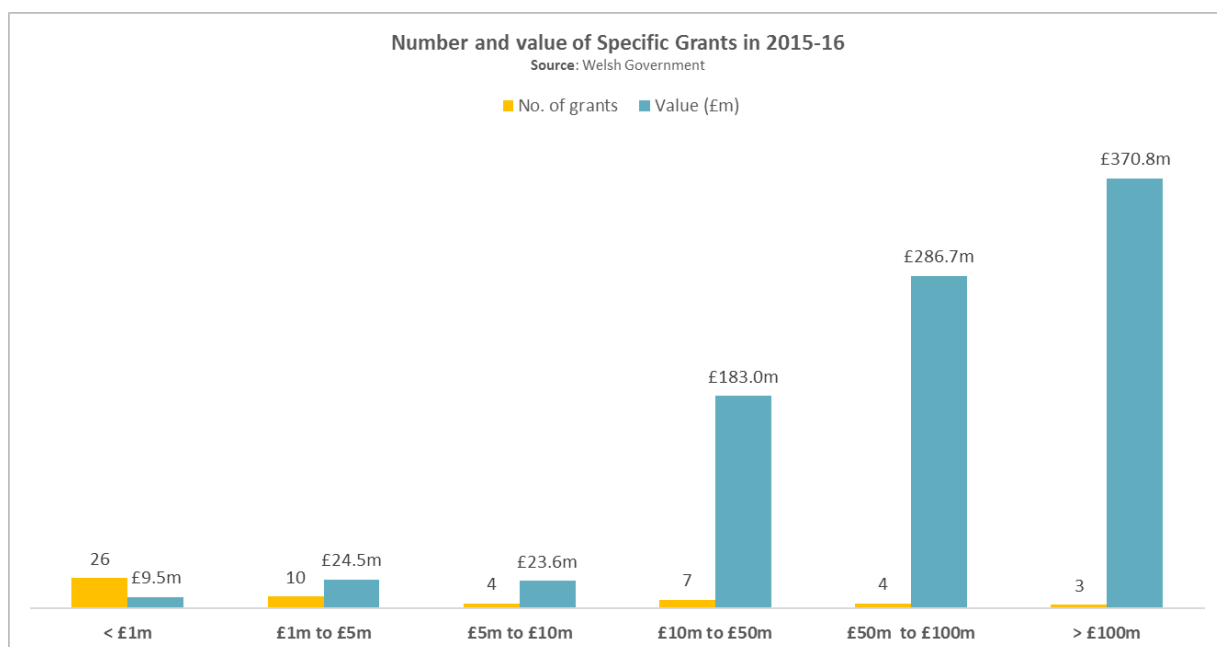
- 108.** The Commission did not separately consider the funding arrangements for police and fire authorities. However, the proposals made for local government above have a link through to the police and fire authorities which also derive their income from local taxation. Our proposals above should increase the local tax take, so this should in the normal course feed through to the benefit of these associated authorities.

A reduction in the number, scale and scope of specific grants

- 109.** Over the course of the meetings the Commission has held with stakeholders across Wales, the single most recurring issue raised has been regarding the volume of grants local authorities in Wales receive and the administrative burden attached to the majority of these grants, often for relatively small sums of money. A list of the actual grants provided in 2014-15 and the estimate of grants for 2015-16⁸ is provided in **Appendix 10**.
- 110.** This complaint was also raised in the majority of written responses to the Commission's Call for Evidence. Analysis of the most recent settlement with the most complete data (2015-16) reveals that there were 54 specific grants, totalling over £898m. However, as the analysis in **Figure 12** (overleaf) reveals, 48% (26) of these grants were for less than £1m and only accounted for 1% of the total funding distributed.

⁸ Both figures exclude Housing and agency function related grants

Figure 12



- 111.** It is recognised that specific grants are a valuable tool for a government to use - for example, to support targeted improvements, to target investment, and/or to direct pump-priming funding towards political priorities. However, the use of specific grants over an extended period can be expected to create a barrier to local innovation.
- 112.** The extent to which such grants have had a direct positive influence on the outcome desired is unclear, but they appear to have diluted local accountability and autonomy, with authorities directed to spend resources in an area that is not acknowledged be a local priority by citizens and elected members. In addition, the evidence we have examined indicates that the accountability and assurance arrangements put in place by government have been focused on measuring and accounting for *inputs* rather than outcomes.
- 113.** The Commission considered a September 2015 report⁹ to the Communities Scrutiny Committee in Denbighshire which looked at the issue of specific grants.
- 114.** It notes that in 2014-15, approximately £34m was received in hypothecated grants ranging from the largest of £6m to around 10 which were each under £10,000. The appendix to that report

⁹ The report in its entirety can be found under Item 5 at:
<https://moderngov.denbighshire.gov.uk/ieListDocuments.aspx?CId=271&MId=5188&LLL=0>

illustrates graphically how the grants regime hinders proper planning. One example cited is of a £6.1m grant which, over the course of the financial year, was first expected to be cut by the government by 5.8% (£353,000). Later, the council were advised there would be a 15% cut (£915,000), and ultimately received a final reduction of 10.4% (£634,400). This kind of change presents significant challenges for a local authority in terms of its financial planning, ambitions to redesign services and to engage properly with service users.

115. This challenge is not limited to budget areas which are being targeted for reduction. The Commission was presented with an example within the Scrutiny Committee report mentioned above where additional resources (£48,000) were announced on the 12th February for a Play Opportunities Grant with instructions that the grant must be spent by 31st March. The seven weeks between notification of the grant and the year-end is unlikely to have enabled stakeholders and members of the public to be consulted about use of the grant.
116. The Commission considers that the use of specific grants by government to direct resource inputs at local authority level is not effective and should only be used by exception. The evidence we received supports the case that the increased bureaucratic burden falling to local authorities (often for relatively small sums of money) diverts focus and local priorities without demonstrably improving outcomes for service users.
117. The Commission considers that existing grants should be incorporated within the RSG unless there is a compelling case for a time-limited use of a specific grant. In addition, it recommends that to provide greater assurance about the use of public funding, all specific grants should be reviewed on a two yearly basis to ascertain whether the case for hypothecation remains valid or to decide if the grant is to cease or be incorporated within the RSG.

RECOMMENDATION

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

Multi-year funding

- 118. There is significant evidence from opinion polls that citizens believe local government has a greater influence on their everyday lives than the Westminster Parliament, Cabinet, civil service or the National Assembly for Wales. For example, street cleaning, refuse collection, highways access to social housing and child care.
- 119. Councils have a wide range of functions in addition to the examples listed above, including schools, social care for older people, election administration, and emergency planning. The challenge for the Welsh Government and for local authorities is how to ensure they maintain dependable, reasonable quality local services which remain “affordable” in a time of declining public resources.
- 120. People believe local councils are important to the look and feel of an area. If councillors are to make better decisions (and face the electoral consequences of bad ones), they must have both the greater freedom to use resources as residents and businesses see fit, as well as the ability accurately to assess their services with the firm knowledge of the budgets ahead for forthcoming year. It is notable that in evidence received across Wales, one of the most common views expressed was that *“it is impossible to plan multi-million pound services effectively when we don’t know the money available to us from one year to the next”*.
- 121. It is especially important in times of austerity for authorities to be able to forecast their resources with reasonable confidence to plan effectively for and implement service changes (with time for consultation and engagement) to live within more constrained budgets.
- 122. The Commission recommends that the incoming government commits to rolling multi-year indicative grant settlements for local authorities to support more effective long-term planning for local authorities and its service partners. The Commission proposes that indicative rolling three yearly settlements are introduced to achieve this. Of course, the Welsh Government itself does not enjoy complete predictability in its funding and if there is an extreme change in the Barnett formula block grant this would need to be re-examined. But in recent years, changes in priority within the overall budget for Wales have led to greater instability than necessary for local government.

RECOMMENDATION

14 - *Indicative rolling three yearly grant settlements are introduced*

A Welsh OBR

- 123.** We have outlined the need for a change to the way in which local government is funded in order to make it locally accountable and sustainable. In order to maximise effectiveness of projections of economic forecasts we believe an advisory non-departmental public body should be set up. It seems sensible that the body carrying out these functions should work across public finances in its entirety in Wales and we propose that it would report to the National Assembly for Wales on the reasonableness of central government's assumptions and forecasts. In the Commission's view, the advice and scrutiny from an independent body would support a strong, robust government and assist in achieving desired outcomes through providing greater certainty.
- 124.** A Welsh Office of Budget Responsibility would enable effective scrutiny of Government's policy costings and provide regular, updated assessments of the long term sustainability of public finances in Wales.
- 125.** The Welsh OBR would be in a position to provide detailed, apolitical evaluation of the impact of future devolution proposals and their effect upon the Welsh economy, as well as undertaking various research projects throughout the year and publishing relevant briefing documents. It could also play an important role in assessing the extent to which financial plans and systems support the achievement of the seven goals in the WFG Act. In this respect it would complement the work of the Wales Audit Office and the Future Generations Commissioner.
- 126.** The Commission's view is that if central government can be more certain of its economic situation on an ongoing basis, it is better able to plan its resources effectively which will have a positive outcome for Welsh local government and the public sector in its entirety.

RECOMMENDATION

15 - *A Welsh Office of Budget Responsibility be created to independently examine the Government's revenue and expenditure forecasts, including the assumptions made about local government finance and expenditure*

An Independent Grants Commission

- 127.** The Commission is aware of the reality that it is not possible for government to design a funding formula to allocate money which allows all councils to believe they have been fairly treated. That said, the Commission is mindful of the number of representations it has received stating that the existing distribution mechanism is based on outdated data. This aligns with the views expressed by the Independent members of the Distribution Sub-Group (DSG) in the most recent DSG annual report. So while it may once have been fit for purpose, the mechanism has had elements added

to it over the last 15 years which have made it very complex and only comprehensible to a small number of experts. It would be very difficult to explain or defend the system to members of the public.

- 128.** The Commission recommends that the existing formula should be frozen and an Independent Grants Commission established to oversee the development and future operation of a new grant distribution formula, which is capable of being applied to the existing system of local government and local government configuration which may be introduced in the medium term. The Commission believes a short term freeze to the existing formula would provide stability and allow councils to plan over the near term, whilst work is advanced to develop and model the impact of a new formula.
- 129.** We also believe the Independent Grants Commission should be asked to comment on the wider use of grants by Welsh Government. The Grants Commission should undertake a regular review of specific grants.
- 130.** An Independent Grants Commission would have advantages for the Welsh Government. Ministers would still control the total resources available to be distributed as grant, but would no longer be criticised for their decisions about the allocation decisions taken. Councils could make representation to the new commission but, in the final resort, decisions about formulae and other issues would be independent of government.
- 131.** We consider that the audit of grants should remain with the Wales Audit Office (WAO) who have the expertise in this area, but would expect the Grants Commission to link closely with the WAO to ascertain whether grants are being used effectively by Central Government. As the Grants Commission would be independent, there would be no vested interests represented at meetings and decisions would be apolitical, with the National Assembly for Wales allocating the quantum of finance available to local government and the Independent Grants Commission allocating it to authorities accordingly.

RECOMMENDATION

- 16 -** *The existing RSG formula be frozen*
- 17 -** *An Independent Grants Commission be established to oversee the development and future operation of a new grant distribution formula*

Performance and accountability framework

- 132.** If Councils are to be given more opportunities to raise income and increase revenue they must be able to demonstrate sufficient expertise to manage this increased responsibility and accountability. Good community, political, corporate and directorate leadership with a ‘will do, can do’ attitude is fundamental to success. Well governed organisations balance their different responsibilities and use information to decide where to allocate effort and resources to meet competing demands. An open culture must be underpinned by robust performance management based on outcomes, financial and information systems and an accountability framework which defines responsibilities across the organisation
- 133.** The Welsh Government will need a strengthened and uncomplicated national performance framework to evidence Councils’ strength of culture and governance and how well they are using their increased revenue raising powers and how well their services are performing. Tax raising powers could be reduced if there is evidence that a Council has not got satisfactory arrangements in place.
- 134.** There must be real commitment to ensuring that these components are working effectively and robust measurement of effectiveness, based on strong self regulation.

RECOMMENDATION

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

Expected benefits of our recommendations

For Central Government

- 135.** Our package of reforms is undoubtedly ambitious. We are challenging the Welsh Government to cut many of the strings it currently uses to control local spending and performance. We are challenging councils to accept a higher level of financial risk, in the knowledge that the only way they can do so is to transform the way they work. However, we have asked ourselves *is there a case for the status quo?*
- 136.** We have concluded that the status quo can no longer be maintained. Sustained reductions in the funding made available to Welsh councils mean that the range and quality of services they can offer will deteriorate over time without fundamental changes in service models and service delivery. The only way that local government can continue to support its residents is to transform

the way services are delivered to ensure they remain sustainable and affordable. A substantial body of international good practice and wider economic thinking suggests that giving councils greater freedom will enable authorities to be more creative, efficient and effective in responding to the pressures of sustained financial austerity.

- 137.** This report is not about the future shape and role of local government, but it is absolutely obvious that financial regimes can provide powerful incentives to change local behaviour. We believe that our proposals will point Welsh local government in a direction which is more innovative and entrepreneurial, relying more on the resources that they can generate locally and reducing demand for their services.
- 138.** At present, councils have no strong incentive to drive economic growth. Every penny of additional business rates or council tax they generate is equalised away into a central pot. Giving them more of a stake in the growth of their area has the potential to create a better environment for new business and more jobs. It should help to create a more prosperous Wales.
- 139.** The need to drive economic growth and manage reduced income will also provide a strong incentive for councils to invest in programmes which reduce demand for public services. Most people want to be financially autonomous and the state's goal should be to help them do so through effective programmes to tackle the underlying causes of deprivation, helping people back into work and achieving independence.
- 140.** While our approach inevitably draws some lessons from reforms currently underway in England, we believe we have set out a distinctively progressive Welsh approach. Unlike the Westminster Government, Wales will continue to provide councils with substantial level of national grant funding and will continue to need to redistribute a significant quantum of resources between authorities and wish to provide investment for economic growth and transformation. Our approach therefore provides a mix of benefits and challenges to partners in Welsh Government. The citizen benefits through local people having a stake in economic growth, with resources recycled back into better public services; the Welsh Government's own tax base would grow if councils respond to the new incentives proposed and; local authorities would receive greater freedom to make the right decisions on behalf of local communities and benefit through a reduction in bureaucracy.

Summary of recommendations

Our recommendations are summarised as follows:

- 1 -** Non-domestic rates be retained in full by local authorities
- 2 -** In the year of implementation, measures be put in place – such as adjustments to grants receipts or pooling arrangements - to ensure that no authority is better or worse off financially than in the previous financial year
- 3 -** A revaluation of council tax be undertaken as soon as possible and at least every five years thereafter
- 4 -** The Welsh Government introduce legislation to make it possible for city regions, or other sub-national groupings of authorities, to reform bandings and the ratio of council tax payable from band to band
- 5 -** Existing discounts be reviewed with the objective of giving individual local authorities discretion over their use
- 6 -** De-hypothecation of capital funding streams
- 7 -** Local authorities be given greater discretion over the range and level of fees and charges
- 8 -** As Welsh Government achieves greater fiscal devolution this should flow through to the local level
- 9 -** The merit of a locally-retained share of Welsh Government income tax should be considered again in the next five years
- 10 -** The Welsh Government legislates to introduce a permissive list of small local revenues for local authorities to use
- 11 -** City Regions are given the power to add a supplementary business rate whose sole purpose would be to assist in paying for large capital projects. These powers should be available to other regions as they evolve
- 12 -** Existing specific grants be incorporated within the RSG unless there is a compelling case for a time-limited use of a particular grant

- 13 -** Every specific grant be reviewed on a two yearly basis to ascertain if the case for hypothecation remains valid or to decide if the grant is to cease or be incorporated within the RSG
- 14 -** Indicative rolling three yearly grant settlements are introduced
- 15 -** A Welsh Office of Budget Responsibility be created to independently examine the Government's revenue and expenditure forecasts, including the assumptions made about local government finance and expenditure
- 16 -** The existing RSG formula be frozen
- 17 -** An Independent Grants Commission be established to oversee the development and future operation of a new grant distribution formula
- 18 -** The Welsh Government review its arrangements for the performance management of local authorities so authorities are able to properly evidence how well they are using their increased revenue raising powers and how well services are performing

Appendices

Appendix 1 – Analysis of revenue expenditure by service 2014-15

AUTHORITY	REVENUE EXPENDITURE 2014-15										Revenue expenditure per head
	Education	Social services	Council fund hsg & hsg benefit	Environmental services	Roads & transport	Libraries, culture, heritage, sport & rec	Planning & econ devt	Council tax benefit & admin	Other revenue expenditure	Total	
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£
Isle of Anglesey	57,855 <div><div>37%</div></div>	32,423 <div><div>21%</div></div>	24,866 <div><div>16%</div></div>	10,453 <div><div>7%</div></div>	8,746 <div><div>6%</div></div>	4,515 <div><div>3%</div></div>	2,752 <div><div>2%</div></div>	698 <div><div>0%</div></div>	14,533 <div><div>9%</div></div>	156,841 <div><div>100%</div></div>	£2,235
Gwynedd	102,248 <div><div>35%</div></div>	64,655 <div><div>22%</div></div>	38,746 <div><div>13%</div></div>	20,997 <div><div>7%</div></div>	17,397 <div><div>6%</div></div>	9,596 <div><div>3%</div></div>	6,714 <div><div>2%</div></div>	1,330 <div><div>0%</div></div>	26,482 <div><div>9%</div></div>	288,165 <div><div>100%</div></div>	£2,357
Conwy	94,674 <div><div>35%</div></div>	64,184 <div><div>24%</div></div>	43,092 <div><div>16%</div></div>	16,730 <div><div>6%</div></div>	9,633 <div><div>4%</div></div>	11,061 <div><div>4%</div></div>	2,377 <div><div>1%</div></div>	1,161 <div><div>0%</div></div>	24,908 <div><div>9%</div></div>	267,821 <div><div>100%</div></div>	£2,303
Denbighshire	88,754 <div><div>38%</div></div>	51,980 <div><div>22%</div></div>	35,819 <div><div>15%</div></div>	13,375 <div><div>6%</div></div>	8,652 <div><div>4%</div></div>	9,077 <div><div>4%</div></div>	2,784 <div><div>1%</div></div>	1,683 <div><div>1%</div></div>	24,337 <div><div>10%</div></div>	236,460 <div><div>100%</div></div>	£2,495
Flintshire	127,144 <div><div>40%</div></div>	73,702 <div><div>23%</div></div>	45,794 <div><div>14%</div></div>	16,367 <div><div>5%</div></div>	15,389 <div><div>5%</div></div>	11,813 <div><div>4%</div></div>	3,787 <div><div>1%</div></div>	1,707 <div><div>1%</div></div>	22,906 <div><div>7%</div></div>	318,610 <div><div>100%</div></div>	£2,289
Wrexham	106,301 <div><div>36%</div></div>	67,077 <div><div>23%</div></div>	47,652 <div><div>16%</div></div>	23,443 <div><div>8%</div></div>	8,441 <div><div>3%</div></div>	10,181 <div><div>3%</div></div>	4,121 <div><div>1%</div></div>	997 <div><div>0%</div></div>	25,945 <div><div>9%</div></div>	294,158 <div><div>100%</div></div>	£2,282
Powys	113,591 <div><div>38%</div></div>	76,092 <div><div>25%</div></div>	35,123 <div><div>12%</div></div>	20,595 <div><div>7%</div></div>	12,212 <div><div>4%</div></div>	10,487 <div><div>4%</div></div>	4,736 <div><div>2%</div></div>	1,742 <div><div>1%</div></div>	24,715 <div><div>8%</div></div>	299,293 <div><div>100%</div></div>	£2,163
Ceredigion	62,250 <div><div>36%</div></div>	40,360 <div><div>23%</div></div>	17,863 <div><div>10%</div></div>	10,317 <div><div>6%</div></div>	11,877 <div><div>7%</div></div>	5,852 <div><div>3%</div></div>	2,367 <div><div>1%</div></div>	913 <div><div>1%</div></div>	20,323 <div><div>12%</div></div>	172,121 <div><div>100%</div></div>	£2,522
Pembrokeshire	104,546 <div><div>39%</div></div>	65,481 <div><div>24%</div></div>	37,336 <div><div>14%</div></div>	15,962 <div><div>6%</div></div>	10,398 <div><div>4%</div></div>	7,011 <div><div>3%</div></div>	4,647 <div><div>2%</div></div>	1,831 <div><div>1%</div></div>	20,263 <div><div>8%</div></div>	267,475 <div><div>100%</div></div>	£2,500
Carmarthenshire	158,759 <div><div>38%</div></div>	102,878 <div><div>24%</div></div>	59,315 <div><div>14%</div></div>	21,805 <div><div>5%</div></div>	19,402 <div><div>5%</div></div>	12,990 <div><div>3%</div></div>	7,167 <div><div>2%</div></div>	1,776 <div><div>0%</div></div>	39,052 <div><div>9%</div></div>	423,144 <div><div>100%</div></div>	£2,524
Swansea	186,543 <div><div>33%</div></div>	127,270 <div><div>23%</div></div>	106,983 <div><div>19%</div></div>	24,625 <div><div>4%</div></div>	21,077 <div><div>4%</div></div>	20,783 <div><div>4%</div></div>	11,283 <div><div>2%</div></div>	3,023 <div><div>1%</div></div>	62,791 <div><div>11%</div></div>	564,378 <div><div>100%</div></div>	£2,299

Continued overleaf

AUTHORITY	REVENUE EXPENDITURE 2014-15										Revenue expenditure per head £
	Education	Social services	Council fund hsg & hsg benefit	Environmental services	Roads & transport	Libraries, culture, heritage, sport & rec	Planning & econ devt	Council tax benefit & admin	Other revenue expenditure	Total	
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	
Neath Port Talbot	114,429 32%	98,549 27%	61,785 17%	18,358 5%	13,923 4%	13,076 4%	7,444 2%	2,515 1%	29,882 8%	359,960 100%	£2,481
Bridgend	126,471 39%	72,634 22%	58,142 18%	16,120 5%	11,948 4%	10,044 3%	5,103 2%	1,124 0%	24,378 7%	325,963 100%	£2,308
Vale of Glamorgan	113,156 41%	58,164 21%	42,365 15%	14,353 5%	9,433 3%	9,139 3%	2,473 1%	1,950 1%	25,185 9%	276,219 100%	£2,562
Rhondda Cynon Taf	224,170 38%	148,212 25%	82,369 14%	36,801 6%	17,768 3%	22,656 4%	10,890 2%	2,099 0%	47,267 8%	592,233 100%	£2,339
Merthyr Tydfil	50,027 34%	36,980 25%	21,427 14%	8,903 6%	5,433 4%	5,646 4%	6,432 4%	866 1%	13,241 9%	148,957 100%	£1,977
Caerphilly	157,931 38%	91,009 22%	61,390 15%	25,272 6%	17,208 4%	17,232 4%	6,821 2%	1,334 0%	35,437 9%	413,633 100%	£2,399
Blaenau Gwent	59,987 34%	43,198 25%	29,089 17%	10,017 6%	5,511 3%	5,697 3%	2,814 2%	1,085 1%	18,468 11%	175,865 100%	£2,248
Torfaen	83,846 37%	51,039 22%	40,247 18%	12,129 5%	8,762 4%	7,596 3%	5,885 3%	1,042 0%	16,774 7%	227,320 100%	£2,163
Monmouthshire	69,535 38%	42,994 24%	25,984 14%	11,126 6%	6,955 4%	8,468 5%	3,222 2%	776 0%	13,482 7%	182,542 100%	£2,072
Newport	126,193 36%	88,406 25%	61,559 17%	13,794 4%	10,118 3%	12,804 4%	4,708 1%	1,461 0%	33,285 9%	352,327 100%	£2,152
Cardiff	281,925 35%	176,042 22%	174,143 22%	42,624 5%	28,605 4%	26,995 3%	6,605 1%	4,971 1%	54,460 7%	796,371 100%	£2,256
All authorities	2,610,336 37%	1,673,329 23%	1,151,088 16%	404,167 6%	278,887 4%	252,720 4%	115,133 2%	36,083 1%	618,114 9%	7,139,857 100%	£2,309

Source: StatsWales - Revenue outturn (RO) data collection 2014-15, Welsh Government

Appendix 2 – Analysis of revenue financing by authority 2014-15

AUTHORITY	FINANCING OF REVENUE EXPENDITURE 2014-15 (net of service Fees & Charges)							
	Council tax £m	Council tax reduction scheme £m	Share of re- distributed NNDR £m	Discretionary NNDR relief £m	RSG £m	Specific grants	Appropriations & adjustments £m	Total £m
Isle of Anglesey	32,019 21%	-5,228 -3%	20,471 13%	-50 0%	72,495 47%	35,128 23%	17 0%	154,852 100%
Gwynedd	59,540 21%	-9,916 -4%	35,646 13%	-259 0%	132,666 48%	59,041 21%	583 0%	277,300 100%
Conwy	52,155 19%	-8,911 -3%	34,098 13%	-101 0%	117,244 44%	70,282 26%	4,053 2%	268,821 100%
Denbighshire	45,981 20%	-9,167 -4%	27,245 12%	-130 0%	112,894 49%	54,160 23%	390 0%	231,372 100%
Flintshire	66,046 21%	-10,529 -3%	43,876 14%	-117 0%	142,542 44%	76,143 24%	2,467 1%	320,429 100%
Wrexham	54,962 19%	-10,035 -3%	38,802 13%	-90 0%	131,711 45%	77,881 27%	0 0%	293,231 100%
Powys	66,178 22%	-8,068 -3%	38,880 13%	-128 0%	135,436 45%	60,131 20%	6,130 2%	298,560 100%
Ceredigion	33,500 19%	-4,732 -3%	22,992 13%	-148 0%	76,263 43%	37,950 22%	9,542 5%	175,367 100%
Pembrokeshire	44,231 16%	-7,511 -3%	35,668 13%	-256 0%	124,377 44%	64,757 23%	23,668 8%	284,934 100%
Carmarthenshire	80,756 19%	-14,244 -3%	53,410 13%	-120 0%	199,071 47%	94,828 23%	6,338 2%	420,040 100%
Swansea	101,717 18%	-18,981 -3%	70,092 13%	-375 0%	237,542 43%	169,009 31%	-7,448 -1%	551,557 100%

Continued overleaf

AUTHORITY	FINANCING OF REVENUE EXPENDITURE 2014-15 (net of service Fees & Charges)							
	Council tax £m	Council tax reduction scheme £m	Share of re- distributed NNDR £m	Discretionary NNDR relief £m	RSG £m	Specific grants	Appropriations & adjustments £m	Total £m
Neath Port Talbot	65,263 19%	-15,644 -4%	40,630 12%	-176 0%	164,447 47%	94,556 27%	1,316 0%	350,392 100%
Bridgend	65,529 20%	-14,254 -4%	40,408 12%	-138 0%	148,002 45%	87,874 27%	0 0%	327,420 100%
Vale of Glamorgan	62,242 21%	-8,957 -3%	36,297 12%	-200 0%	116,184 40%	74,676 26%	11,493 4%	291,735 100%
Rhondda Cynon Taf	96,680 17%	-23,897 -4%	67,465 12%	-400 0%	287,210 49%	153,350 26%	4,396 1%	584,804 100%
Merthyr Tydfil	23,997 16%	-5,872 -4%	16,864 11%	-20 0%	72,424 48%	39,537 26%	3,015 2%	149,945 100%
Caerphilly	59,500 14%	-14,634 -3%	50,854 12%	-229 0%	212,837 49%	116,288 27%	6,045 1%	430,662 100%
Blaenau Gwent	28,206 16%	-8,722 -5%	20,201 12%	-150 0%	90,003 52%	43,318 25%	1,306 1%	174,161 100%
Torfaen	37,320 17%	-8,380 -4%	26,097 12%	-140 0%	104,447 47%	63,434 28%	610 0%	223,388 100%
Monmouthshire	50,663 28%	-6,097 -3%	26,737 15%	-6 0%	66,819 37%	40,578 23%	1,185 1%	179,879 100%
Newport	52,356 16%	-10,910 -3%	41,092 12%	-76 0%	168,162 50%	97,520 29%	-10,386 -3%	337,758 100%
Cardiff	142,923 18%	-30,983 -4%	101,253 13%	-300 0%	322,851 40%	271,042 34%	1,145 0%	807,932 100%
All authorities	1,321,762 19%	-255,672 -4%	889,080 12%	-3,608 0%	3,235,629 45%	1,881,481 26%	65,866 1%	7,134,539 100%

Appendix 3 – Specific and general grants over the last 10 years

	Financial Year									
	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Specific grants	£1,404.1m	£1,443.0m	£1,535.9m	£1,712.0m	£1,886.3m	£1,924.4m	£1,943.2m	£2,029.6m	£1,988.8m	£2,011.1m
General grants (RSG)	£2,675.0m	£2,876.0m	£2,986.7m	£3,033.4m	£3,118.7m	£3,209.1m	£3,299.8m	£3,197.1m	£3,445.6m	£3,296.3m
Gross revenue expenditure	£5,556.2m	£5,857.5m	£6,100.6m	£6,523.4m	£6,835.4m	£6,957.2m	£7,072.1m	£7,247.9m	£7,333.6m	£7,288.0m
Grants as %age of Gross Revenue Exp										
Specific grants	25%	25%	25%	26%	28%	28%	27%	28%	27%	28%
General grants (RSG)	48%	49%	49%	46%	46%	46%	47%	44%	47%	45%
Indices (2005-06 = 100)										
Specific grants	100	103	109	122	134	137	138	145	142	143
General grants (RSG)	100	108	112	113	117	120	123	120	129	123
Gross revenue expenditure	100	105	110	117	123	125	127	130	132	131

Source: StatsWales - Financing of revenue outturn expenditure

Appendix 4 – Analysis of council tax income by authority 2014-15

AUTHORITY	COUNCIL TAX					Total income 2014-15 £m	Net CT as %age of Total income
	Gross income £m	Council tax reduction scheme £m	as %age of Gross Income	Net Council Tax income £m	as %age of all Wales Net CT income		
Monmouthshire	50,663	-6,097	12%	44,566	4%	179,879	24.8%
Powys	66,178	-8,068	12%	58,111	5%	298,560	19.5%
Vale of Glamorgan	62,242	-8,957	14%	53,285	5%	291,735	18.3%
Gwynedd	59,540	-9,916	17%	49,623	5%	277,300	17.9%
Flintshire	66,046	-10,529	16%	55,517	5%	320,429	17.3%
Isle of Anglesey	32,019	-5,228	16%	26,791	3%	154,852	17.3%
Ceredigion	33,500	-4,732	14%	28,768	3%	175,367	16.4%
Conwy	52,155	-8,911	17%	43,244	4%	268,821	16.1%
Denbighshire	45,981	-9,167	20%	36,814	3%	231,372	15.9%
Carmarthenshire	80,756	-14,244	18%	66,513	6%	420,040	15.8%
Bridgend	65,529	-14,254	22%	51,275	5%	327,420	15.7%
Wrexham	54,962	-10,035	18%	44,927	4%	293,231	15.3%
Swansea	101,717	-18,981	19%	82,736	8%	551,557	15.0%
Neath Port Talbot	65,263	-15,644	24%	49,619	5%	350,392	14.2%
Cardiff	142,923	-30,983	22%	111,940	11%	807,932	13.9%
Torfaen	37,320	-8,380	22%	28,939	3%	223,388	13.0%
Pembrokeshire	44,231	-7,511	17%	36,720	3%	284,934	12.9%
Rhondda Cynon Taf	96,680	-23,897	25%	72,783	7%	584,804	12.4%
Newport	52,356	-10,910	21%	41,446	4%	337,758	12.3%
Merthyr Tydfil	23,997	-5,872	24%	18,125	2%	149,945	12.1%
Blaenau Gwent	28,206	-8,722	31%	19,483	2%	174,161	11.2%
Caerphilly	59,500	-14,634	25%	44,866	4%	430,662	10.4%
All authorities	1,321,762	-255,672	19%	1,066,091	100%	7,134,539	14.9%

Source: StatsWales, Financing of revenue outturn expenditure 2014-15

Appendix 5 – Analysis of NDR income by authority 2014-15

AUTHORITY	Share of re-distributed NNDR £m	Non Domestic Rates			Net NDR Income £m	Net NDR as %age of Total income
		Discretionary NNDR relief		as %age of all Wales NDR income		
		£m	£m			
Monmouthshire	26,737	-6	26,731	3.0%	179,879	14.9%
Flintshire	43,876	-117	43,759	4.9%	320,429	13.7%
Wrexham	38,802	-90	38,712	4.4%	293,231	13.2%
Isle of Anglesey	20,471	-50	20,421	2.3%	154,852	13.2%
Ceredigion	22,992	-148	22,844	2.6%	175,367	13.0%
Powys	38,880	-128	38,752	4.4%	298,560	13.0%
Gwynedd	35,646	-259	35,386	4.0%	277,300	12.8%
Carmarthenshire	53,410	-120	53,290	6.0%	420,040	12.7%
Conwy	34,098	-101	33,997	3.8%	268,821	12.6%
Swansea	70,092	-375	69,717	7.9%	551,557	12.6%
Cardiff	101,253	-300	100,953	11.4%	807,932	12.5%
Pembrokeshire	35,668	-256	35,413	4.0%	284,934	12.4%
Vale of Glamorgan	36,297	-200	36,097	4.1%	291,735	12.4%
Bridgend	40,408	-138	40,270	4.5%	327,420	12.3%
Newport	41,092	-76	41,017	4.6%	337,758	12.1%
Caerphilly	50,854	-229	50,626	5.7%	430,662	11.8%
Denbighshire	27,245	-130	27,114	3.1%	231,372	11.7%
Torfaen	26,097	-140	25,957	2.9%	223,388	11.6%
Neath Port Talbot	40,630	-176	40,454	4.6%	350,392	11.5%
Blaenau Gwent	20,201	-150	20,051	2.3%	174,161	11.5%
Rhondda Cynon Taf	67,465	-400	67,065	7.6%	584,804	11.5%
Merthyr Tydfil	16,864	-20	16,844	1.9%	149,945	11.2%
All authorities	889,080	-3,608	885,472	100%	7,134,539	12.4%

Source: StatsWales, Financing of revenue outturn expenditure 2014-15

Appendix 6 – List of organisations and individuals providing oral evidence

The Commission received oral evidence from the organisations listed below and would like to extend their thanks to the individuals listed for giving their time and insight.

Local Authorities:

- Blaenau Gwent County Borough Council
 - Cllr Hedley McCarthy (Leader)
 - David Waggett (Chief Executive)
 - Dave McAuliffe (Chief Finance Officer)
- Bridgend County Borough Council
 - Cllr Mel Nott OBE (Leader)
 - Darren Mepham (Chief Executive)
- Caerphilly County Borough Council
 - Chris Burns (Chief Executive)
- Carmarthenshire County Council
 - Jake Morgan (Director of Community Services)
- Ceredigion County Council
 - Cllr Ellen ap Gwynn (Leader)
 - Cllr Dafydd Edwards (Cabinet Member for Finance)
- City of Cardiff Council
 - Cllr Phil Bale (Leader)
 - Paul Orders (Chief Executive)
- Conwy County Borough Council
 - Iwan Davies (Chief Executive)
 - Andrew Kirkham (Head of Corporate Financial Services)
- Flintshire County Council
 - Cllr Aaron Shotton (Leader and WLGA Deputy Leader and Finance Spokesperson)
 - Colin Everett (Chief Executive)
- Isle of Anglesey County Council

- Cllr Ieuan Williams (Leader)
 - Gwynne Jones (Chief Executive)
- Merthyr Tydfil County Borough Council
 - Cllr Phil Williams (Deputy Leader)
 - Gareth Chapman (Chief Executive)
- Monmouthshire County Council
 - Cllr Peter Fox (Leader)
 - Paul Matthews (Chief Executive)
- Newport City Council
 - Will Godfrey (Chief Executive)
 - Meirion Rushworth (Head of Finance)
- Pembrokeshire County Council
 - Ian Westley (Chief Executive)
- Powys County Council
 - Cllr Wyn Jones (Deputy Leader and Cabinet Member for Finance)
 - Jeremy Patterson (Chief Executive)
 - Jane Thomas (Professional Lead, Finance)
- Rhondda Cynon Taf County Borough Council
 - Christopher Lee (Group Director, Finance)
- Torfaen County Borough Council
 - Alison Ward CBE (Chief Executive)
- Vale of Glamorgan Council
 - Cllr Neil Moore (Leader)
 - Robert Thomas (Managing Director)
 - Huw Isaac (Head of Performance and Development)
 - Carys Lord (Head of Finance)
- Wrexham County Borough Council
 - Cllr Ian Roberts (Deputy Leader)
 - Mark Owen (Director of Finance)

- Phil Walton (Strategic Director)

Other Public Sector Bodies:

- North Wales Fire and Rescue Service
 - Meirick Lloyd Davies (Chair)
 - Dawn Docx (Deputy Chief Fire Officer)
- Powys Teaching Health Board
 - Rebecca Richards (Director of Finance)
- SoLACE
 - Colin Everett (Sustainable Service Delivery Lead)
- Society of Welsh Treasurers
 - Mark Owen (Wrexham County Borough Council)
- South Wales Police
 - Geoff Petty (Treasurer)
 - Umar Hussain (Chief Financial Officer)
- Wales Audit Office
 - Huw Vaughan Thomas (Auditor General for Wales)
 - Anthony Barrett (Wales Audit Office, Assistant Auditor General - Financial Audit)
- WLGA
 - Steve Thomas (Chief Executive)
 - Chris Llewelyn (Deputy Chief Executive)
 - Jon Rae (Director of Resources)
 - Stephen Jones (Regional Coordinator for North Wales)
 - Richard Dooner (Programme Manager)

Think Tanks / Academics:

- Bevan Foundation
 - Victoria Winckler (Director)
- Centre for Cities
 - Andrew Carter (Deputy Chief Executive)

- Ulster University
 - Dr Peadar Davis (Local Taxation Options Research)

Other Representative Bodies/ Individuals:

- CBI Wales
 - Chris Sutton (Chair)
- FSB Cymru
 - Matt Williams (Policy Advisor)
 - Rhodri Evans (Senior Communications Advisor)
- Grant Thornton
 - Jon Roberts (Regional Lead Partner South Wales & West)
 - Julie Masci (Associate Director)
- KPMG
 - Ahmed Goga (Lead, Public Sector & Healthcare)

Members of the Public

- David Elis-Williams
- WCVA
 - Ruth Marks (Chief Executive)
 - Mair Gwynant (Trustee)

Appendix 7 - Responses received to the Written Call for Evidence

The Commission gratefully acknowledges the written evidence received from the organisations listed below and would like to extend their thanks to all those who gave their time and expertise.

- 1 - Arthur Thomas
- 2 - Arts Council for Wales
- 3 - Bevan Foundation
- 4 - Caerphilly County Borough Council
- 5 - City and County of Swansea
- 6 - City of Cardiff Council
- 7 - Cllr Tim Newhouse
- 8 - Dr David Comerford
- 9 - Dr Peadar Davis
- 10 - Federation of Small Businesses Cymru (FSB Cymru)
- 11 - Flintshire County Council
- 12 - Gerald Holtham
- 13 - Gwynedd Council
- 14 - John Henley
- 15 - Learning for Leadership Cymru
- 16 - Mid and West Fire and Rescue Services
- 17 - North Wales Economic Ambitions Board
- 18 - North Wales Fire and Rescue
- 19 - Older People's Commissioner
- 20 - Powys County Council

- 21** - Professor Glen Bramley
- 22** - South Wales Fire and Rescue
- 23** - Specialists in Care Services (SICS)
- 24** - The Institute for Fiscal Studies (IFS)
- 25** - WLGA
- 26** - Wrexham County Borough Council

Appendix 8 - Summary of evidence received

The Commission invited evidence from a wide range of organisations and individuals. In order to maximise the opportunity for oral evidence the Commission held meetings across Wales in Conwy, Powys, Swansea, Carmarthenshire and Cardiff. The Commission also put out a call for written evidence. Inevitably, as there was no obligation to respond, responses received came from those who wished and were able to respond. A full list of those who gave oral and/or written evidence can be found at **Appendices 6 and 7**. The Commission have taken on board all the evidence presented to us, with no evidence carrying more weight than any other. Our conclusions and recommendations are based on our evaluation of this evidence combined with our collective knowledge and experience of the public sector, its governance and funding systems within Wales, the UK and further afield.

1. What do you consider to be the strengths and weaknesses of the existing system of local government finance in Wales?

There is a certain inevitability that when a Commission has been set up to propose alterations to a financial system, the responses received will focus more heavily upon the weaknesses. Any new system to be introduced, however, would do well to give regard to and indeed incorporate and build upon existing strengths.

Key **strengths** identified were:

- The largest source of funding Councils have in the AEF is predominantly based on local information – population, number of school pupils, lengths of roads etc. so it takes into account local drivers.
- Individual councils being able to influence taxation levels via the council tax, with budgets being approved by Full Council, so they are strongly influenced by local politicians, representing the local population.
- There have been some grants transferred into the RSG in recent years, but could be more progress here.
- The funding formula provides some predictive certainty if the quantum of funding to be passported through it is known, in advance, to a sufficient extent.
- The formula, for all its imperfections, does at least try to smooth out issues such as rurality and deprivation

- The current system is relatively stable allowing reasonable assumptions to be used for financial planning in the absence of multi-year settlements. The system in Wales has been better at delivering fairer, more equitable outcomes than has been the case in England.

Identified **weaknesses** in the system revealed many areas of commonality including:

- A lack of local accountability as too much of the finance is in the form of a government grant, leaving councils with too little discretion over how much finance they raise
- The system was seen as being “*cumbersome, dated*” and consistently producing “*late notification for authorities about their financial settlement for the following year*”. An additional comment on this theme was that “*multi-million pound organisations cannot work with funding being announced on an annual basis a few months in advance of the financial year*”
- The system is confusing with some funding coming via unhypothecated grant, some via the non-domestic rates pool, some via local taxation and some via hypothecated grants
- Over reliance on specific grants which may change at short notice is not conducive to medium term financial planning
- High levels of direct government grant funding obfuscates devolved policy making and in doing so blurs public accountability between tiers of government.

2. What should the objectives of central funding be? What kind of grant system should support those objectives?

If we begin the process of examining how central funding should work, the above question generated a general consensus that central funding should:

- Fairly allocate general taxation income to the population based on need
- Ensure there is local choice on how that funding is spent
- Ensure the population can expect a basic standard of services wherever they may live.
- Provide a resilient funding base for councils to meet their minimum statutory duties and to meet costed Government social, economic and environmental policy objectives and new legislation

3. *Are grant distribution mechanisms fit for purpose and what changes would be desirable?*

Having ascertained what people felt the objectives of central funding should be, we then examined whether the current system achieves those objectives or whether there are barriers that act as an impediment to achieving the objectives.

The Institute for Fiscal Studies (IFS) noted that *“It is widely perceived that grant mechanisms are complex and poorly understood, and some authorities complain that they are treated unfairly by the current system. It is therefore wise to review these mechanisms”*.

Other comments received included:

- Changes in our grant amount from one year to the next can be caused by changes in some (or usually, all) of: the grant distribution formula, the total amount of grant across Wales, the notional distribution of total Standard Spending Assessment (SSA) between services, and underlying data such as pupil numbers and population. It is difficult for us to understand – let alone communicate to our citizens – the main reasons for the differences each year and whether or not these changes are justified
- The SSA formula has not been reviewed in its entirety for about 15 years; however, some service formulae have been updated from time to time (e.g. Consumer Protection in 2015/16). We are aware that reviews of some parts of the formula are ongoing and that other elements have been looked at in the past but without any resulting formula changes (in some cases because the potential financial impacts were difficult to understand or explain). As a result, the current formula seems to be rather *piecemeal* and it is very difficult to know whether, overall, it produces a fair outcome for individual authorities.
- The level of complexity hinders the current system. Too few people are able to explain the system even within local government and there is little or no understanding within the general public. There is a sense that reform is long overdue but because this has been long delayed this is likely to produce significant redistribution of funding and without a damping mechanism would create instability.
- Any discussion about grant mechanism cannot be divorced from discussions about other funding mechanisms such as local tax raising powers. The link between funding and the drivers of expenditure is increasingly tenuous and in some cases the use of existing data sets in the formula is at best questionable. The use of proxy measures for (say) poverty or rurality means that the

real cost of service delivery is not reflected in the allocations produced by the grant distribution mechanism.

4. *Will the potential structural reorganisation affect the operation of the system? Would it provide an opportunity for a parallel financial reform?*

As stated previously, the Commission operated within a background of potential Local Government Reorganisation and was keen to ascertain how LGR may impact the operation of the financial system. The Commission, whilst mindful of the fact that any recommendation made would need to be transferable from the existing LG structure to any potential new one, were keen to examine whether LGR may in fact also provide an opportunity to implement a new financial regime. Responses received included:

- It would provide that opportunity and it really shouldn't be missed. However, without absolute clarity about the functions of local government it will be at best a tinkering exercise, probably adding rather than removing historical complexity. Central Government (in Whitehall or Cardiff Bay) actually provides very few services. It does set the policy context which is totally legitimate but it really should stay out of the day-to-day micro managing of services it does not provide. Set objectives, set policy, set parameters and then let local government do what it does best (and much better than central government), deliver effective, efficient, responsive services
- Simple mergers of neighbouring authorities with disparate council tax levels will either result in a need for equalisation, dampening mechanisms or immediately difficult messages in areas facing cuts and retrenchment at the same time as tax transfers between resident populations
- The existing formula, which to a large extent is portable from one structure to another, would not be fit for purpose with less councils. It already places statistical reliance on data from only 22 Councils and a lesser number would make the formula extremely unreliable and open to challenge. This has been commented on within several DSG reports in recent years. Any structural change will require a new basis for determining funding allocations and would therefore be an appropriate time to amend the existing distribution mechanism.

5. *What additional pressures do rurality and deprivation introduce?*

Conscious of the diverse geographical make-up of Wales, the Commission sought to understand how deprivation and rurality added pressure to local authorities. Responses received included:

- Delivering some services (for example domiciliary care, special education, library, environmental health) in rural areas is incredibly expensive (lack of a viable quantum, travel times/costs, no economies of scale) and all too often pockets of deprivation in rural areas are too small to show up at the more macro scale used to drive funding formulae but rurality enhances the negative impacts of deprivation – expensive transport (or no transport, lack of cheaper shops, poor local networks, services not available, etc.)..... it is debilitating, expensive, puts added pressure on all services and often results in reactive services being overwhelmed without the resources to develop preventive services
- Rurality introduces extra costs for providing the same level of service because costs such as transport and staff time increase. There is a lower tax base per square mile than in a more built up area. Also economic growth is more of a challenge – with poor transport links companies are unlikely to invest in the area, for example.
- Rurality results in higher costs of some services where travel distance is a key cost driver of cost or where sparsity demands a sub-optimal distribution or number of service points e.g. fire stations. This of course is not unique to rural areas as the valleys and coast of South Wales present their own unique geographical problems in the efficient distribution of resources.
- Deprivation can bring additional costs to Councils because there are more users of Council services and less of an ability to charge for services as the population can't afford to pay
- Deprived urban settings tend to generate greater problems associated with density of premises, traffic, crime and anti-social behaviour all of which require more costly service provision. A comparison of the number and type of incidents within South Wales for example reveals stark differences between the constituent council areas. As an example, in the majority of council areas, more than 75% of fires attended are deliberately set. In Monmouthshire this figure is nearer 33%.
- They both provide additional pressures, but deprivation is a deep rooted issue that is very difficult to resolve. Deprivation is directly linked to poor performance in education, along with more extensive health and social care issues. Communities in deprived areas tend to be more dependent on public sector support and funding (welfare). Rurality will incur additional costs but also often represents those “better off areas” in Wales, that rely less on public sector provision.

6. Are any reforms required to the system of capital expenditure determination and funding?

Having looked at the issues regarding revenue, the Commission then sought to examine whether similar issues existed regarding capital expenditure and funding. Comments received included:

- Too large a proportion of capital investment funds is being retained by Welsh Government, for example for selective transport and infrastructure projects, with insufficient funds devolved to regions and to councils for more local determination. The system for national-regional planning needs to be developed further for effective targeting of capital borrowing and grants to jointly agreed priority projects
- The Prudential Code has, for a number of years, allowed local authorities to determine their level of borrowing within a set of indicators agreed by councils. This gives considerable scope to raise capital within limits of affordability and creates a closer link between revenue budgets and capital funding. The current flexibilities remain a considerable improvement on the former system of credit approvals and any reform should continue to allow current levels of local determination about capital expenditure and its affordability

7. Is council tax fit for purpose? What reforms might be made, if any?

- Having examined the system for revenue and capital received from the Welsh Government, the Commission then sought to better understand and reflect upon the existing system of local tax collection. For council tax, comments received include:
- Council tax is not popular but it is a very suitable tax for local authorities since the tax base is immovable, collection is easy and evasion is hard. It does require reform however. Firstly, the tax should be made more buoyant by an appropriate scheme of annual indexation to house prices. Prices are available from the real estate sector on a detailed and high frequency basis. Price increases can be monitored down to broad post-code level. A smoothed indexation scheme should be adopted eliminating the need for periodic revaluations. This could be something like the weighted average of annualised house-price rise over the previous 12 years and the increase in the previous year.
- A recurrent tax on residential property is a sensible form of taxation for local government finance, and a key part of a well-functioning and efficient overall tax system. However, council tax would benefit from *significant reform*. While council tax in Wales is based on property values that are

substantially more up-to-date (2005) than in England and Scotland (1991), they are still more than 10 years old and there are no plans for further revaluation. It seems likely that the longer revaluation is delayed, the larger the changes in relative values will be (for instance, because of different economic and demographic trends in different parts of Wales). This makes any revaluation more painful to implement, further lessening the chance of one occurring. But clearly it would be nonsensical for council tax bills in 2015 to be based on relative property prices in 2005. It would therefore be sensible to move to a defined revaluation cycle (akin to that with NDR), with revaluation every 5 years or so. Even over 5 years, changes in relative values may be large so it might be worthwhile using local or regional price indices to index relative values in the intervening period. Linking council tax rates to local property prices directly may also reduce volatility and divergence in the property market (as higher prices would lead to higher council tax bills, which may reduce demand somewhat, lessening upward pressure on prices).

- Some current council tax allowances should be devolved to local authorities to determine. The 25 % allowance for people living alone could be abolished, for example, at local discretion, raising revenue, since it is not clear what purpose it serves. The exemption for properties housing students could be reviewed. Providing student accommodation is such an attractive investment that the exemption seems to be leading to above average profits for providers.
- Overall, we believe that the council tax system is fit for purpose, on the grounds that this is the tax that provides the most suitable compromise between taxing property and taxing people. Therefore, we believe that there is no need to abolish council tax in its entirety in order to modernise the provision, but the Welsh Government must work with local authorities to ensure that those who use public services contribute fairly towards them. We believe that holding the revaluation exercise much more regularly, with sustained re-banding, would give the public more confidence about the robustness, transparency and fairness of the arrangements. Also, there is a need for a full review of the exemptions and discounts arrangements. The current arrangements are a mess, and they must be updated. Some of the current exemptions are archaic, or fail to reflect the current situations of Councils. For example, it is seen locally that significant blocks of buildings for students come under the council tax arrangements, but receive full exemption, although the public would expect that many of them are businesses that would be considered under the business tax regime. In an area with a high number of students, this can have a significant impact on the tax base.

8. Is the non-domestic rate working well? What reforms might be made, if any?

Having ascertained the views regarding council tax, it was sensible to then examine the current situation with Business Rates (also known as Non-Domestic Rates or NDR). Responses included:

- Currently property values do not distinguish between the value of the land occupied and the value of buildings on it. It would be good to make the distinction and progressively shift the tax off the buildings and on to the land, as recommended by the Mirrlees Commission and as is the practice in New Zealand, Denmark, some states of Australia and some US municipalities. This would require research and development of capability in the Valuation Office Agency so cannot be done quickly but it is a reform that should be planned over the coming years. It would result in a fall in land prices and remove the investment disincentive in current NDR. For both reasons it would be a boost to business once teething troubles were resolved. A step towards making this practical would be the adoption of valuation reporting procedures that the VOA is proposing for England, whereby businesses report on the characteristics of their properties and self-value them
- Implementing land value taxation in practice is not a simple task. It is often difficult to value land separately from the property that is built on it, for instance. And the owners of valuable but undeveloped land could be liable for significant amounts of tax, even though the land would not yet be generating an income (in principle, this could be dealt with via tax deferral, but this may itself act as a disincentive for sale and development). Further work by economists, tax practitioners and the property industry to overcome these issues is therefore needed. But local government and the Welsh Government (and the UK government) can drive forward such developments by engaging with these organisations to investigate and design a feasible system of land value taxation. This is a worthwhile goal because land value taxation has much to recommend it in terms of economic efficiency, and by design it would mean that the plethora of complex schemes that are being added to the existing system of business rates to address particular problems associated with taxing business property investment would not be needed
- SB Wales has for some time warned that Business Rates are in need of significant reform. In their current form, Non-Domestic Rates are unresponsive to economic trends, and can act as a disincentive to smaller businesses looking to expand and invest. We have also argued that the lack of a meaningful link between Non-Domestic Rates receipts and the Local Government grant means Local Authorities have little incentive to pursue policies which support local business growth. Non-Domestic Rates are a source of circa £1bn a year in revenue for the Welsh

Government (and subsequently Local Authorities) and FSB Wales recognises the need to protect this revenue stream, and to grow it in line with economic growth. Indeed, business rates' relatively *static* pot, whilst not reflecting business conditions, is a virtue from the point of view of the Government as it provides a predictable and secure stream of revenue. However, it is our view that the tax currently falls disproportionately on those small businesses with premises, something implicitly recognised by the now, year-on-year, retention of the Small Business Rates Relief scheme, which should be extended and made permanent. There are strong arguments to be made that receipts from the collection of NDR should be retained by Local Authorities and that the RSG becomes the main stream of central funding for Local Authorities, and we urge Welsh Government to come to a position on retention early in the next Assembly.

- The CBI's view (and hope) is that with improving IT infrastructure, the frequency of revaluations can be increased and not be based upon two year old antecedent valuation dates (2005 revaluation was based upon 2003 valuations for example). It was also noted that the CBI want the increase in rateable value to change from RPI to the historically lower CPI figure and feel that uniform business rates should be restructured in this way
- It was noted that in certain areas of London, they pay an additional 2p in the pound of business rates to pay for the Cross Rail project. The CBI queried whether such a tax could be introduced to pay for the Metro project for example
- The decision by the Welsh Government to place business rates policy within the Minister for Economy's portfolio suggests that WG see it as a lever for achieving economic or business policy aims, not as simply a stable source of revenue for Welsh Government. Yet WG have adopted a *business as usual* approach, with a recommendation for stability in the short and medium term and the potential for devolution and greater local retention only being considered following local government reorganisation. This could be over 5 years away. We believe that the Welsh Government should look again at this issue to ensure that the Welsh City Regions is not left behind English city-regions
- Full retention of National Non-Domestic Business Rates (NNDR) both base and growth, for local taxation to be invested in local infrastructure and local services to businesses, and as a direct incentive to promote economic growth. A compensatory scheme would be required from the Revenue Support Grant system for those councils with low industrial/commercial taxation generating businesses. The option for local taxation supplements to be applied for locally agreed

priorities with the business community e.g. prudential borrowing in invest in local infrastructure should be allowed

9. *Would you favour local government in Wales taking control of additional taxes? If so, which ones?*

Having examined the existing system of finance and the locally raised taxes, the Commission then moved on to ascertain opinions as to whether there were other, additional taxes that people were in favour of local government not necessarily raising and implementing but having control over. Responses included:

- The Welsh Government should seek Westminster approval for a hotel or tourist tax as levied in much of continental Europe. The tax should be fully devolved to local authorities to charge what they think the local market could bear. As such it should be a net addition to their resources and not be counted in assessing the revenue-support grant because visitors use local authority services without currently paying towards them. There is a case for considering a number of local environmental taxes. Landfill tax revenues could be devolved or assigned to local authorities
- Increased Revenue Raising Capacity, through the introduction of new, small taxes. Though the sums raised by these taxes are relatively small, they do unlock a revenue stream to service some borrowing costs and could include:
 - Tourist / Hotel Tax
 - Recycling / Waste Taxes
 - Taxation of derelict land.

If introduced these should be fully devolved to local areas and should be considered a net addition to local budgets, and so should not be considered when assessing the revenue support grant.

- A review of the legislation for developer contributions such as S106 agreements to ensure fairer and more assured contributions by developers to local community infrastructure
- We note that the *Tax Collection and Management (Wales) Bill* – which was the subject of consultation in the summer of 2015 – includes the following clause regarding the operation of the new Welsh Revenue Authority (WRA); “13(1) WRA may delegate any of its functions to any person prescribed by regulations made by the Welsh Ministers”.
- We cannot see a reason why *any person* in this context cannot include local authorities; Welsh Ministers through secondary legislation, not the WRA, would provide the power. In that regard,

Gwynedd Council suggests that the Welsh Government (if the Bill comes into force in accordance with the draft) should internalise tolls and taxes such as a stamp duty and land fill for local collection. This would be an opportunity to take advantage of the expertise already in place within the local authorities.

- Any additional tax raising powers will need to be carefully assessed by Welsh Government to avoid destabilising local economic activity and avoid producing unintended consequences. Even so, there is merit in allowing councils to explore what may suit local circumstances. For example, some councils may see a tourism based tax (as used to support local funding in France and Italy amongst others) as a viable option.

10. Should incentives for growth play a greater role in the funding system?

The Commission then moved on to examine whether incentives for growth could play a greater role in the funding system, with the following responses being received:

- The degree to which the local government finance system provides financial incentives versus financial equalisation and risk insurance is to a large extent a political question.
- The authority supports any initiative that promotes growth to increase funding. However, growth also brings cost in providing public services. The development of more business and housing and a greater population will increase risk and the associated need for fire cover. If incentives are to work, the funding generated must find its way to those services impacted by growth.
- Yes, but it's not all about financial incentives, an attractive workforce to the private sector is just as important, i.e. appropriately skilled and a fit and healthy workforce.

11. Could fees and charges be used to a greater extent than at present?

Again, in examining what changes could ultimately be proposed, the Commission were keen to seek the views on fees and charges and whether they could be used differently. Responses received included:

- If restrictions on not being able to make a profit were removed local authorities could use profit from one area to subsidise another.
- More services could be charged for at the point of use rather than an assumption that they should be free for all. (Services could be funded more by users than general taxpayers)

- There is some opportunity to use fees and charges to generate income and change behaviour. This needs to come from Welsh Government as well - i.e. free universal services gives the wrong message if local government determine that the public should pay more for services.
- There are a number of caps and restrictions placed on local authorities in respect of income generation – i.e. council tax and social care. These should be removed.
- Fees and charges not only raise income but also signal to the public that some services come with a cost and by charging appropriately it will become evident if the public value them enough to continue by paying a fair amount.
- The income cap on social care services should be reviewed. It cannot be appropriate that those who can afford to pay for services have their contribution capped at a time when those in need are facing cuts in service provision due to the reduction in funding councils must absorb.

12. How do reductions in council expenditure affect the sustainability and quality of services? Might different financing arrangements (not additional resources) improve the outlook?

Having examined the areas above, the Commission then wanted to ascertain how services have been affected by the recent period of austerity and whether alternative financial arrangements could improve the outlook for service users. Responses noted included:

- If one repeatedly cuts the core services in order to protect the frontline then eventually the front line suffers from lack of strategic support, corporate thinking and innovation. A greater freedom of action (removal of ring-fencing, clarity, longer time frames) would enable longer term and more effective responses to the pressures of Austerity.
- Councils try to maintain the same services even though funding has been reduced – this means that often the quality of the service provided slips – waiting times become longer or less staff time is available to help the more vulnerable for example. Different financing arrangements by themselves are unlikely to improve this – additional resources are required. However, there are some changes that may improve the outlook – for example removing hypothecated grants and adding these to the un-hypothecated grant would give Councils more freedom to spend their resources on local priorities.
- There is no realistic and meaningful discussion going on at a national level regarding the future role of public authorities. Whilst austerity removes the resources which underpin service provision (quality or quantity), promises continue of improved services to the public and

regulators continue to assess and report based on outdated expectations of delivery. Continuing in this vein can only result in unrealistic expectations, greater public concern and disquiet and an even greater perception of failure.

- The reductions in council expenditure will inevitably affect the sustainability and to some extent the quality of services. A scenario is likely to emerge over coming years that unless greater freedom and flexibility is given to local authorities there will be greater proportions of budget spent on social services and some discretionary services will cease unless delivered by other bodies such as community councils or by the Third Sector. The raising of the cap on income contributions for care services should feature in the debate. Different financing arrangements can only improve the outlook if they help produce additional resources and greater flexibility and transparency. The devolution of an element of tax raising powers would enable a wider debate with the local population about which services should be maintained.

13. Are there issues relating to the finance of housing which adversely affect local government? If so, do you have suggestions for change?

Finally, the Commission sought views on issues relating to housing finance which may adversely affect local government which they could examine and usefully comment upon. Responses received were:

- Councils should have the freedom to set service charging policies which meet local need and are locally supported, without having to follow uniform policies as part of the Welsh Government policy aim of all landlords achieving the Welsh Housing Quality Standard (WHQS) by a deadline year. A sustainable system of Major Repairs Allowance is needed for continued capital investment to achieve and maintain WHQS. The recently agreed capital borrowing allowances for new social house-building by councils is welcomed. Repeat borrowing approvals in later years should be a shared central-local social policy priority.
- The rigid requirement to ring-fence tenant related income and expenditure within the Housing Revenue Account should be open to debate. Councils have a statutory role around homelessness that currently must be funded by the general fund. A more holistic and mature approach that sees this as a wider housing related issue should allow some element of funding (with safeguards around limits) to come from the HRA.

Appendix 9 – Changes in local authority Non-Domestic Rates receipts 2002-03 to 2014-15

Non-Domestic Rates receipts	4 years to 2006-07			4 years to 2010-11			4 years to 2014-15		
	Receipts 2006-07	Change from 2002-03		Receipts 2010-11	Change from 2006-07		Receipts 2014-15	Change from 2014-15	
	£000s	£000s	%	£000s	£000s	%	£000s	£000s	%
Isle of Anglesey	12,063	6,806	▲ 129%	12,855	792	▲ 7%	12,277	-578	▼ -4%
Gwynedd	24,383	-5,862	▼ -19%	31,758	7,375	▲ 30%	35,410	3,652	▲ 11%
Conwy	22,247	4,739	▲ 27%	26,061	3,814	▲ 17%	27,724	1,663	▲ 6%
Denbighshire	18,136	2,776	▲ 18%	17,670	-466	▼ -3%	19,908	2,238	▲ 13%
Flintshire	44,682	5,077	▲ 13%	55,063	10,381	▲ 23%	63,626	8,563	▲ 16%
Wrexham	29,798	3,156	▲ 12%	45,256	15,458	▲ 52%	37,371	-7,885	▼ -17%
Powys	20,705	3,500	▲ 20%	25,060	4,355	▲ 21%	26,652	1,592	▲ 6%
Ceredigion	11,871	3,263	▲ 38%	15,750	3,879	▲ 33%	16,587	837	▲ 5%
Pembrokeshire	25,271	1,903	▲ 8%	40,440	15,169	▲ 60%	49,739	9,299	▲ 23%
Carmarthenshire	29,771	5,172	▲ 21%	35,072	5,301	▲ 18%	44,614	9,542	▲ 27%
Swansea	61,110	14,057	▲ 30%	62,727	1,617	▲ 3%	69,077	6,350	▲ 10%
Neath Port Talbot	29,755	8,351	▲ 39%	33,186	3,431	▲ 12%	39,061	5,875	▲ 18%
Bridgend	32,378	5,474	▲ 20%	37,941	5,563	▲ 17%	41,394	3,453	▲ 9%
Vale of Glamorgan	30,146	2,545	▲ 9%	33,859	3,713	▲ 12%	37,688	3,829	▲ 11%
Rhondda Cynon Taf	42,650	9,426	▲ 28%	48,317	5,667	▲ 13%	47,648	-669	▼ -1%
Merthyr Tydfil	12,807	3,160	▲ 33%	14,835	2,028	▲ 16%	16,823	1,988	▲ 13%
Caerphilly	26,439	3,743	▲ 16%	29,691	3,252	▲ 12%	34,641	4,950	▲ 17%
Blaenau Gwent	10,018	2,200	▲ 28%	10,780	762	▲ 8%	12,247	1,467	▲ 14%
Torfaen	18,957	4,300	▲ 29%	18,187	-770	▼ -4%	20,657	2,470	▲ 14%
Monmouthshire	19,195	4,179	▲ 28%	18,751	-444	▼ -2%	22,174	3,423	▲ 18%
Newport	48,397	10,207	▲ 27%	53,220	4,823	▲ 10%	56,001	2,781	▲ 5%
Cardiff	135,425	28,951	▲ 27%	158,504	23,079	▲ 17%	174,316	15,812	▲ 10%
North Wales Econ Ambition	151,309	16,692	▲ 12%	188,663	37,354	▲ 25%	196,316	7,653	▲ 4%
Central Econ Area	87,618	13,838	▲ 19%	116,322	28,704	▲ 33%	137,592	21,270	▲ 18%
Swansea City Region	90,865	22,408	▲ 33%	95,913	5,048	▲ 6%	108,138	12,225	▲ 13%
Cardiff City Region	376,412	74,185	▲ 25%	424,085	47,673	▲ 13%	463,589	39,504	▲ 9%
WALES	706,204	127,123	▲ 22%	824,984	118,779	▲ 17%	905,635	80,652	▲ 10%

Appendix 10 – Specific grants 2014-15 and 2015-16

Existing Grant name	Note	2015-16 ⁷ £m	2016-17 ⁸ £m
Communities and Tackling Poverty			
Supporting People	5	123.688	124.400
Flying Start Revenue	5	77.401	76.051
Families First	5	43.422	38.352
Communities First (Clusters)		27.540	27.540
Cardiff Bay Legacy Funding		6.253	6.146
Communities LIFT	1	0.947	0.980
Community Cohesion Grant	3	0.360	0.360
Town Centre Partnerships		0.422	0.220
Remploy ESG		0.213	0.115
Communities First Pupil Deprivation	2	1.601	0.000
Economy, Science and Transport			
Bus Services Support Grant		25.000	25.000
Young Persons Discounted Bus Travel Scheme/ Youth Concessionary Fares		5.000	9.750
Bus Revenue Support (Traws Cymru)		1.500	2.187
Road Safety	5	2.000	2.000
CyMAL		1.693	1.254
Youth Entrepreneurship in FHE	1, 3	0.926	0.819
Bus Revenue Support		0.550	0.413
SBRI Innovation Catalyst Programme (LA Element)		0.600	0.200
Wales Transport Entitlement Card		0.200	0.200
Travel Plan Co-ordinators		0.125	0.125
NDR Retail Relief Scheme	2, 5	17.674	0.000
NDR Open for Business Scheme	1, 2	0.250	0.000
Concessionary Fares Scheme	5, 6	60.500	n/a
New Developments	6	0.395	n/a
Education and Skills			
Education Improvement for Schools	3	142.594	134.000
Post-16 Provision in Schools	5	104.544	101.074
Pupil Deprivation	3	81.457	89.246
Schools Challenge Cymru	1, 3	15.600	15.000
Adult Community Learning	5	3.737	3.811
Youth Work Strategy Support	5	2.756	2.756
Out of School Childcare	5	2.300	2.300

Continued overleaf

Existing Grant name	Note	2015-16 ⁷ £m	2016-17 ⁸ £m
School Uniform	5	0.742	0.742
International Education Programme	1	0.665	0.665
Welsh Language Promotion & Facilitation (LA Element)	1	0.375	0.401
Development of the Seren Network	1, 3	0.300	0.100
Business Improvement Districts		0.203	0.045
Mentoring & Networking Support for Head Teachers	1, 3	0.093	0.033
Learning In Digital Wales	2, 3	0.250	0.000
First World War Commemoration	1, 5, 6	0.214	n/a
Finance and Government Business			
Heads of the Valley & Bridgend Effect Project	1, 2	0.219	0.000
Health and Social Services			
Substance Mis-use Action Fund	3	22.663	22.663
Social Care Workforce Development Programme	5	7.149	7.149
Delivering Transformation	3	2.770	2.830
Deprivation of Liberty Safeguard	1, 3, 5	0.200	0.230
Natural Resources			
Single Environment	5	67.310	64.320
Animal Health & Welfare Framework	1, 2	0.500	0.000
Ceredigion Oil Buying Syndicate	2	0.059	0.000
Private Water Supply Risk Assessment	1, 2	0.004	0.000
Public Services			
Youth Crime Prevention Fund		4.900	4.420
Domestic Abuse Service - Core		1.244	0.608
Armed Forces Day Funding		0.020	0.020
Local Service Board Development	2, 5	0.669	0.000
Regional Collaboration Fund	2, 3	5.174	0.000
Successor Outcome Agreement	2, 4, 5	31.100	0.000
All Grants		898.071	768.525

Notes:

1. New grant in 2015-16
2. Ending in 2016-17
3. Paid on a regional basis
4. Transferring into RSG from 2016-17
5. Paid to all 22 Local Authorities
6. Figures not available at time of publication
7. The information sets out grants that will be paid to LAs in 2015-16 and estimated amounts for 2016-17 where currently known
8. Amounts for 2016-17 are indicative at this stage and are liable to change