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'From co-operative to competitive localism? The changing balance between equity and efficiency in local government under the Conservative / Liberal Democrat coalition'

Ed Turner
Aston University, Aston Triangle, Birmingham B4 7ET
e.turner@aston.ac.uk

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Abstract: This paper considers whether there has been a shift in the balance between equity and efficiency in respect of decentralised public policy in England since the election of the Conservative / Liberal Democrat coalition in 2010. Drawing on the literature on policy decentralisation and fiscal federalism from both Political Science and Economics, reasons are discussed why a trade-off between equity and efficiency might be expected. The context of English local government then outlined, and consideration is then given to four areas of policy: business rate localisation, the 'New Homes Bonus', council tax benefit and social housing, and regional economic development. In each case, some shift in the balance away from concern with equity towards one with efficiency is discerned: whether or not this is desirable will prove a matter of political and moral, as well as scientific judgement.

1. Balancing equity and efficiency in local government finance

In designing systems of decentralised policy-making, there are a whole host of normative and empirical considerations that can feature, relating to the size, power, democratic structure and financing of sub-national polities. For instance, both politicians and scholars may question whether there should be universal entitlements to particular national standards of public services, funded by redistribution of funds between one area and another (cf. Oates 1999, pp. 1127-9). They might also ask whether a greater number of sub-national jurisdictions is more effective at meeting citizens' demands (Dowding et al 1994, pp. 772-3). They could question whether, if sub-national polities have the power to borrow, there is a risk they will cheerfully run up excessive debts, safe in the knowledge that a 'bail out' for central government is assured (Rodden 2006). They may consider whether there are any necessary implications of political decentralisation for the nature of the welfare state (Obinger et al 2005), environmental regulation (Kelemen 2000; Olewiler 2006), or business taxation (Oates 1972; McKenzie 2006).

This article focuses in particular on the possibility of a trade-off between concerns of efficiency and equity in the design of decentralised policy-making. This introductory section sets out some of the ways in which such a trade-off might exist. The latter sections of the paper then apply the concerns of the literature to a number of proposals to reform local government in England.

Competition for citizens and optimising policies: Tiebout efficiency

In a seminal article, Charles Tiebout (1956, p. 418) sets out his bold claim that:

> ‘The consumer-voter may be viewed as picking that community which best satisfies his preference pattern for public goods. This is a major difference between central and local provision of public goods. ... The consumer-voter moves to that community whose local government best satisfies his set of preferences. The greater the number of communities and the greater the variance among them, the closer the consumer will come to fully realizing his preference position.'

The basic claim, then, is that citizens will be mobile, and will move to a municipality which best satisfies their preferences. We may thus conceive of municipalities as being in a competition to retain footloose citizens. Tiebout’s argument is based on a highly restrictive set of assumptions (ibid., p.419): in particular, the assumptions that citizens are fully mobile, and live entirely from dividend income, are far-fetched! However, Tiebout’s basic claim has proven influential in subsequent theoretical and empirical work on political decentralisation.

Dowding et al (1994) unpack Tiebout’s claims, and those which have been derived from his initial article, for instance noting that there are likely implications for property values. Of crucial importance for this article, however is the obvious extension to Tiebout’s argument that citizens will move according to the level of taxes, as well as services (ibid, p. 768).

Decentralisation and local fiscal policy

This then taken us to the next development in the argument. As Dowding et al (ibid. p. 769) content, scholars have sometimes posited a positive correlation between government size and inefficiency. There are two reasons for this: the first is that bureaucrats will seek to maximise their budgets, but this can be constrained if there is a larger number of small jurisdictions, and secondly Tiebout-competition between jurisdictions, seeking to offer an attractive and efficient balance of taxes and services:

> ‘With a mobile population, fiscal decentralisation is seen as a powerful constraint on Leviathan and, *ceteris paribus*, the growth of the public sector. The greater the number of jurisdictions, the greater the competition and a closer analogy to the private market ... With increasing geographical size the likelihood of fiscally induced migration across jurisdictional boundaries diminishes . A highly fragmented system encourages households to vote with their feet, thus limiting policy-makers' ability to act independently of citizens' wishes’ (ibid., p. 769).

This claim has been subject to extensive empirical testing, especially in the US. There is some support for the ‘decentralisation hypothesis’, that decentralisation to larger number of smaller, multi-purpose government units restricts growth of government spending (ibid, p. 770, also Nelson 1987; Jin / Zou 2002; Rodden 2003), although there are a number of caveats, in particular depending on whether taxes are levied upon more or less mobile factors, and whether there are fiscal equalisation arrangements in place.

There has been extensive research on the extent to which people are mobile in order to find provision of services (and a balance between service level and taxation) which matches their preferences (Dowding et al 1994, pp. 782-3). Often, this has been wrapped up with tests of Hirschman's seminal 'Exit, Voice, Loyalty' framework (Hirschman 1970), which powerfully conceptualises possible responses of consumers to dissatisfaction with the provider of a good (be it a firm, or a unit of government). For instance, John et al (1995) looked at data in relation to London boroughs and local taxation levels, and found 'strong support for the assumption that taxes and services can influence residential mobility' (p. 395). Again, though, there are caveats: residential mobility is of course motivated to some degree by factors other than tax-service packages (such as availability of property or employment), and Fox et al (1989, cited in Dowding et al 1994, p.783), find that decisions to move according to fiscal factors are more likely for outward rather than inward moves, due to the more limited information available in the latter case.

Oates (1972; 1999) introduces some important criticisms of the Tiebout model's normative implications. Oates recognises the general principle that:

> 'The efficient level of output of a "local" public good (i.e., that for which the sum of residents' marginal benefits equals marginal cost) is likely to vary across jurisdictions as a result of both differences in preferences and cost differentials. To maximize overall social welfare thus requires that local outputs vary accordingly.' (1999, p. 1122).

However, he draws attention to an important qualification:

> 'The result of tax competition may well be a tendency toward less than efficient levels of output of local services. In an attempt to keep taxes low to attract business investment, local officials may hold spending below those levels for which marginal benefits equal marginal costs, particularly for those programs that do not offer direct benefits to local business' (Oates 1972, p. 142, cited in McKenzie 2006, p. 27).

This is an early statement of concern about risks around tax competition: that policy-makers, seeking to attract footloose capital, will keep taxes lower than they should be, and in particular (cf. the reference to 'local businesses') there may well be under-provision of public goods, the benefit of which extends beyond the affected area (McKenzie 2006, p. 28).

A potential solution to the co-ordination problem identified above is for the central government to provide some intergovernmental grants: as Rodden notes, 'The global trend toward fiscal de-centralization has occurred almost exclusively through increased grants and shared revenues rather than the devolution of tax authority.' (2003, p. 705). Aside from the possibility that these will lead to the provision of necessary public goods which might not occur in an entirely decentralised structure, the provision of intergovernmental grants can also have a powerful political justification: that of *fiscal equalisation*. As Oates puts it (1999, p. 1127):

> ‘The purpose of these grants is to channel funds from relatively wealthy jurisdictions to poorer ones. Such transfers are often based on an equalization formula that measures the "fiscal need" and "fiscal capacity" of each province, state, or locality. These formulae result in a disproportionate share of the transfers going to those jurisdictions with the greatest fiscal need and the least fiscal capacity.’

Whether or not such fiscal equalisation mechanisms are adopted goes to the heart of a state’s normative judgement about the relative balance of equity and efficiency. On the one hand, if a nation state aims to ensure that public services are provided at an equivalent level throughout a territory (perhaps accounting for different needs – so that the higher costs associated with a state’s demographic features are accounted for – as well as different fiscal capacities), then such equalisation mechanisms are a ‘must’. On the other hand, they can create powerful perverse incentives for politicians to ‘over-fish’ the common pool, demanding a greater share of central government transfers. Politicians may well be loath to take politically costly decisions to reduce budgets, noting that fiscal equalisation will mean that savings end up being redistributed. A common criticism of the fiscal equalisation mechanism amongst the German Länder is that those which receive money from elsewhere lack incentives to undertake politically costly reforms, instead being able to pass the costs of non-reform onto other levels of government (cf. Rodden 2006, p.185). There is also a loss of the political accountability which is associated with fiscal decentralisation.

Fiscal equalisation mechanisms, although widespread (for instance, in Australia, Canada and Germany – they are of lesser significance in the US; cf. Peterson 1995, pp. 129-52; Oates 1999,pp. 1127-8), are thus extremely contentious. They may succeed in holding a crumbling federation together, as in Canada, or help meet a constitutional commitment to equivalence of living standards, as in Germany; alternatively, they may fuel resentment of regions perceived to be lazy and unproductive, fuelling discontentment and strengthening separatist movements (as in the Italian case). In any event, they certainly <u>do</u> appear to undermine the ‘competitive pressures’ that result from fiscal decentralisation. Bluntly, it can be posited that the greater the level of fiscal equalisation, the lower the downward pressure on state expenditure (Rodden 2003), giving rise to a perceived trade-off between equity and efficiency.

Decentralisation and welfare

A related but distinct issue in studies of political decentralisation concerns the implications if responsibility for welfare is decentralised. Peterson (1995, p. 111) explains that ‘States may cut their welfare benefits because they fear that high benefits attract and retain the poor within their state’: he refers to anxieties amongst such states about becoming ‘welfare magnets’, and in a detailed study (ibid, pp. 108-28) found substantial evidence that this fear did indeed drive state policy in the US, with cash benefits falling by 42 percent between 1970 and 1993 (ibid, p. 127). As Peterson baldly puts it (ibid., p. 128):

> 'To recommend that the provision of welfare should be locally controlled and its marginal cost borne by state and local taxpayers is to recommend that the poor be all but abandoned.'

Such a dismal view of decentralisation is not universally shared. Keating (2009, p. 111) notes that 'some devolved areas may themselves be more solidaristic than larger states', and Jeffery (2009; Jeffery and Wincott 2010) notes that there may be a commitment, in public opinion, to nation-wide levels of provision such that a 'race to the top' in certain types of welfare is a possibility. One rather important difference would appear to be in the type of welfare provision provided: while universal healthcare entitlements (in a system where the vast majority of citizens access state healthcare) may be subject to upward pressure on account of public opinion, as in the case of UK health and social care provision that Jeffery considers, this is rather less likely for transfers to a highly marginalised group, perceived to be the 'undeserving' poor.

Some scholars have also considered the impact of federalism upon welfare state development. Until recently, it was held that federalism was inimical to welfare state development, with decentralisation making it harder to develop social security programmes at the central level (Obinger et al 2005, pp. 3-4). However, this has latterly been challenged: whether or not federalism hinders welfare state development depends on the level of democratic development at the time the welfare state emerged, the type of federalism, and the mechanism used to finance social security (Leibfried et al 2005, p. 339). Moreover, federalism can also inhibit welfare retrenchment, depending on the nature of political institutions and conflict (ibid. pp. 339-40).

Decentralisation and regulation

Policy decentralisation and the quest for competitive advantage may also have implications for the pattern of regulation within a polity. The simple starting point is this: in order to achieve a competitive advantage, attracting footloose capital, legislators at a sub-national level will reduce levels of regulation (for instance, environmental regulation, though the same thought may apply to such other spheres as financial or labour market rules). This will lead to competition between jurisdictions, and overall a sub-optimal level of regulation, with damaging consequences, for instance, for the environment (Oates 1999, pp. 1134-5).

In fact, evidence for this proposition, at least in the field of environmental regulation, is limited, as the competitiveness advantages achieved by lowering environmental regulation are limited and do not outweigh the perceived disbenefits (Vogel 2000). In the field of labour market policy, Barenberg (2000) also finds rather mixed evidence, with the existence of downward pressure on regulation depending upon the preferences of the actors involved, and whether there is a possible competitive advantage from a more regulated labour market.

* * *

To summarise the foregoing discussion, then, three lessons can be drawn to guide our further discussion.

1. Decentralisation of policy decisions (be it in the field of fiscal policy, welfare or regulation) can lead to a strengthening of competitive pressures. Without external intervention (for instance from the central government), these may lead to sub-optimal policy choices, with lower levels of state expenditure, welfare or regulation than would otherwise be chosen and would be desirable.

2. There is a perceived trade-off between efficiency and equity, in particular in relation to inter-governmental transfers, which reduce local-level accountability for policies and can lead to over-fishing of a common pool of resources, but which can help level an otherwise unequal playing-field for different sub-national units.

3. Empirical evidence does not point to pure 'races to the bottom', and indeed there are some instances of upward competitive pressure. However, the evidence for some competitive effects if policy is decentralised (in particular, fiscal policy without a redistribution mechanism).

In relation to this latter point, Harrison's view of the Canadian federation can be generalised:

> 'Provinces within the Canadian federation are not completely at the mercy of destructive provincial competition … Rather, corporate taxes continue to increase steadily while subsidies to business have fallen, environmental standards are stable …, minimum wages continue to increase. … *That is not to say that provinces do not face a less extreme version of a race to the bottom … that prompts them to set standards or taxes lower than they would have done in the absence of mobility of capital, goods and individuals'* [or in the absence of decentralised policy-making: ET] (Harrison 2006b, p.257, my emphasis).

The subsequent sections of this paper consider the ways in which these pressures could play out in potential reforms to local government in England.[1] For reasons of space, this article only focuses on England and local government, rather than wider fiscal arrangements in the UK - although in fact concerns of the balance between equity and efficiency are equally important in considering the relationship between the devolved bodies and the rest of the United Kingdom (McLean / McMillan 2003; McLean et al 2009). Such a focus is relatively unusual, although by no means unheard of: for instance, in 1995 John, Dowding and Biggs considered whether Tiebout-effects were present through an analysis of English household mobility in the light of the poll tax (John et al 1995), Darby, Muscatelli and Roy (2002) drew extensively on the fiscal federalism literature to argue for revision of the fiscal relationship between regions in the UK, and authors in Greer (2009) consider the implications of the changing territorial settlement in the UK for the nature of 'social citizenship', albeit often without reference to the theoretical works cited above.

[1] Because several of the matters considered here are devolved, and so will not apply or will apply differently in Scotland, Wales and Northern Ireland, only England is considered. Moreover, this paper does not tackle the rather complex implications arising from two-tiered local government across much of England, with functions split between district and County councils.

The next section briefly sketches arrangements for local government finance prior to 2010, arguing that concerns of national equity appeared prominent. Thereafter, four proposed initiatives put forward by the Conservative / Lib Dem government elected in 2010 will be examined, to see if a change in the balance between equity and efficiency can be detected. The conclusion will assess the evidence and, returning to the literature, point to potential problems and opportunities that may arise from these policies.

2. Balancing equity and efficiency in English local government: the context

The historical context of local government in Britain reflects the highly centralised character of the British state, at least until the introduction of the devolved institutions in 1999. Compared to the confederations mentioned above: Canada, the US, Italy, and Germany, political power and fiscal control in the UK was far more centralised. Rodden (2006, pp. 28-9) presents data for 39 countries over the 1990s, and finds that, on the important measure of the proportion of revenue raised locally, local government in the UK is the sixth most reliant upon central government grants (behind Botswana, Indonesia, Ireland, Nigeria and Peru). The system of local government finance (for a full outline, see Wilson / Game 2011) means that local authorities in England depend very significantly upon central government grant to finance their services, with further income coming from the Council Tax. In setting this tax, however, they enjoy relatively little autonomy, with 'excessive' increases liable to lead to 'capping' imposed by central government. Much of the money local government receives from central government in fact comes from redistributed business rates: while these are levied locally, the level at which they are charged is centrally determined and they are pooled and returned to local authorities according to an assessment of need. There is local discretion over charging for some services (such as car parking). The borrowing autonomy of local government is also strictly limited by central government.

The relative lack of autonomy of local government in the UK is mirrored in its lack of policy autonomy. Although local government is responsible, to a greater or lesser degree, for delivering a range of functions, from road repairs to education provision, from administering council tax benefit to providing leisure services, the legal framework within which it does so is tightly constrained, and it has been subject to significant central government oversight through an exacting regime of monitoring and inspection. In performing land-use regulatory functions, too, local authorities are far from autonomous, needing to develop policies in line with 'higher-level' government guidance and subject these local policies to an examination by a government inspector. Those seeking permission to build have the right to appeal to a government inspector if they believe local or national rules have not been followed.

There are, no doubt, a variety of reasons for the rather centralised nature of the British state, falling outside the scope of this article. Wollmann (2004, pp. 644-5) for instance points to a political judgement of Conservative governments in the 1980s and 1990s to weaken the power of the Labour Party, which still retained some strength in local government, and also bring a variety of functions under central control, as well as pursue a political agenda of a 'lean state' throughout the British polity. But beyond these politically contingent factors, these weakness of British local government does perhaps reflect a nationwide commitment to having common standards in service provision: some 66% of English citizens expressed the view that 'Standards for services such as health, schools roads and police should be the same in every part of Britain' (Jeffery 2009, p. 85); support for uniformity across Britain was also, incidentally, prevalent in Scotland and Wales. As Sir Michael Lyons, in introducing his review of local government finance, noted:

> 'Questions about local government taxation and the funding of local services are not simply matters for technical analysis, but need instead to be considered in a wider context. They must be part of a broader debate about the type of country we want to live in: ... how we manage the inevitable tensions between diversity, choice and a desire for common standards. ... We should, I believe, be as interested in how we might develop the distinctiveness of different places and how we leave space for different local choices which improve people's satisfaction, as we are about how we seek to achieve potentially expensive, and frequently elusive, "consistent" standards. I, for one, would hope to see debate about postcode lotteries being replaced, over time, by discussion of "managed difference" – recognising the right and the ability of local communities to make their own choices, confident in their own competence, and in the knowledge of their own preferences.' (Lyons 2007, pp. ii-iii)

Reflecting its author's perception of a British public sceptical of a sharp shift towards policy and fiscal decentralisation at the expense of common standards, the recommendations of this apparently major review of local government finance were very much incremental in nature, urging modest reforms to the system of council tax and business rates, rather than wholesale localisation. Even the cautious recommendations did not all find favour with the government, with changes to council tax banding and capping not being pursued.

One other important feature of the English policy context concerns the introduction of the regional tier of policy-making (Webb / Collis 2000). Initially, the government had visions of directly-elected regional government spreading across England, but these were swiftly downscaled after the defeat of a proposal to establish a Regional Assembly in the North East of England in a referendum in 2004. In the meantime, regional assemblies were created in nine English regions (and were indirectly elected, with the exception of the Greater London Assembly), exercising (again with the exception of the more significant GLA) modest powers over land-use planning. Alongside these, Regional Development Agencies (RDAs) were set up, accountable to the UK government, in each of the English regions, intended to promote economic development. The RDAs reflected 'a general consensus ... that economic restructuring was best organised around regional networks, partnerships and institutions' (ibid., p. 859), both for functional reasons and also to develop institutions capable of bidding for EU structural funds.

The RDAs, then, became substantial bodies in the delivery of regional economic development. However, their abiding aim was to secure the *integration* of regions into the national economy and ensure the successful delivery of government policy there: Webb and Collis (2000, p 861) cite an overview of the Bill which created RDAs as emphasising that the programme was 'founded on a belief that *to improve the economic performance of the country as a whole* it is vital to look at problems in regional terms as well as nationally [emphasis not in original]'. This was reflected in the RDAs' budgets: in the 2009/10 year, the South East Regional Assembly had a budget out-turn of £166 million, substantially less those of the RDAs in the more deprived regions of the North East (£247 million), Yorkshire (£320 million) or the West Midlands (£296 million; government out-turn figures).

Once again, then, in the construction of England's sub-national institutional architecture, we see evidence of a strong commitment to the achievement of national standards and the value of equity, rather than encouraging economic competition between different territorial jurisdictions.

3. A change in direction? Reform of business rates

As was noted above, income received by local authorities from business rates (or more properly, the national non-domestic rate - NNDR) is currently centrally set, pooled and redistributed according to a rather complicated formula assessing need as part of the 'formula grant' which provides English local authorities with their largest source of income.[2]

In March 2011, the Secretary of State for Local Government, Eric Pickles, announced a 'Local Government Resource Review'.[3] The first three issues raised in the terms of reference appear to reflect a view in Whitehall of the need to find a balance between efficiency (and transparency) and a desire to stimulate competition between jurisdictions on the one hand, with considerations of equity on the other. Conservation would be given to:

1. 'The optimum model for incentivising local authorities to promote growth by retaining business rates, whilst ensuring that all authorities have adequate resources to meet the needs of their communities and to deliver the commitments set out in the Spending Review;
2. the extent to which these proposals can set local authorities free from dependency on central funding;
3. considering how to fund authorities where locally raised funding would be insufficient to meet budget requirements and control council tax levels ... recognising that some parts of the country are currently more dependent on government funding.'

Following various hints, the Deputy Prime Minister, Nick Clegg, announced in June 2011 that local authorities would indeed be able to retain some of their business rate income locally. In his speech to the Local Government Association's conference, he

[2] In fact, there are a couple of caveats: although the basic rate, or 'multiplier', of the National Non-Domestic Rate, is set centrally, there are some 'reliefs' which can be granted with a degree of local discretion and funding. These are not explored here, since they deal with areas, such as charitable buildings, which are unlikely to be the feature of competition between jurisdictions.

[3] All documents relating to the reform of the NNDR are available at http://www.communities.gov.uk/localgovernment/localgovernmentfinance/lgresourcereview/

stated, on the one hand, that this would be a ‘massive new initiative’ for local authorities to boost economic growth, and would ‘reverse decades of centralisation to make our communities masters of their own economic destinies’. On the other hand, mindful of the obvious implications for national equity, he told councillors that ‘No authority will receive less funding than they would have done previously. The new system will start on a level playing field – where you progress from there is up to you’ (Guardian, 30th June 2011).

Fuller details of the way in which business rate localisation might work were released in July 2011, with a short consultation, supplemented by various technical appendices in August 2011. An important point was made plain early in the consultation paper: that there would be no change in the way that business rates were set, and their level would continue to be determined by central government (p. 10). Thereafter, the government sketched a system whereby a ‘baseline’ would be set, with authorities which were currently net contributors to the national pool paying an ongoing tariff, and authorities receiving from the pool receiving a ‘top-up’. Thereafter, local authorities would retain a proportion of any growth in business rates beyond that baseline, save that, if an authorities made ‘disproportionate’ gains, it would pay a levy which would be used to reduce negative volatility in the system. The government would retain the option of ‘resetting’ the system if it felt income from business rates had become out of kilter with local authorities’ resource needs (pp. 19-20).

In not allowing local authorities to vary the level of business rates themselves, the government has clearly avoided a possibility of a ‘race to the bottom’ in terms of taxation levels in this regard. Instead, it sees potential efficiency gains in terms of a greater willingness of local government to take politically costly decisions, for instance in granting planning permission for commercial buildings, in order to realise economic growth. This reflects a lasting concern that the structure of the England’s local government finance mitigated against development: for instance, the Barker review of planning stated that:

> ‘It is vital that the incentives facing decision-makers are aligned with the benefits of development. Support for development can be weakened in instances where the costs of development are local, short-term and highly visible, while the benefits may be regional, long-term and less apparent – such as promoting wider employment and competition in product and labour markets. This is exacerbated by the present system of local government finance, which does not offer balanced incentives to planning authorities’ (Barker 2006, p. 14)

Although planning policy is perhaps the most obvious local government function which might be shaped by the creation of incentives for growth through partial localisation of business rate income, local governments would also face an incentive to seek out the most effective way of attracting new business to the area, steer expenditure towards areas which would promote business rate growth and redouble efforts to attract investment.

The change might, then, be considered to promote greater efficiency in local policies towards growth and in decisions on land-use regulation (thus strengthening allocative efficiency – the efficiency of land allocation). However, notwithstanding the setting of a 'baseline' of funding, there might be continued concerns about the impact upon national equity. Crucially, after the establishment of the 'baseline', the government's mechanisms to reflect the differences in territorial capacity to promote growth become distinctly vague, and cater only for 'large, unforeseen negative volatility' (p. 23). However, just as the fiscal capacity of local authorities will vary at the start of the scheme, we might expect their ability to *generate growth* to vary rather significantly. As a result, poorer local authorities, unable due to factors outside their control to expand their business-rate yield, face a structural disadvantage which goes beyond the 'unforeseen negative volatility' which the government intends to correct.

In summary, then, the reform of business rates *does* herald a shift towards a more competitive version of localism. It will introduce immediate fiscal consequences to local authorities on account of decisions they take which impact upon economic growth, thus reducing the inefficiencies which result from fiscal equalisation mechanisms discussed in section 1. At the same time, because the structural disadvantage of some areas is only considered to a minimal extent in the government's proposals, they would appear to erode the currently very strong commitment to national equity in England's system of business rates.

4. Rewarding growth? The New Homes Bonus

The quotation from Barker (2006) above, drawing attention to the absence of incentives for local authorities to take decisions to grant planning permission where these were politically costly, applies just as much to residential as to commercial development, and Barker held this, to some degree, responsible for the failure to release sufficient land for development to meeting Britain's housing need.

As a result, both major parties considered ways of providing some benefit to local authorities for granting planning permission. The Labour government expanded the use of so-called 'Section 106' agreements, so that developers could be required not only to fund facilities immediately required by a development (such as a road leading to it) but also make contributions to such amenities as local parks and community centres (Allmendinger 2011, p.132). It also introduced the 'Housing and Planning Delivery Grant' which established some fiscal rewards to local authorities which saw new houses delivered in their areas (ibid, pp. 124-5). The Conservatives, in opposition, proposed going further, intending to allow local authorities to get an increase of 100% in council tax income for all new properties which were built for the six years after their construction (Conservatives 2009).

In August 2010, the Housing Minister Grant Shapps announced a scheme similar to that trailed in the Conservatives' previous policy paper.[4] Local authorities would receive a 'bonus' equivalent to the national average of the council tax band for each new property constructed in their area, for the six years after its construction. The funding for this scheme would come from a mixture of the previous funding for

[4] Official documents relating to the New Homes Bonus are at http://www.communities.gov.uk/housing/housingsupply/newhomesbonus/

‘Housing and Planning Delivery Grant’, which would be abolished, and a ‘top-slice’ from local authorities’ revenue support grant. As a consequence, there would, in effect, be redistribution towards those local authorities which saw new homes built in their areas, away from those which did not.

As in the previous section with regard to business rates, the New Homes Bonus does strengthen the accountability of local government, by ensuring that it feels bears some of the fiscal consequences for its planning decisions, rather than these being almost entirely borne by central government. Indeed, there were anxieties for instance from the Council for the Protection of Rural England that this would lead to inappropriate developments, with ‘cash-strapped’ local authorities chasing the bonus (Wilson 2011, p. 15). To the extent that this ‘fiscal accountability’ is strengthened, the New Homes Bonus could well strengthen efficiency. It might also strengthen ‘allocative efficiency’, by seeing a more appropriate amount of land released for housing development.

However, the consequences in terms of ‘equity’ are three-fold. First, the number of homes constructed in a local authority area is not something which is entirely the gift of that local authority: it will in part depend upon the local authority’s approach to development, but also the availability of land and, crucially, the state of the local housing market. A disparity in New Homes Bonus payments may therefore be expected to emerge between areas with buoyant housing markets and those without. Secondly, the Bonus only considers net additions to stock, which was criticised as harming those deprived areas where replacement of existing stock was necessary (ibid., p. 13). Thirdly, the funding mechanism, with a ‘top slice’ from existing grant (calculated according to need), would see funding shift from ‘needy’ areas to those with the most buoyant housing markets. Some ‘rough and ready’ undertaken by the National Housing Federation (which represents housing associations) suggested that wealthier southern England would stand to gain some £342 million per year by the end of the sixth year of the scheme, while the poorer north would lose over £104 million (NHF 2010, p. 5).

Similar conclusions can be drawn to those in the foregoing section. On the one hand, these proposals do not turn the prevailing system of local government finance, with its clear prioritisation of national equity over efficiency, upside down: even in the final year of its operation, the New Homes Bonus might be expected to total around £1.2 billion nationally, out of total formula grant going to local authorities of £29 billion (ibid. p. 5). However, it does strengthen the rewards for local authorities to secure housing growth, potentially leading to greater efficiency (with fiscal costs being borne to some degree by those taking decisions that affect them, rather than the centre), at the expense of equity.

5. Opening the door to welfare decentralisation? Reforms to council tax benefit and social housing

As discussed in the introduction, there are powerful concerns (cf. Peterson 1995, pp. 108-28) that decentralisation of responsibility for welfare to sub-national jurisdictions can create powerful incentives for those authorities to reduce entitlements, both to save themselves money, but in particular to avoid acting as ‘welfare magnets’.

Whether or not benefit recipients are actually mobile in response levels of transfers is only partly relevant: if policy-makers perceive that they will be so, benefits may well be cut, and so the 'race to the bottom' becomes a self-fulfilling prophecy (Schram / Sos 1998).

The scale of British welfare provision is largely determined at a national level, albeit with decentralised implementation being carried out both by local authorities, which handle Housing Benefit and Council Tax Benefit, and also the agency of the Department for Work and Pensions, JobCentre Plus (which handles the administration of various out-of-work benefits as well as some job placement activity).[5] Although there were occasional suggestions that responsibility might be decentralised (for instance, Essex County Council, run by the Conservatives, proposed that it should have the ability to vary welfare benefits; cf. LGA 2009, p. 27), welfare policy retained a strong national character. The same issue applies in the case of social housing policy, which also forms a part of the welfare 'safety net'. Here, housing benefit levels are controlled by central government (reflecting housing costs in different areas), entitlement to assistance in finding a property, or indeed to social housing (provided either by local authorities or not-for-profit bodies at a sub-market rent), is set down in national legislation, and rent levels in social housing are subject to national control (Lund 2011).

As part of the Comprehensive Spending Review in October 2010, the Government announced that it would seek to reduce expenditure on Council tax benefit by 10% from 2013/14, and that it would be accompanied by a measure of 'localisation', so that local authorities could design their own schemes of council tax benefit (HM Treasury 2010, p. 50). Further details were announced in a consultation launched by the Department for Communities and Local Government in August 2011 (CLG 2011a). Council tax benefit is currently a locally-administered benefit, funded entirely by central government, which meets the cost of council tax (a local tax on property) for certain defined groups, essentially those on lower incomes. The government proposes to allow local authorities the flexibility to devise their own benefit schemes; they would be eligible to retain any money they saved as a result of reducing entitlements. Local authorities would face some constraints: notably, they will be required to provide continued benefits according to a national standard for pensioners and other unspecified vulnerable groups, but they will be able to vary levels of council tax benefit for other groups.

Although the announcement of the change in the Comprehensive Spending Review would suggest a primarily fiscal motivation for this change, the government's consultation paper also suggests a motivation concerned with *efficiency*:

> 'The Government has decided to localise support for council tax to give local authorities a greater stake in the economic future of their local area, and so supporting the Government's wider agenda to enable stronger, balanced economic growth across the country. ... [Also to] give local authorities a financial stake in the provision of support for council tax. This reform will

[5] In this instance, we are largely talking of British provision, as welfare is not principally a matter devolved to the Scottish, Welsh and Northern Irish institutions.

create stronger incentives for councils to get people back into work.' (ibid, p. 10)

In contrast to the measures discussed in the previous two sections, however, the level of expenditure on council tax is even less within the control of local authorities than is the number of new homes constructed or the level of business rate income. As a result, the main way in which a local authority could gain a financial advantage from varying council tax benefit would be to reduce the level of provision: this would not only free up funds for other purposes, but might also serve to encourage the displacement of working-age recipients of the benefit. This is precisely the concern which leads Peterson (1995, p. 192) to argue for US federalism to determine welfare policy at the national level, or at least ensure that states do not achieve a competitive advantage by cutting benefits.

Basinger and Hallerberg (2004) consider the possibility of 'races to the bottom' in competition between countries, and find these are tempered by both 'transaction costs' (due to the number of veto-players in the legislative process) and 'constituency costs', arising from the political costs of pursuing unpopular policies which benefit capital. Harrison (2009a, pp. 8-9) suggests that these pressures will temper attempts to retrench welfare provision at the sub-national level in response to competitive pressures. In the case of council tax benefit, however, such confidence might be misplaced: the 'transaction costs' associated with agreeing a scheme within an individual local authority will be minimal, as political power is, at that level, quite concentrated, and the 'constituency costs' will only be present if the working-age recipients of council tax benefit will be able to bring their influence to bear more than, say, those of a wider population seeing a reduction in council tax as a result of reductions in council tax benefit (or enjoying an enhanced service that has been financed out of the money saved). It might be hypothesised that the recipients of council tax benefit are simply too marginalised, too disparate (and perhaps also insufficiently numerous) a group of people to be able to oppose such reductions.

In 2010, the government also announced a series of changes to social housing (CLG 2010), which strengthened the extent of local authority discretion in a number of aspects of social housing policy. Social housing providers would have some ability to increase rents to up to 80% of market levels (although they would be required to reinvest the proceeds in new-build housing). They would be able to issue new tenancies for a time-limited period (of at least two years), rather than needing to provide security of tenure, as existed previously. There would be greater local discretion over who should be eligible for social housing, and entitlements of the homeless to social housing, as opposed to a placement in private rented accommodation, would be reduced.

In this case, the stated logic did not draw upon a desire to foster of competition, but rather on a desire to achieve allocative efficiency of a scarce good: as the Minister stated in his foreword (ibid, p.5): 'The system must be more flexible – so that this scarce public resource [social housing] can be focused on those who need it most, for as long as they need it'.

In this instance, too, we can see a strengthening of the concerns of efficiency over those of equity: greater allocative efficiency of social housing might well be achieved, but entitlements across England are likely to vary as a consequence, and local authorities will face strong incentives to vary these downwards, both in order to minimise their costs and in order to avoid becoming ‘social housing magnets’.

This section has demonstrated that there is evidence of some welfare decentralisation. In both cases, a concern with efficiency formed part of the government’s stated rationale for the policy, and in both cases likely disparities in the level of entitlements (whether to council tax benefit or social housing) will emerge, thus presenting a cost in terms of equity. Moreover, in both cases there will be ‘competitive pressure’ upon local authorities to reduce their level of provision.

6. Targeted efforts to support poorer areas? The Regional Growth Fund and Local Enterprise Zones

In section 2, it was explained that the architecture of regional economic development was created with the explicit intention of fostering *national* economic goals, helping poorer regions to ‘catch up’, and thus reflected a commitment to national equity. This section will consider two initiatives in the field of economic development: the abolition of Regional Development Agencies, with their partial replacement by the Local Economic Partnerships and the Regional Growth Fund, and the creation of Local Enterprise Zones.

In June 2010, the government announced the closure of the Regional Development Agencies. Some of their functions would be absorbed nationally, while other functions (notably relating to economic development) could be taken on by new bodies called ‘Local Enterprise Partnerships’ (LEPs), which would be partnerships between groups of local authorities upon functional economic areas and the local business community, typically with a chair drawn from the business side (BIS 2010). Crucially, there is no core funding from government, although LEPs will be eligible to bid for other funding, including from the government, and there is an expectation that local authorities may pool costs to fund them (HM Government 2010, pp. 15-6).

Additionally, as part of its budget in 2010, the government announced plans for a Regional Growth Fund, which would ‘be used to encourage private sector enterprise, create sustainable private sector jobs and help places currently reliant upon the public sector make the transition to sustainable private sector led growth’ (ibid, p. 32). Funding for the Regional Growth Fund totalled £1.4 billion over three years, and although all areas were invited to apply, it was clear that the focus of funding would be on the country’s more deprived regions (this was reflected in the failure of all but one bid for funding from the first round of RGF bids from the south east of England, compared to 14 bids succeeding in the north east). When challenged about apparent lack of concern for the north of England (for instance as a result of the policies discussed in sections 3 and 4), ministers often pointed to the RGF (e.g. Wilson 2011, p. 13) as evidence to the contrary.

The third element of the government’s new strategy for regional economic development concerned the idea of ‘Local Enterprise Zones’, announced in the March 2011 budget. These would benefit from business rate discounts, retention of income from business rate growth by the local authorities within the area of the Local

Enterprise Partnership, the possibility of a deregulated planning framework and super-fast broadband. Initially the broad location for 11 zones was announced, supplemented by a further 11 zones announced in August 2011 (CLG 2011b).

The key question here is whether the changes in the architecture of regional economic development herald a shift from one which had an explicit aim of moving towards greater national equality to one which encouraged competition between regions. A first and important part of the answer is that the changes appear to mark a reduction in overall funding for regional economic development. Whereas the RDAs' budget out-turn was £2.25 billion in 2009/10 (which was due to be scaled back to £1.44 billion in 2010/11), funding for the regional growth fund is to total £1.4 billion over three years, the LEPs do not benefit from direct central government funding, and the estimated cost of tax reliefs associated with Local Enterprise zones would rise from £20 million in 2012/13 to some £80 million in 2015/16.[6] There has, therefore, been a scaling back of government investment in this area.

Alongside the reduction in funding, the government appears to have shifted towards an approach which gives new agencies charged with delivering regional economic development, the LEPs, greater autonomy from central government: proposals for LEPs were developed locally, rather than on boundaries prescribed by central government, and unlike the RDAs, they are free to appoint their own governance boards, albeit within centrally-set parameters. This may lead to some shift towards greater competition between regions, rather than steering development activity towards national goals. In a similar vein, the Local Enterprise Zones may compete for investment on the basis of the quite substantial tax advantage they will be able to offer businesses, thus potentially simply taking investment which would otherwise have gone elsewhere – indeed, this was a finding from a similar experiment with enterprise zones launched by the Thatcher government in the 1980s (Potter / Moore 2000).

In the area of economic development, therefore, there is a modest shift towards a more 'competitive' approach in the policies being pursued by the government since 2010, along with a reduction in central government expenditure committed to reducing regional economic inequality.

7. Conclusions

At the outset, this paper set out the view that policy decentralisation and in particular fiscal decentralisation could, under some circumstances, increase efficiency. At the same time, decentralisation at times posed challenges for those concerned with equity. At no stage is this clearer than when considering fiscal equalisation mechanisms, which, in an attempt to create a 'level playing field' amongst different jurisdictions, have the effect of blurring accountability for decisions with fiscal consequences, and potentially creating perverse incentives to 'over-fish' the common pond. In designing political systems, there appears to be a trade-off between efficiency and equity, and this is reflected in contemporary debates in Germany, Italy Canada and the United States, where the governments of economically powerful regions, often with backing from those who retain a normative

[6] Figures are drawn from relevant government out-turn data and budget books.

attachment to a smaller state, go head-to-head with governments of more disadvantaged regions, supported by those concerned with maintaining national equity: this has often attracted the terms ‘co-operative’ and ‘competitive’ federalism.

In England, the changes envisaged are relatively modest: a shift to federalism is certainly not envisaged, and it is likely that, even after the various policy changes discussed in this paper, England will remain a highly centralised country, with policy competences of local authorities, as well as their ability to generate their own revenue, heavily circumscribed. At present we are seeing an incremental shift, rather than a paradigm shift, in the relative power and fiscal autonomy of local government.

Nonetheless, analysis of each of the areas discussed here shows a discernable shift away from a ‘co-operative’ model of territorial relations towards one which owes more to competition: there has been a conscious effort to choose policies which promote efficiency (be it in levels of public expenditure or in the allocation of resources, such as land or social housing), and in each case there may be a price tag attached in terms of equity. In the cases of business rates reform and the new homes bonus, land may be allocated more efficiency and local accountability will for decisions taken which have a fiscal effect will be strengthened; at the same time, economically prosperous municipalities stand to gain and their more deprived counterparts are likely to lose out. In the case of reform of council tax benefit, there will be competitive pressures on local authorities to reduce expenditure, and likewise there will be rewards for those who scale back the entitlements in the field of social housing: the result will be a greater diversity in benefit levels and social housing entitlements, undermining national equity, as well as, most probably, a reduction in average entitlements across the country. In the case of the apparatus for regional economic development, there appears to be less central control able to emphasise national goals, and the promotion of an instrument (Local Enterprise Zones) which will stimulate inter-jurisdictional competition; at the same time, expenditure in this area has been sharply cut back, again with implications for national equity. Interestingly, in each case, the language used to justify these policy changes has been quite explicit in its aim to promote efficiency, although often with some reassurance that concerns of national equity have not been completely forgotten.

Scholarship, from the perspectives of both Political Science and Economics, is by no means unanimous either on the normative desirability nor the empirical consequences of the shift identified here. Some, starting with Tiebout (1956), supported by Brennan and Buchanan (1980), Weingast (1995) amongst many others point to the ways in which decentralisation can promote efficiency, constraining and constraining the ‘Leviathan’ of central government. Others, such as Peterson (1995), Schram and Sos (1998) and Oates (1972; 1999) point to the risks inherent in such an approach, which may lead to the undesirable under-provision of public goods and welfare, in a desire to remain competitive. Still others, such as Basinger and Hallerberg (2004), Harrison (2006a, b), McKenzie (2006), Keating (2009), and Jeffery and Wincott (2010) suggest that in the real world, outcomes will be rather more complicated, constrained by politics, that competitive pressures may lead government expenditure upwards as well as downwards, and, although competitive pressures may exist, there should not be an expectation of an unrelenting ‘race to the bottom’ if policy is decentralised.

On the basis of this assessment, it is clear that there identifiably has been such a shift in policy in English local government since May 2010: one which may well strengthen accountability and efficiency, but at the expense of national equity. It is too early to consider the precise effects of these changes, and that will be a matter for further empirical exploration (it will be welcome, incidentally, to see the insights from this substantial literature being applied to British politics). However, whether the price of achieving this greater efficiency, at the expense of national equity, has been worth paying will likely be a matter as much for political, indeed moral judgement as for scientific research.

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