Embedded Autonomy

Financing a Resilient Local Government Effectively

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ISBN 978-981-97-9029-6 ISBN 978-981-97-9030-2 (eBook)
https://doi.org/10.1007/978-981-97-9030-2

This Palgrave Macmillan imprint is published by the registered company Springer Nature Singapore Pte Ltd.
The registered company address is: 152 Beach Road, #21-01/04 Gateway East, Singapore 189721, Singapore

Acknowledgements

Over the last ten years, the indications that there has been a major sustained failure to properly fund local services in England have grown in profile. The central motivation in this book is to consider, in that context, how England could fund its local government differently. How can the continual hand to mouth existence of local authorities, and those that work to support them, be improved? While there has been plenty of rhetoric and policy initiative around devolution of power to local authorities in recent decades, continuing recently with the English Devolution Bill, there has been far less attention paid to how any of these endeavours will be practically delivered and, most importantly, funded. Consequently, this book tries to give a more balanced view of the function and funding of local government and, in doing so, attempts to open a wider conversation around what local government is actually for in England in the absence of any codified constitution, and to provide a more positive account of local government delivery.

Not only does local government need a new financial programme—it also needs a progressive intellectual basis upon which a new programme can sit. In this book, we utilise system-based thinking to understand local government finance as a holistic entity and forward *embedded autonomy* as a new way of framing and perhaps uniting the competing aims from central and local government for their own autonomy. Embedded autonomy attempts to harness a perception-based tightrope where too much surrender to local autonomy harms wider society and too much constraint on local autonomy prevents local government from operating efficiently. Currently debate and traditional practice operates at the extremes of this tightrope, more so the centralising tendency. We propose a system that balances both.

This book is the initial output of a research project led by Kevin Muldoon-Smith at Northumbria University, in partnership with Mark Sandford at Bristol University and the Local Government Information Unit (LGIU), which is seeking to understand how local government finance works internationally, with a view to informing how practice and reform can be instigated in England. The initial case study locations, Germany, Italy, and Japan, have offered rich insights for how improvements can be made in England. These locations have also been useful in highlighting that England is not alone in struggling with local authority insolvency and wider questions of how to fund public services. However, these locations do things differently and our conclusions indicate that they do many things better.

This international focus also opens a two-way interaction, between England and international best practice, where each can learn from the other. This process has helped to communicate the practice and experiences of local government to an international audience. However, an additional motivation in the research was to underline the role local government finance plays in questions of governance, territorial development, economic growth and, at its root, the life chances of citizens in any given location. The intention is that drawing the attention of a multi-disciplinary audience to local government finance will help to answer the underlying question in this book—what if English local government was funded differently?

In carrying out this research, and writing this book, there has been considerable use made of existing government and constitutional documentation, especially as it relates to the structure and regulation of local government finance systems. Throughout the project there has also been continual support from civil servants, council officers, local councillors, and politicians who have all been vital in understanding the technical detail and esotericism of local government finance sources, and the local democratic interaction with an often-opaque system of working. Thanks go to the research assistants who have helped support this project throughout the project journey: Cameron Forbes, Sara Lilley, and Yoshio Shimbo. Each played a significant role in developing the initial reporting in each location and particularly translating documentation from the different international contexts. Special thanks go to Jonathan Pearson who had a hand in the analysis of all three case study locations.

Thanks are extended to those experts who have helped direct our enquiry in each country. Stuart Hoggan and Mike Woods have provided invaluable insights into the historical operation of the local government finance system in England, helping to point out the reality and challenges of central government efforts to deliver change, both from a central and local government perspective. Andrew Stevens has been a valuable source of insight into the workings of the Japanese local government finance system, signposting us to additional contacts and information sources. Francesco Porcelli has been a continual point of reference in the Italian local government finance system, highlighting that some of England's often derided previous practice have been taken forward as underlying parts of successful local government systems overseas. Thanks are also due to Peter Eckersley, Rene Geissler, and Steffen Zabler, all of whom improved the underlying understanding of the German system of local government finance. All of these colleagues helped to avoid only taking on board the elements of these international case studies that appeared to support critique of the English system—highlighting how the challenges in each country make the case for reform in England far stronger.

Thanks also go to all of those involved in the book's production, Marion Duvall and Connie Li at Palgrave for the understanding and direction through the publishing process, the anonymous reviews at proposal and final submission, and all of those who have provided comments on either sub-section, chapters, or the full manuscript. In terms of the refinement of the proposals in this book, thanks go to participants at various LGIU-led sessions with local councillors, special interest groups, and various government departments who have all provided comments and helped to road test and develop the central arguments.

While all attempts have been made to capture the technical detail in each country, all errors are the authors' own.

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Mark Sandford
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Contents

List of Figures

List of Tables

1

Introduction

This book is engaged with the financial uncertainty currently facing the local government sector in England. It seeks to explain the reasons why this situation has arisen and the implications for public service delivery in the coming years. It then systematically examines examples of international best practice to understand how the local government finance system in England could be improved. It then presents a set of proposals for reform to the English local government finance system that encapsulates the principles of what the authors call *embedded autonomy*. It argues that local government in England cannot stand on its own two feet without a resilient[1] and well-funded local government finance system based on cooperation, fairness, and scrutiny.

England's councils are in serious financial trouble. Six, including Birmingham, Nottingham, and Croydon, have issued "section 114 notices", indicating an undeliverable budget, since 2020.[2] A cross-party

[1] Financial resilience in this book is taken to mean enough meaningful funding to fairly fund the local government finance system in good time and certainty alongside transparent and rigorous negotiation, monitoring, and scrutiny procedures.

[2] Issuing a section 114 notice is often described as 'bankruptcy' in media coverage. This is not correct as English local authorities cannot go bankrupt. A section 114 notice is issued by a chief finance officer (section 151 officer) if they have reason to believe their authority is about to incur

K. Muldoon-Smith et al., *Embedded Autonomy*,
https://doi.org/10.1007/978-981-97-9030-2_1

report published by the Levelling up, Housing and Communities Select Committee in the House of Commons, at the beginning of 2024, stated that government must plug a £4 billion funding gap to have any chance of financial resilience in the short to medium term (2024), while later in the year the Local Government Association placed this figure at £6.2 billion (2024). Not since the poll tax riots in the early 1990s have issues of local government finance and taxation figured so prominently in public debate.

Various organisations have begun to take note of this situation and approach solutions from several perspectives, in relation to place-based budgeting (Denham & Studdert, 2024), devolution (Institute for Government, 2023), liberating public services (Demos, 2024), streamlining of the grants system (Centre for Cities, 2023), and the overall reform of the local government finance system (Local Government Information Unit, 2024). This echoes intermittent calls for reform in the 2000s and 2010s (Travers & Esposito, 2004) and continual advice from the Institute for Fiscal Studies (2024) and Charted Institute for Public Finance and Accountancy (CIPFA) during the same period (2019) in relation to the financial resilience of local government finance.

While six section 114 notices represent a small fraction of the 317 local authorities in England, it can be argued that the entire local government finance system in England is teetering. This situation has only been sharpened by the impact of the Covid-19 pandemic, inflation, energy costs, economic stagnation, and in-built uncertainty in the current method of allocating funding from central government. Now, each year, local authorities must continually make challenging decisions in relation to what not to fund, rather than meaningfully considering how best to represent local citizens and how to develop their local areas.

Demonstrating the system-wide struggles in local government, in March 2024, 19 local authorities were granted exceptional financial support for the 2024–2025 financial year. This comprised permission for local authorities to use capital receipts or borrowing to cover revenue costs in their budgets, up to a total value of £1.5bn in the 2024–2025

unlawful expenditure, including if they will not be able to balance their budget in the financial year. A section 114 notice indicates severe financial difficulties that must be resolved at speed.

financial year. While this flexibility has helped fend off bankruptcy in the short term, it also highlights the unusual practices that are being utilised by the local government sector to survive. The mixing of capital finance with that of revenue is a highly unusual accountancy procedure (Webb, 2024), and ties local authorities to debt liability in the medium to long term. Reminiscent of the banking system collapse in 2008, some local authorities are literally borrowing across the medium to long term to fill immediate funding shortages. The split between revenue and capital budgets was previously a key principle that underpinned prudence, budgetary stewardship and medium-term financial sustainability.

This situation follows a period of sustained austerity and financial retrenchment in the local government sector—the total spending power of local government has declined significantly since 2010 (Muldoon-Smith & Sandford, 2021). There has almost been a path-dependent assumption in recent years that demands for austerity require the government to pursue reductions in local government spending without limits. But this assumption overlooks the role of local government in delivering on political goals that are often shared with central government: pared-back funding has eroded the ability of local government to act and, in doing so, damaged the capacity of central government to drive change.

English local government now faces existential funding questions. The local government finance situation should be a concern for all political parties irrespective of their time in power or political leaning. It might be tempting for a new reforming government to regard local authority financial failures as a minor inconvenience that can be tolerated when there are bigger fish to fry. However, as Will Hutton (2024) recently argued in the *Observer*, England is discovering that the local is political: that society begins with good access to social care and regular bin collections. Councils are critical delivery partners for any UK government. If financial difficulties hobble their capacity to act, the government loses time and capacity too. Local government finance is notoriously technically complex, unrewarding, and politically arduous: but the situation in England, coupled with the ambitions of the government elected in 2024, means that not tackling local government finance's predicament is now extraordinarily risky.

There has been a great deal of attention given in recent years to big ticket national and foreign policy items—Brexit, immigration, war. In contrast, almost through a process of deliberate myopia, the economic, social, and community role of local government has been largely overlooked. Scholarly and media attention has focused on devolution of power to novel sub-national governance arrangements, many featuring metro mayors.[3] This book argues that there needs to be a reset and change in mindset in relation to local government finance. While Chancellor Rachel Reeves has placed emphasis on stringent fiscal rules and even reshaping markets to form a 'securonomics' at the national scale, and growth at the regional scale, there needs to be the same emphasis on financial resilience at the local scale. A major mission of any government should be stability of local government finances. Recognising that the financial resilience of local government is a systemic part of the regional and national economy is the starting point for any reform of local government finance systems, to restore certainty and discretion and encourage new ideas around autonomy and resilience.

This is the mission of this book. We build up a body of evidence through each chapter that makes clear that local government finance reform should be based on co-dependent principles of embedded autonomy and financial system-based resilience. The principle of embedded autonomy draws, in part, on the work of Peter Evans (1995) who applied the concept of embedded autonomy to the developmental state, to define a government process that supported industrial development, without becoming predatory. The 'embedded' component recognises that the state and society are entwined, while 'autonomy' recognises that businesses need the right incentives to set goals and develop within a system of continuous renegotiation.[4] It contrasts with the model of bidding and 'earned autonomy' (Jones & Stewart, 2002) favoured in recent decades and rigid conceptualisations of resilience.[5]

[3] The local elections in May 2024 were arguably the largest devolved election in the history of England. Eleven metro-mayors now govern half of the electorate in England (12 if London is included). Yet it is currently unclear how far the existing cohort of metro-mayors can align their multi-million-pound funding streams to buttress local authority services and structures.

[4] Evans's work has been taken forward since. E.g., Jacobs (2003) has used the concept to critique metropolitan development in North America, Clark and Rosales (2022) have investigated the Latin American Pink Tide, and Styhre (2019) has used it to consider the institutional history of the firm.

[5] In arguing for embedded autonomy and resilience we do not refute the role of the state in local government finance. Rather, we try to suggest how both could work harmoniously.

Focus of the Book

> Councils have faced a prolonged war of attrition from above. Over the last decade or so, councils have faced severe financial pressures resulting from tight limits imposed from above, increased demands from below, and the difficulties of raising sufficient local tax revenue. (Cochrane, 1993, p. 2)

This quote from Cochrane (1993) could easily describe the circumstances of local government today. The challenges that the sector currently faces are not new. The English local government finance system has faced uncertainties and pressures for decades. Yet the current reasons for this are often unclear and the potential future trajectories of local government finance are equally contested (Hawksbee, 2022; Mudie et al., 2023). The aim of the book is to develop a distinctive approach to understanding the local government finance system, as a complex adaptive system, and to point towards potential future directions for local government financing. This amounts to challenging the assumption that it is sustainable to fund local government out of the current financial model.

Cochrane's seminal *Whatever Happened to Local Government?* remains as relevant today as it was on the day it was published in 1993. However, the vast majority of scholarly contributions to local government finance learning have coalesced around the critical financialisation literature in recent years—particularly the impact of capital markets on local authority decision making and power relations. Perhaps first gaining real prominence with Rachel Weber in 2010 with her research into tax increment financing in Chicago, several authors have taken the study of financialisation forward: Fields (2018) in relation to automated landlords, Peck and Whiteside (2016) in relation to local authority bankruptcy in Detroit, and latterly Beswick and Penny (2018) in relation to municipal financialisation, Penny (2022) in relation to local housing companies as revenue generating machines, and Pike (2023) in relation to local authority investment and statecraft. There is now a considerable international literature around financialisation, particularly examining the interaction of capital markets, the state in its various guises, land and property development, and physical assets (see Ward et al., 2024 for a summary of future research directions in financialisation and Hasenberger 2024 for an account of financialisation and its relation with local government).

However, the findings and recommendations in this book are foregrounded by a belief that the exponential growth in financialisation literature has clouded the underlying role of local government or municipal finance structures in the provision of services, governance, and local place making. In the UK, financialisation plays a relatively minor role in local government finance. Opportunities for the influence of financialisation on local government funding are heavily contingent on structures of governance in any given state and the underlying economic conditions in each location—often the *right* conditions are rare and restricted to a minority of premium locations (Muldoon-Smith & Greenhalgh, 2015). The volume of publications can mean that financialisation threatens to take on an outsized role in the local government financial debate, in the absence of any alternative analysis of the local government finance system in England.

Mundane questions of the funding of local authorities—overwhelmingly the greatest concern for local authority solvency in terms of quantum of money and impact on local areas—have received less attention. Studies do exist of the stresses caused by funding reductions (e.g., Gray & Barford, 2018; Hastings et al., 2015), but they focus on critiquing central decision-making and do not attempt to explore alternative models of financing.

This book, therefore, focuses on the financial pressures faced by local government in England during recent decades and asks a simple question: How could local government be funded differently? This focus, and central question, enables us to ask the following core research questions:

1. How does the local government finance system currently work in England?
2. To what extent do existing and proposed sources of income address the solvency challenge in English local government?
3. What can international systems of local government finance tell us about potential options for reform in the English local government finance system?

4. How can transition into more progressive modes of local government financial working take place?

The authors examine these questions for several reasons. First, sharp reductions in central government grant funding in England since 2010 (Gray & Barford, 2018) have driven significant concerns over the current and future solvency of English local authorities and the asymmetric nature of austerity—local authorities have not been able to replace these transfer grants with equivalent sums of locally generated income. Second, these concerns have, in turn, generated advocacy and proposals for increased fiscal decentralisation in parallel to arguments in favour of devolution, embedded in a long-term disquiet at British centralism. Third, this latter debate, so far, has been stunted. UK governments have avoided grasping the nettle of considering the structure of local government funding since the replacement of the Community Charge by council tax in the early 1990s, preferring no or incremental change. But equally, calls from the sector for fiscal devolution (LGA, 2022; Copus et al., 2017) have often disregarded the political ramifications of devolving revenue-raising powers, risking the appearance of demands for cash from one interest group among many. The consequence is that while literature, lobbying, and policy change have grown significantly in relation to devolution, examination of the finance system that underpins both local authorities and metro-mayors has been limited and superficial. Taking this argument to its logical conclusion, greater fiscal devolution could easily exacerbate the problem of uneven service provision because poorer areas are less well-placed to generate their own revenue.

Impact and Significance

The originality in this book is found in its alternative perspective of local government finance—encapsulated in the underlying system-based perspective and the new conceptual formulation *embedded autonomy*. Originality is also found in the analysis of international case studies to inform potential change in England and its consequent focus on reform in England. The central arguments and findings in the book, while related to England, also have broader application. England has long been seen as a laboratory for new forms and techniques of policy and governance (Pike et al., 2019). All countries have unique central–local contexts and administrative procedures for funding their public services. However, the initial findings and wider discussion in this book provide a factual source for policymakers (and those that provide scrutiny) to evaluate and propose new initiatives for funding local government. For professionals struggling with the day-to-day management of local government funding, the book provides an overview of the constraints and challenges of rewiring the funding of statutory obligations. The findings will serve to assist international efforts to stabilise and strengthen systems of local government, which can fall prey to abstract demands for 'more powers' with little underpinning evidence. Examining the nature, agency, and techniques of local government funding systems—and the path dependencies they can unwittingly introduce—sheds a new light on international academic debates surrounding (1) how territories are funded, remain solvent, and develop over time; and (2) how this concern interfaces with wider geographies of development and political imperatives toward equalisation between territories.

The Underlying Arguments and Arrangement of the Book

This book argues that analyses of the financial challenges faced by England's local authorities typically focus on single elements of the finance system. For example, considerations of local authority decision-making take place without consideration of the sector's relationship with central government; or demands for local government autonomy omit any consideration of equalisation[6] between locations. While practitioners and academics often refer to the local government finance 'system', they rarely adopt a system-based analysis. The result is a set of arguments that

[6] Traditionally equalisation can take two forms: (1) vertical equalisation refers to the distribution of income from the state while (2) horizontal equalisation refers to the distribution of income between local areas, based on a ratio of relative local need and economic circumstance.