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Reimagine local authority funding

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Local authorities' funding is increasingly dependant on their ability to raise revenues within their boundary. But successful people often leave the place they grew up as their careers develop, taking their tax contributions with them – which often disadvantages the country's poorest areas. Louise Sunderland has a solution.

Earlier this year, it emerged that Liverpool FC star Mo Salah had donated £330,000 to his home village in Egypt so it could buy land to build a water treatment plant[1]. Previously, the striker has paid hundreds of thousands of pounds to build a hospital, youth centre and school in the area. Salah might earn a higher weekly wage than the average Egyptian playing for the Reds, but he has not forgotten his roots.

Salah's generosity is far from rare among the financial elite – there are lots of examples of millionaires donating money to the places they grew up. Such examples of giving, however, are very much down to the individual: many areas that have produced enormously wealthy people never receive a financial payback. And still fewer benefit from their more everyday success in producing much larger numbers of successful middle-class professionals – many of whom build their careers in major cities far from their home towns.

But what if there was a way to ensure greater consistency in how local areas are rewarded for producing financially-successful individuals? Could the reallocation of a small part of every citizen's income tax revenue back to their home town help to improve the prospects of the most deprived parts of the country, whilst ensuring that local public services are rewarded for their success in providing people with the best possible start in life?

Vicious circles

Currently, local authorities in areas with under-performing economies are hit by a double whammy. Not only is it difficult for them to attract workers, but the brightest and most talented amongst their young people often move away to more affluent areas in search of work. Each council helps to create the circumstances in which its youth can thrive.

But as soon as people leave the area to take the next step on their career ladder, the council loses their contributions to council tax and business rates revenues – plus the flow of their disposable income into the local economy.

People's success in their careers has much to do with the quality of local services and councils' contribution to forming strong communities. Early years and social services; primary and maintained secondary schools; youth clubs and local amenities; anti-crime initiatives, small business support and planning policies – all of these feed into people's life chances, helping to shape their prospects of setting up a profitable business or attending a top-flight university. Yet the moment that people move away from their home areas, those local services stop receiving the rewards of their success.

Equally, areas struggling economically and providing poor services are often spared the consequences of their failings. Troubled individuals who end up in the criminal justice system can incur huge costs to the state – more than £35,000 a year if the resident ends up in prison[2]. And when people commit crimes or exhibit anti-social behaviour outside their home areas, it's the councils, public services and residents of their new neighbourhoods which must pick up the pieces – and experience the disruption, costs and harm that they cause. Like areas which export entrepreneurs, areas which export criminals break their connection with those individuals as soon as they've moved away.

Looked at from the perspective of the national economy, the system of local authority funding is inherently unfair, and helps to entrench existing economic inequality.

Areas with historically high levels of economic activity – such as central London boroughs – gain the tax revenues and economic activity of people whose life chances were shaped far away. Meanwhile, in poorer areas, successful and effective councils fail to benefit from the rewards of their work as people depart in search of educational and job opportunities. Indeed, the poorer the area – and thus the greater the council's achievement in helping to create high-potential individuals – the more likely it is that those people will up sticks and leave.

Integrating policies

This dynamic is set to grow stronger still – for government is currently examining proposals which would make councils even more reliant on income from business rates collected in their area. The aim is to promote economic growth, rewarding councils which increase their business rates take. However, the councils with the worst prospects for growth often have both the highest need for public funding, and the lowest proportion of households which are economically active – and thus paying council tax.

As part of this move, the government intends to go some way towards levelling the playing field through a 'fair funding review'. This would alter the current needs-based formula, which redistributes some business rates income from richer to poorer areas. However, whilst this amended formula is likely to cushion the blow, the logic of the government's approach is that the existing economic climate in a local area is set to become still more important in determining their resources.

"The system of local authority funding is inherently unfair, and helps to entrench existing economic inequality"

Our suggested reforms – like the government's business rates changes – would reward areas according to their success in achieving public policy goals; but they would make the system more truly fair by ensuring that councils are measured on the economic growth they create outside their patches as well as within them.

Separately, the government's Industrial Strategy includes a 'Place' and 'People' focus. But if local government is to be part of place-making and have an important role in inclusive growth, then we need to think differently. Only when councils' contributions to creating successful people are fully recognised will they have the resources to invest in improving places.

Virtuous circles

Nobody is suggesting a radical move away from the current system, which is based on the principle that local revenue is raised and spent within a local area. This model has various advantages – including providing incentives for authorities to promote growth in order to boost business rates, and the democratic accountability of local leaders being held responsible for the economic health of their areas.

But the current paradigm, as we have seen, is far from perfect. And there are tweaks to the system that could better reward – or indeed penalise – councils according to their performance. It would be fairly straightforward to redirect a small proportion of each UK worker's tax contributions back to the place where they were raised; but it could also be transformative.

Under this system, councils would be granted a share of the future national insurance or income tax revenues paid throughout the working lives of that place's 'alumni'. This income, collected by Her Majesty's Revenue and Customs, could be redistributed to the hometown local authority by the Ministry of Housing, Communities and Local Government.

This would overcome one of the biggest problems with the current redistribution formula, which relies on fiscal transfers based on need. If councils knew they would benefit from the success of those raised in their areas, they would be given a much greater incentive to invest in services likely to increase the life chances of their population.

Instead of being seen as a problem, an exodus of talented people leaving to make a better life in another part of the country would then be seen as a benefit. And the contributions they make to their home town could be used to improve services for future generations, or to fund investments transforming the fortunes of less prosperous areas.

The system would provide an additional source of income for those councils which have low business rates incomes and a high proportion of non-council tax payers.

The mechanics of reform

For bureaucratic simplicity, each citizen's home town could be recorded as the local authority where they live when they're issued with their National Insurance number on their 16th birthday. This would enable the seamless allocation of a proportion of all future income tax or national insurance to their hometown local authority as they move from job to job.

The new system could be introduced on a place-by-place basis, with central government setting criteria for an area to qualify. And a mechanism would be required to recognise the very different circumstances of different local authorities: it's much easier for a leafy Home Counties area to export high-earning individuals than for a post-industrial northern town – so baseline statistics on council areas' levels of deprivation and unemployment could be used to create a 'value added' metric.

This concept could change local authorities' calculations about resourcing and prioritisation. For under the existing system of local government funding, there is little economic incentive for hard-pressed councils to provide services such as youth clubs. But if keeping their young people out of trouble and less likely to drop out of education had a positive impact on councils' future income, such spending would make more sense. Indeed, it would be sensible for them to invest in maximising the opportunities available to their talented young people – perhaps providing tuition scholarships for the brightest schoolchildren, or offering youth services designed to build kids' ambitions and identify their potential.

Of course, it would take some time for the results of such investments to reap rewards. As a way of recognising this, the system could be phased in over a number of years. Over a period of time, increased funding for local authorities should – assuming that councils succeeded in boosting their output of successful young people – result in a steady reduction in the need for central government spending on 'safety net' services such as prisons and health services.

Gradually moving to a system where all citizens pay back into the communities which raised them would create a direct link between local authorities' effectiveness in providing life opportunities for their young people, and the rewards accruing to those authorities. And most people – however far they move as they build their careers – retain a strong emotional link to the place they grew up. Under this system they could, like Mo Salah, take pleasure in the knowledge that their success will help to benefit the generations who come after them.

Contact

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