IfG INSIGHT | DECEMBER 2022

INSTITUTE FOR GOVERNMENT

Subnational government in England

An international comparison

Thomas Pope, Grant Dalton
and Maelyne Coggins

Summary

The UK, and England specifically,* is one of the most centralised large, advanced economies in the developed world. Compared with other countries, less government spending happens through local authorities, which are the main subnational government unit in England. This fact has received increasing attention in recent years. The advent of metro mayors in the mid-2010s began tentative steps towards greater decentralisation of powers in England. And the government's focus on 'levelling up' has prompted more debate about whether England is too centralised, with the government's white paper on levelling up arguing that further devolution must be part of the solution.[1]

* In this paper, we focus on the structure of subnational government in England. Data from the Organisation for Economic Co-operation and Development (OECD) for the UK will include data for Scotland, Wales and Northern Ireland as well as England, but England is large enough that data for the UK as a whole is dominated by, and mostly reflects, the situation in England. Devolution of responsibilities and funding to the devolved administrations is an interesting topic in its own right, but not the subject of this paper.

Advocates for reform often appeal to England's status as an international outlier, so this paper digs beneath the headline claims to identify and examine the features of the English system that are unusual. To do so we rely on comparable data across large, advanced economies and additional qualitative analysis of Germany and Japan (including interviews with country experts) – two other G7 countries that have very different subnational systems but are less centralised than England.

Understanding the ways in which power is decentralised and devolved in other countries provides valuable insight into how, and in what policy areas, a decentralisation agenda might be effectively pursued within England. The experience of other countries can also identify potential pitfalls.

The main ways in which English subnational government stands out internationally, which should be used to inform and shape debates about decentralisation in England, are as follows:

- **English subnational government is an unusual patchwork of governance models**, after successive partial reforms. Systems tend to be more consistent elsewhere. Most strikingly, in much of England there is a 'missing middle' tier of government. Local authorities are very small compared with the highest tier of subnational government in other countries, which has implications for their capacity. Mayoral combined authorities fill this gap in some parts of the country, but even they are relatively small by international comparison.
- **Central government control over economic development and health spending and policy design explain much of the headline gap between subnational government spending in England and elsewhere.** In contrast, English local authorities are unusual in having widespread discretion over social care, which is often more centralised in other countries. Central government control over transport, skills and other economic development levers especially stands out given that these are policies that benefit from co-ordination within an area and local knowledge. But it is notable that where these powers are decentralised in other countries, they tend to be devolved to regions, states or provinces, which are substantially larger than English local authorities.
- **The reliance of English subnational government on ring-fenced grants is exceptional.** The use of grants – particularly numerous small, competitive funding pots, which are a common means of financing local government in England, prevent long-term certainty and local co-ordination, and use up valuable resources – is highly unusual.
- The flip side of this is that English local government is entitled to less tax revenue. **English local government only receives revenue from property taxes while subnational governments in other countries mostly have access to other tax revenues.** But access to tax revenue need not mean full, or even partial, control over tax rates or the tax base. In both Germany and Japan, for example, subnational

governments receive a guaranteed share of the national revenue from some taxes. These revenue streams operate more like a grant, but one that is linked to tax revenues and so provides long-term certainty, albeit at the expense of being more exposed to economic fluctuations in the short term. Where tax rates do vary locally, control over rates tends to be at high levels of subnational government to prevent excessive local tax competition. Even then, the evidence suggests that varying rates at local levels can cause inefficiency.

These all have implications for how further devolution can be pursued in England in the future. If additional powers are to be devolved, the government must ensure there is the right set of subnational government institutions with enough capacity and at the right geographic level to design and deliver the relevant policies effectively. This is the rationale for the development of mayoral combined authorities.

Even in countries with substantial subnational government control, some policies are still controlled centrally. This points to the importance of identifying which policies and areas of spending are most appropriate for subnational government. International examples suggest that health and economic affairs could be good candidates as they are often delivered at a subnational level in other large economies.

Finally, the English model of subnational finance is unusual, and the reliance on grants with strings attached rather than tax revenue does limit what local government can do. But any devolution of tax rates should consider carefully the taxes devolved and the incentives provided. Many of the gains from tax devolution might be achieved through devolution of revenue streams with no or limited control over rates.

The structure of subnational government

Subnational government structures look very different across countries. Some countries, like England, are unitary, meaning that central government is the only sovereign entity and can change the powers and responsibilities of lower levels of government. Others, such as Germany and the United States, are federal, meaning that sovereignty is shared. Constitutional protections prevent the central government from changing the powers of the state or provincial government tier.

But even within these categories, structures can look very different. Most large countries have at least two tiers of subnational government. Even in unitary countries, the size and responsibilities of tiers below central government can be very different in different countries. Throughout this report, we rely on insights from Germany and Japan (see Box 1 for a brief explanation of these two systems) alongside analysis of wider international datasets.

Box 1 **Subnational government in Germany and Japan**

Germany

Germany is a federal system – sovereignty is shared between different levels of government. This structure is laid out in the German constitution (basic law). Beneath the federal government sit three tiers of subnational government: the Länder (top), the districts (middle) and the municipalities (bottom).

There are 16 Länder, which vary in size, population and gross domestic product (GDP). The largest, North-Rhine Westphalia, has a population of nearly 18 million and accounts for 20.5% of German GDP. The smallest, Bremen, has a population of fewer than 0.7 million people and accounts for less than 1% of German GDP.[2]

There are 401 districts – 294 rural districts and 107 urban districts – with an average population of 210,000.

There are then many municipalities at the lowest level of local government – 11,054 in 2017/18 – meaning that municipalities on average cover a population of 7,400.[3]

This structure deliberately ensures that powers and responsibilities are shared between national and subnational government. The federal government is responsible for national issues, such as foreign affairs, defence and social welfare (although some elements of this are devolved), and sets and levies most taxes. Otherwise, most legislative and administrative functions are assigned to the Länder. Within the Länder, many responsibilities are then devolved further to districts, while municipalities are in charge of local community matters such as waste water management or street cleaning. In some policy areas, such as transport, districts join together to deliver services at more appropriate economic geographies.

Japan

Japan is a unitary system – the central government holds sovereignty. The Japanese constitution lays out a unitary system alongside a framework for subnational governance. Beneath the central government sit two tiers of subnational government: the prefectures (upper tier) and the municipalities (lower tier).

There are 47 prefectures containing one metropolitan district (Tokyo), two urban prefectures (Kyoto and Osaka) and one circuit (Hokkaido). The largest prefecture, Tokyo, has a population of nearly 14 million and accounted for 37% of Japanese GDP between 2000 and 2014. The smallest, Tottori, had a population of 0.55 million and accounted for less than 1% of Japanese GDP in the same period.[4]

There are 1,741 municipalities, covering cities, towns, villages and special wards. Their average population size is 72,715.

Japan has often been characterised as a centralised country. In the early 2000s, political opinion in Japan was that the centre of government was too dominant and it was unable to appropriately deal with economic decline outside Tokyo, Osaka and Kobe.[5] In response, the central government introduced the 'trinity reform package', which brought about local financial reform. The package has increased fiscal devolution in Japan via three elements:

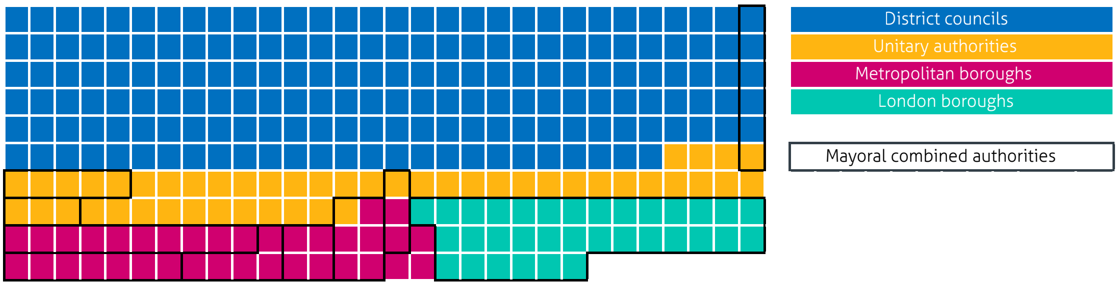
- a reduction in ring-fenced grants from central to local government
- local tax reform transferring a greater share of tax revenue to local government
- the introduction of local allocation tax (LAT), which gives local government a predetermined share of national taxes.

Even so, central governmental still plays a major role as local government is still largely dependent on the fiscal resources that central government provides. Broadly, central government is responsible for national issues such as foreign affairs, defence, social security, universities and national road infrastructure. But subnational government provides most public services – including policing, environmental protection and, in terms of the control of standards if not spending levels, health. Prefectures have considerably more administrative capacity, and a greater variety of responsibilities, than municipalities.

English local government is a patchwork of different arrangements in different places

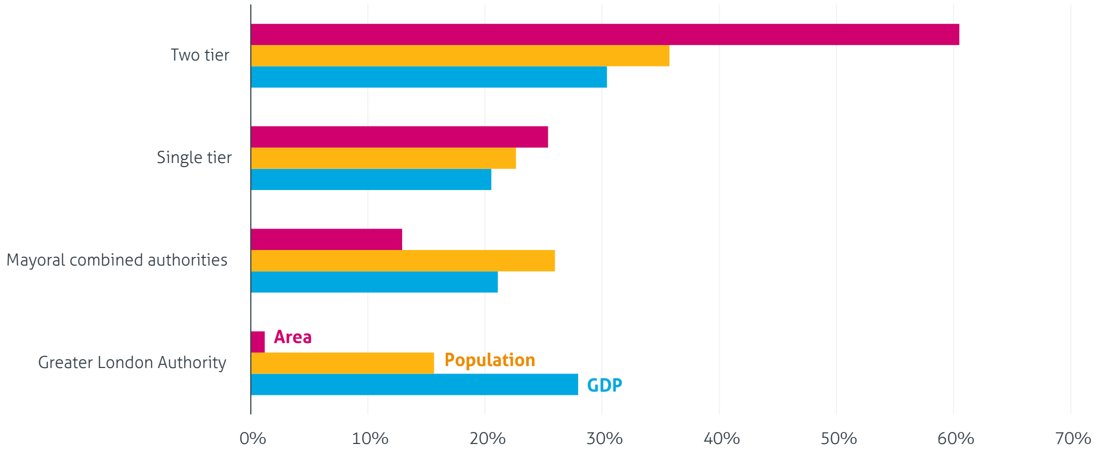
The structure of English subnational government is especially complicated (see Figure 1), and the creation of combined authorities in recent years means it is increasingly a patchwork of different organisations in different places. Every part of England is represented by a local authority. In some (mostly more rural) areas, there is a two-tier structure, with upper-tier county councils and smaller district councils below them. Much of the rest of England outside cities is covered by unitary authorities – local authorities that carry out the roles of county and district councils. London has a different set-up again, with the Greater London Authority (GLA) sitting above the 32 London boroughs. And there are now nine mayoral combined authorities, which have a mayor and some additional powers and sit above collections of local authorities, mostly in metropolitan areas. There are also other authorities, overlapping with these boundaries, that have responsibility for particular public services, such as integrated care systems (health and social care) and police authorities (police). While these are on a similar scale to each other, and to some units of local government, they each cover slightly different local geographies, making co-ordination more difficult. See Figure 2 for the coverage of the different models of subnational governance in England.

Figure 1 **A map of different models of subnational governance in England**



Source: Institute for Government analysis.

Figure 2 **Coverage of different models of subnational governance in England, 2020**



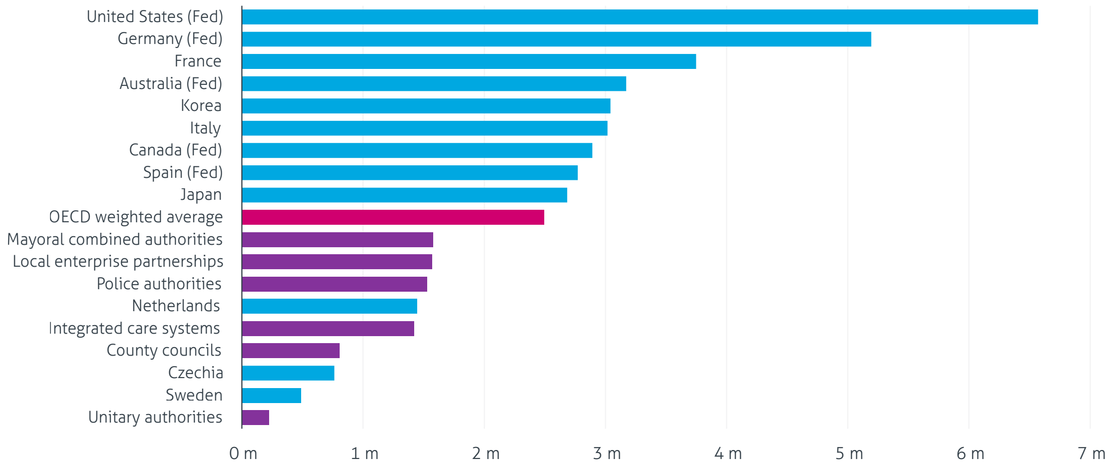
Source: Institute for Government analysis of Office for National Statistics (ONS), local authority GDP, population and area data, mid-year 2020. Notes: Single tier includes unitary authorities and the three municipal councils that are not part of a mayoral combined authority.

Subnational government is complicated in all countries, but the English patchwork set-up is unusual. In other countries, the subnational structure (and the powers that are devolved) tends to be more uniform, at least at the level immediately below national government. This is required in federal systems (like Germany), where the country's constitution establishes the structure. But it also tends to be the case in unitary systems too (such as Japan). The advent of mayoral combined authorities in some parts of England but not all, with additional powers, has made the English set-up especially patchy. In those areas, the combined authority is the organisational unit just below national government, while in other parts of the country the next level below central government is much smaller local authorities.

Outside combined authorities, England has a 'missing middle' of large subnational organisations relative to other countries

International comparison reveals a compelling logic for larger, combined authority units in England. In most large, advanced economies, the largest subnational government tier covers an average population of more than two million (see Figure 3), and in some cases even larger (as Box 1 describes for Germany and Japan). This regional tier of government covers a sufficient population and geographic area to encompass whole economic areas, making it a more natural level for economic levers to sit. In contrast, unitary local authorities in England cover less than a tenth of the population of the regional government tier in other countries, on average. Before mayoral combined authorities, and in areas of England without them, the most striking feature of English subnational government compared with other countries is this 'missing middle' – the lack of a large regional or metro government tier. And even metro mayor authorities cover smaller populations on average than this middle tier in other countries, with some smaller combined authorities such as Tees Valley smaller than some large unitary authorities.

Figure 3 **Average population covered by the highest-level subnational authority in large, advanced economies, 2019, compared with the average population of different types of government units in England, 2020**

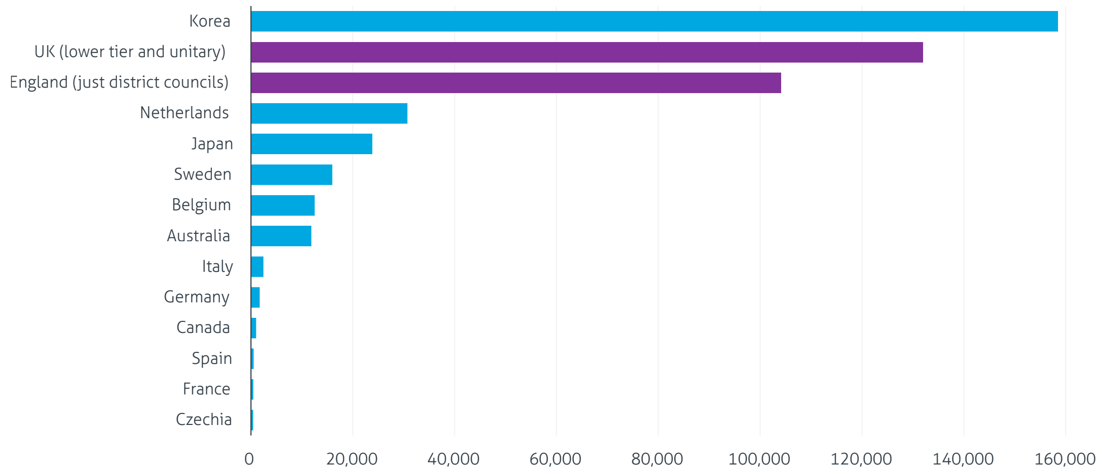


Source: Institute for Government analysis of OECD data on the mean size of subnational governments, and ONS data on the size of English local authorities and the overall population of England, mid-year 2020. Notes: Includes all OECD countries with a population over 10 million and a GDP per capita over $40,000 in 2021. (Fed) signifies federal governments. In the OECD data Spain is classed as a "federation or quasi-federation country". Some local enterprise partnerships (LEPs) overlap in area, and the data displayed in the chart simply divides the population of England by the number of LEPs, and so slightly understates the size of the average LEP. For police authorities, the Metropolitan Police was included even though it has some national duties, but non-geographically distinct forces have not been included.

Local authorities are larger than municipalities in other large, advanced economies

English local authorities are very large, on average, compared with municipal authorities (that is, the lowest tier of subnational government) in other advanced economies. Sitting below the regional tier, municipal authorities are responsible for many of the local services that local authorities in England are responsible for, such as bin collections, libraries and local roads. These are services that can be delivered best locally, where local knowledge is important and there may be fewer benefits from economies of scale. In many countries, the average municipality covers a population of fewer than 10,000 people, but the average local authority in England is more than 10 times that size (see Figure 4).

Figure 4 **Median population covered by the lowest level of subnational government unit in large, advanced economies, 2019**



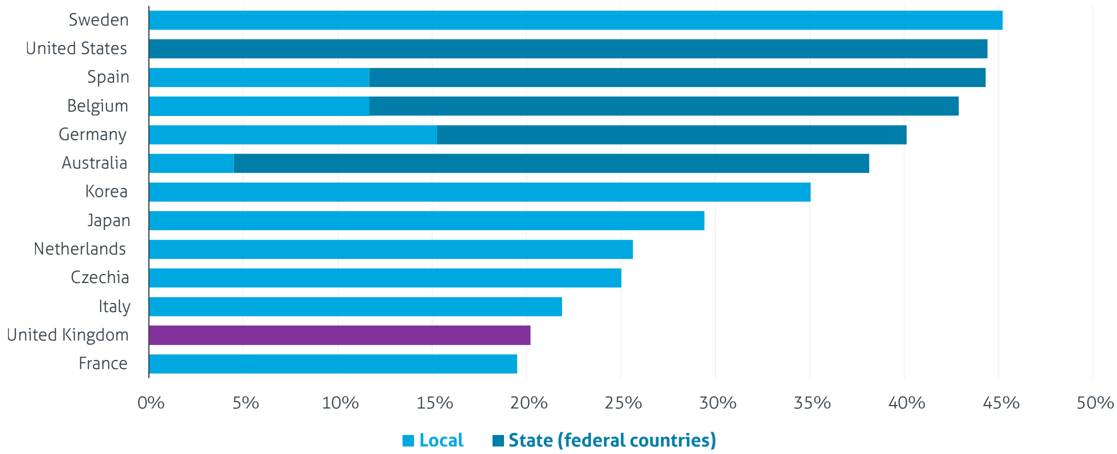
Source: Institute for Government analysis of OECD data on the size of subnational governments and ONS data on the size of English local authorities. Notes: Includes all OECD countries with a population over 10 million and a GDP per capita over $40,000 in 2021. UK (lower tier and unitary) refers to the 314 local authorities in England (including London boroughs and unitary authorities), 22 in Wales, 32 in Scotland and 11 local councils in Northern Ireland, while the England (just district councils) figure only includes district councils in two-tier areas not covered by mayoral combined authorities, and uses 2020 rather than 2019 data.

The powers and responsibilities of subnational government

The headline figures show that the UK spends less locally than other countries

The UK is often described as the most centralised large advanced country in the world, based on the small share of overall spending that subnational, as opposed to central, government determines and delivers. Local government accounts for little over 20% of total spending in the UK, compared with around 40% or more in Germany, Belgium and other countries (see Figure 5). Even this statistic overstates the degree of local autonomy over policy in the UK. Schools account for more than 20% of local spending, but a national formula sets school budgets, the curriculum is set nationally and local authorities have only relatively limited control over how locally maintained (non-academy) schools are run.[6]

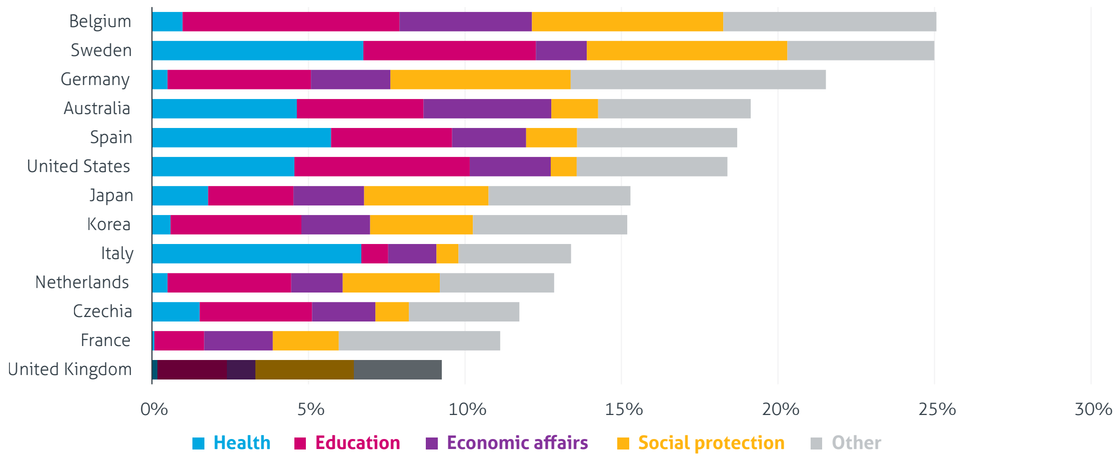
Figure 5 **Share of total government spending accounted for by subnational government in large, advanced economies, 2019**



Source: Institute for Government analysis of OECD data on government expenditure by level of government and function. Notes: Includes all OECD countries with a population over 10 million and a GDP per capita over $40,000 in 2021. For federal countries, data is split into state or provincial spending and spending at subnational government tiers below that. For unitary countries, including the UK, all subnational government spending is presented as local government spending. Data presented excludes all spending categorised as general intergovernmental transfers, and presents state and local spending as a proportion of the sum of all spending, including state, local, central and social security spending.

Figure 6 breaks down total spending at a local level by policy area. In most areas, UK subnational government spends less as a share of GDP than similar institutions in other countries. But there are three areas in particular where the UK is an outlier: economic affairs, health and social care.

Figure 6 **Subnational government spending by policy area in large, advanced economies, percentage of GDP, 2019**

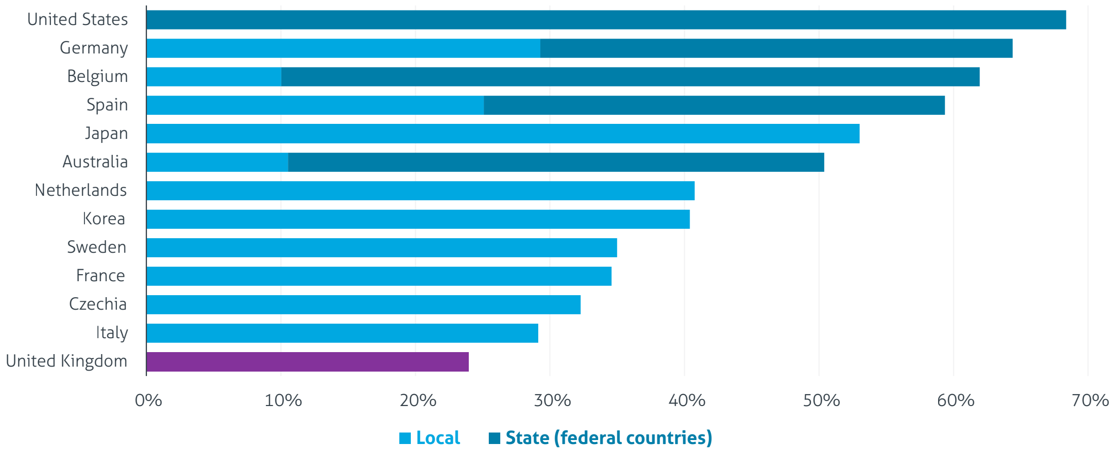


Source: Institute for Government analysis of OECD data on GDP (expenditure approach) and subnational expenditure by function. For Japan, OECD GDP data was not available so the World Bank calculation of GDP was used instead. Notes: Includes all OECD countries with a population over 10 million and a GDP per capita over $40,000 in 2021. Excludes general intergovernmental transfers.

Economic policies like transport are especially centralised in England

England spends much less on economic affairs at a local level than other countries (see Figure 7). This category includes transport (which accounts for most of this spending in all countries) and research and development (R&D). Economic development spending explains around 15% of the gap between local spending on average in advanced unitary countries and that in the UK, a large amount given it is a relatively small budget in most countries.[7] Recent Institute for Government research has highlighted the important role of economic policies affecting infrastructure, innovation and skills in driving local growth.[8] We also found that all of these policies are more effective when they are co-ordinated in places – for example, investing in transport to help skilled people reach the right jobs and tailoring skills policy to meet local demand emerging from local R&D specialism.[*] Co-ordinating those policies in places is difficult from the centre of government, where policy areas naturally become more siloed and there is not enough knowledge of specific local circumstances. This makes a good case for decentralisation.

Figure 7 **Share of economic affairs spending at a subnational level in large, advanced economies, 2019**



Source: Institute for Government analysis of OECD data on government expenditure by level of government and function. Notes: Includes all OECD countries with a population over 10 million and a GDP per capita over $40,000 in 2021. (Fed) signifies federal governments. In the OECD data Spain is classed as a "federation or quasi-federation country". For federal countries, the data is split into state, provincial or regional spending and spending at subnational government tiers below that. For unitary countries, including the UK, all subnational government spending is presented as local government spending. The data represents state and local spending as a proportion of the sum of all spending on economic affairs, including state, local, central and social security spending.

The level of subnational government responsible for these policies in other countries is also instructive. In federal systems, the state, provincial or regional tier mostly holds responsibility for the policies rather than more local levels of subnational government. One exception is Germany, where transport is the responsibility of districts, which are of a similar size to English local authorities. But rather than operate the policy at the level of the small geography of each district, districts form groups (known as transit districts) that match the local economic geography so that decisions can be made in a coherent way across the economic area that transport effects.[9]

* Skills spending is not included in 'economic affairs'. However, among countries for which data is available, vocational education spending is unusually centralised in the UK.

In Germany, public funding for R&D comes from a combination of the Länder and the federal government. For example, Germany's federal ministries fund 42 R&D institutions focused on the respective interests of the federal ministries. But Länder are the primary funder of university research in Germany overall.[10]

The data does not allow us to split economic development spending by different subnational tiers in unitary systems, but in Japan, economic development is almost exclusively the purview of the large prefectures. These also operate at a high enough level to cover functional economic areas. This is also the case in other unitary countries, such as France and Italy.[11]

There is a sound rationale for economic policies to operate at a regional, or economic area, level, rather than more locally. Economists have often argued that skills policies should be determined at the relevant labour market level – the effective pool of workers that employers are fishing in for their workers.[*,12] Therefore, the skills gaps need to be determined at that level. And transport policy will often extend beyond smaller local boundaries, meaning effective policy for people living in an area is best decided at a higher level, rather than a local one.

The organisation of health and social care in England is also an international outlier

The other areas where England stands out relate to public services, and specifically health and social care. Just 0.2% of GDP is devoted to locally controlled health spending, compared with 1.7% on average in unitary OECD countries. This differential accounts for more than half (55%) of the UK's divergence from 'normal' local government spending in developed unitary countries.[13] In many other countries, health is a devolved matter and subnational governments make policy. Even in places like Germany and Japan, where health insurance spending is decided centrally, the Länder and prefectures respectively are responsible for service delivery, including the supervision of hospitals. In other countries, such as Sweden, spending responsibility is devolved.

The English system is very centralised, with the Department of Health and Social Care (DHSC) making NHS decisions. The system acknowledges the need for local delivery and a degree of local control, but rather than devolving policy to an appropriate local government, DHSC instead has set up local bodies (integrated care systems) that report directly to the centre of government. The one exception in England is in Manchester, where the local integrated care system is accountable both to central government and to the Greater Manchester Combined Authority.[14] Similar arrangements are in place for other services, such as the police, and in several combined authority areas the mayor is also the police and crime commissioner.[15]

* Although workers can and do move, the evidence shows that most people, especially non-graduates, tend to live close to where they grew up.

In contrast, social care – a large part of social protection in Figure 6 – is delivered locally. While there are national guidelines, each local authority decides what to spend and how to spend it and can in effect ration care. This allows local authorities to tailor care to local needs, and to build relationships with local providers. But it also means that levels of provision vary depending on where you live in England. In many other countries, this kind of basic social protection would be provided, or at least determined, more centrally. England channels a higher proportion of its spending on old-age social protection at a local level than any other large, wealthy OECD country. In combination with low local autonomy in other spending areas, high spending on social care means English local government is very lopsided. Excluding spending on schools, where local authorities have limited autonomy, social care now accounts for almost three quarters of their spending.[16]

Funding of subnational government

Subnational governments generally fund themselves through:

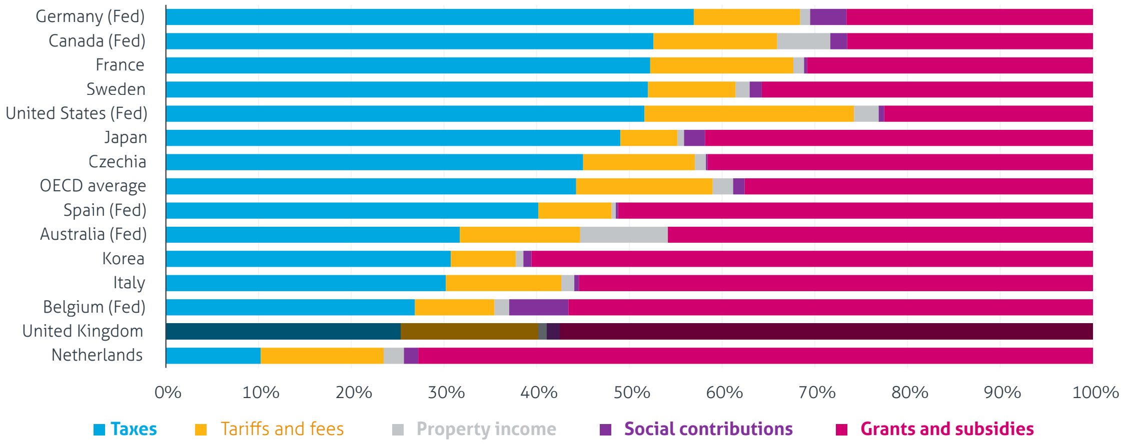
- taxes
- tariffs and fees levied directly from their populations
- taxes levied nationally but 'shared' in some form between central and subnational governments
- grants from other levels of government.

Some subnational governments in other countries are also able to borrow, but here we focus primarily on tax and grant revenue.

Subnational government in England receives less tax revenue than in other countries

English local government relies more on central government grants and less on locally controlled or 'shared' taxes (that is, taxes where subnational governments receive a guaranteed share of nationally collected revenues) than in other countries (see Figure 8). Just under a fifth of subnational government funding in the UK comes directly from taxes. This is in sharp contrast to federal countries like Germany and the United States, but also to most large unitary countries, including France and Japan, where taxes account for around a half of the revenue of subnational governments.

Figure 8 **Breakdown of subnational revenue sources across large, advanced economies, 2019**



Source: Institute for Government analysis of OECD subnational government revenue data, 2019. Notes: Includes all OECD countries with a population over 10 million and a GDP per capita over $40,000 in 2021. (Fed) signifies federal governments. In the OECD data Spain is classed as a "federation or quasi-federation country".

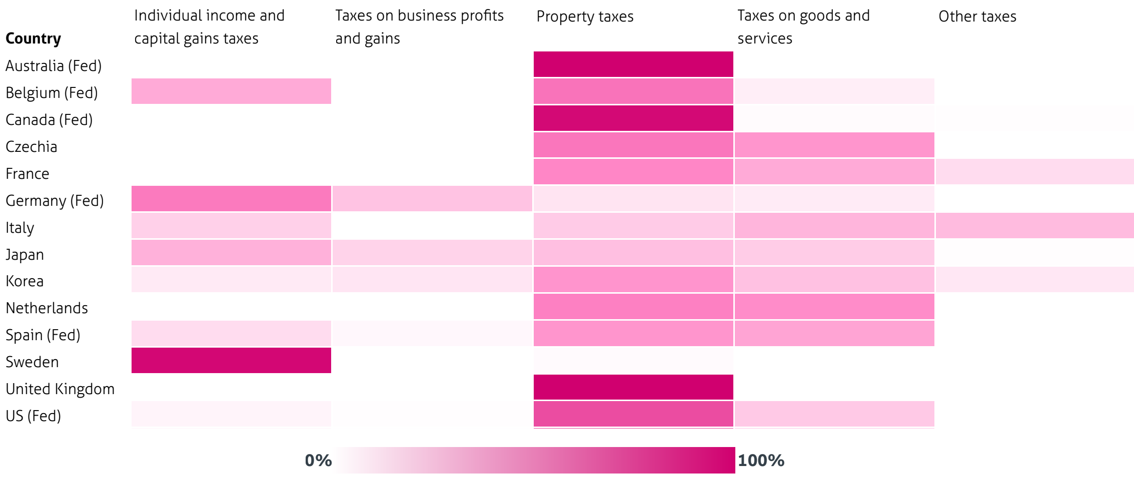
These figures add weight to the theory that England is one of the most centralised developed countries in the world,* but it is important to understand what this subnational 'tax revenue' looks like in other advanced economies. On the whole, it does not mean vastly divergent tax systems within countries, and local autonomy over these taxes is more limited than one might assume.

Local government in England has a less diverse mix of taxes

In England, local government tax revenue is derived exclusively from property taxes, council tax and business rates. Property taxes tend to be the main tax stream at a local government level in OECD countries (a level that accounts for all subnational government revenue in unitary countries and levels below the state, provincial or regional tier in federal countries; see Figure 9). There is a sound rationale for this: it is easy to identify which property should be taxed in which jurisdiction, and as property is immovable, opportunities for avoidance are limited.

* The devolved administrations have much greater revenue-raising powers than English local authorities. For instance, the Scottish government is able to control the rate of (and retain the revenues from) income tax and stamp duty in Scotland, the latter of which the Welsh government also controls for Wales.

Figure 9 **Local government tax revenue by type of tax in large, advanced economies, 2019**



Source: Institute for Government analysis of OECD subnational government revenue data. Notes: Includes all OECD countries with a population over 10 million and a GDP per capita over $40,000 in 2021. (Fed) signifies federal governments. In the OECD data Spain is classed as a "federation or quasi-federation country" In federal countries, this includes only tax revenue assigned to the local or municipal tier.

Even though property taxes account for most revenue at the local government tier in most countries, the UK is unusual in relying solely on that tax stream, especially for a unitary country.[*] Local governments in most other countries derive revenue from either sales taxes or income taxes as well as property. Broadly, these tax streams come in two forms. First, there are small additional taxes that local governments in some countries are allowed to levy. For example, in Japan, local governments can levy up to 23 taxes,[17] most of which are small ones such as tourist taxes. UK local authorities do not have this flexibility. Second, and more important in revenue terms, local governments in some countries are entitled to shares of national taxes such as income tax or corporation tax.

In other unitary countries, subnational governments often have access to tax revenue without control over tax rates

In almost all cases, the income tax and business profit revenue shown in Figure 9 is some form of tax-sharing arrangement, where the tax base and tax rate are the same across the country but local government is entitled to a share of the revenue. Broadly, these arrangements can take two forms. In one model, which is adopted in Germany, each area is entitled to a fixed share of total nationwide revenues, regardless of what revenues are earned from activity in each area. In the other model, which occurs in Japan, the revenue in an area depends on the amount of revenue generated in that area (for example, income earned by people working in that location). The advantage of the former approach is that revenue shares are stable and so the system does not exacerbate inequality, with faster-growing regions benefiting. But in the latter model, subnational governments gain revenue when their economy grows more quickly so they have the incentive to use the levers that are at their disposal (such as the planning system) to boost growth, although other grants are needed to ensure a fair distribution of funds.

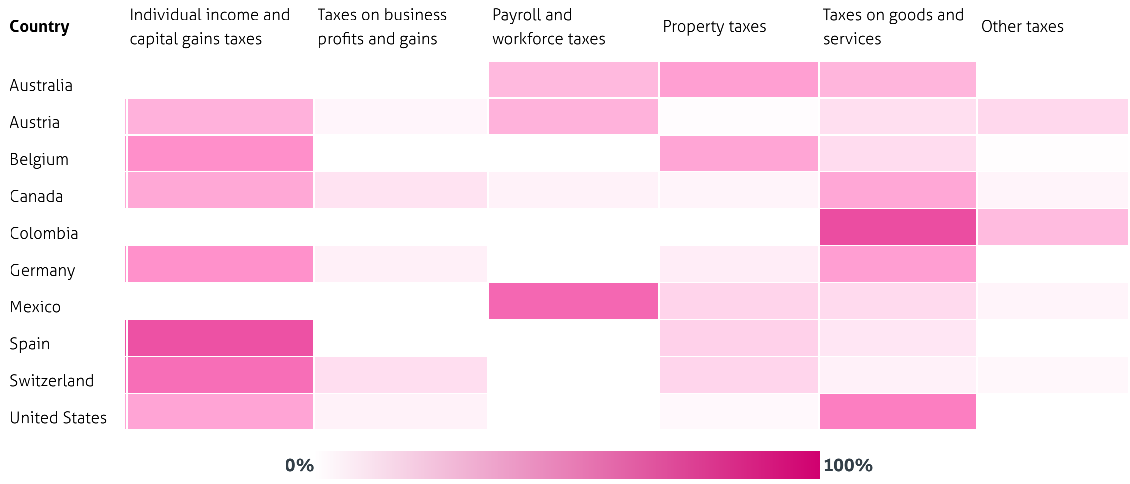
* Local governments are reliant on property taxes, for instance, in Australia and Canada, but in these countries there is also a state level, which a wider range of taxes funds.

Tax-sharing arrangements are designated as 'local tax revenue' in the data. But they do not mean that local areas have any additional control over tax setting. In practice, they operate more like grants from central government to local areas. The benefit of these revenue streams over centralised grants is that they are linked directly to tax revenues rather than being at the discretion of central government. This provides additional certainty and protects local government revenues. These revenue streams also come without the conditions and requirements that central government grants often do in the UK, discussed further below. But they also expose local authorities to economic downturns or other factors that reduce tax revenues, also discussed further below.

Where tax rates are devolved, governments need to manage possible negative effects

There are also some countries where the rates for major taxes are devolved to a local level. Most notably, in Sweden income tax rates (although not the tax base) are set at the municipal level, while regions in Belgium can levy an additional surtax on top of personal income tax (though this accounts for only a small share of revenue).[18] In federal systems, there is more state, provincial or regional discretion over tax rates (see Figure 10).

Figure 10 **State or provincial tax revenue by type of tax in federal advanced countries, 2019**



Source: Institute for Government analysis of OECD revenue statistics. Notes: Includes all federal OECD countries, and includes only tax revenue assigned to the state, provincial or regional tier.

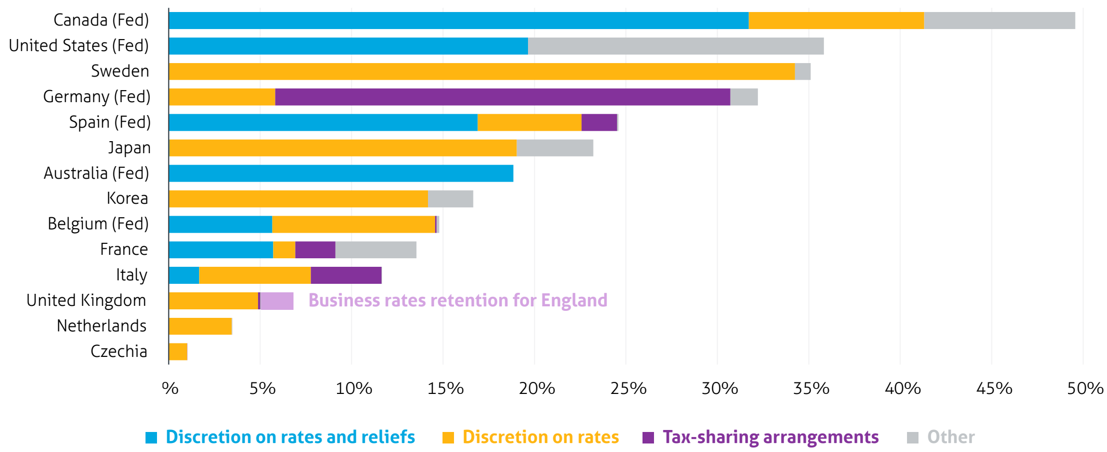
There are benefits to devolving tax rates, including that they can be tailored to fit the preferences of people in different local areas. But one of the risks of devolving tax rates is that it can lead to tax competition – that is, different local areas competing with one another for economic activity by lowering taxes. This is especially a risk for mobile tax bases such as corporation tax, where businesses might be especially responsive to tax rates when making decisions over where to base themselves. This risks creating an inefficient system, and may also lead to concerns around tax avoidance. Divergence over tax rates is easier to manage at a higher geographic level as this risk of tax competition, and complexity, is lessened if there are fewer different tax systems in a country and benefiting from lower tax rates might require moving further than if every local area had a different tax rate.

In countries where tax rates are devolved, there is little evidence of a fierce 'race to the bottom'. In part this is because the incentives to cut tax rates are tempered by fiscal equalisation mechanisms that compensate areas with smaller tax bases, discussed further below.[19] Even so, many tax rates are set centrally in federal countries and tax-sharing arrangements are still used. For example, in Germany, 43.5% of the tax on wages and salaries collected nationally is allocated to Länder and municipalities (three quarters of which goes to Länder).[20] And where rates are devolved, central governments will often impose limits on how much tax rates can vary to restrict tax competition.

Overall, the English system stands out internationally for the low level of tax devolution. But it stands out most of all in terms of the overall level of revenues devolved, rather than control over tax levers. Germany, despite a much more powerful subnational layer of government, gives local governments control of rates for just 6% of taxes by value, while in the UK this is nearer 5% (see Figure 11).

The lessons from other countries suggest that where tax levers beyond property are devolved, this is more likely to be effective and manageable at a state, provincial or regional level. Even then, there is a risk of unproductive tax competition between regions. Which taxes are devolved, and how other sources of revenue adjust to prevent excessive inequality between regions, will affect the extent of this. This is a model that the UK has adopted with Scotland, Wales and Northern Ireland, which have all been given more devolved responsibility for taxes in recent years.

Figure 11 **Local discretion over tax revenues assigned to subnational government in large, advanced economies as a percentage of total tax revenues, 2018**



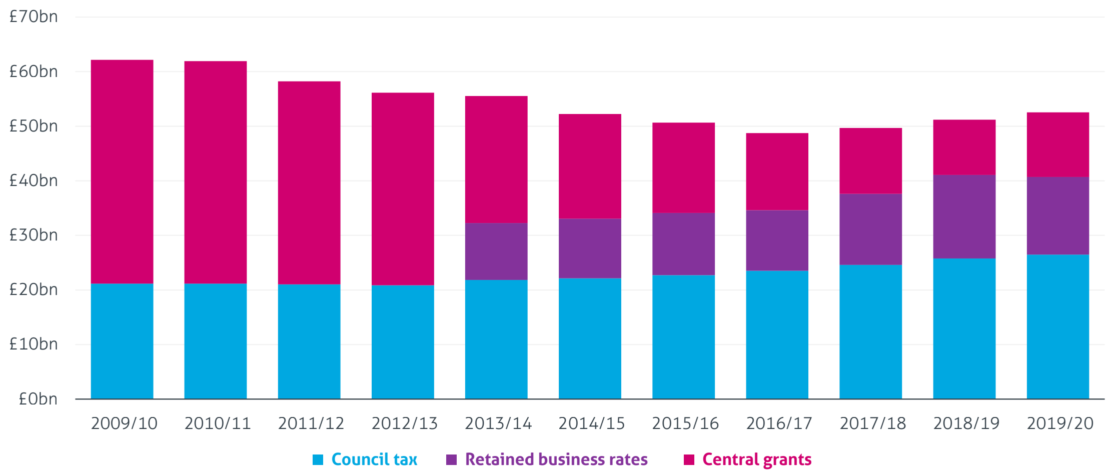
Source: Institute for Government analysis of OECD data on the taxing power of sub-central governments. For the business rates calculation, we used data from the Department for Levelling Up, Housing and Communities on 2017/18 business rates revenue for metropolitan, unitary, county and district councils (excluding fire and rescue authorities, waste authorities, combined authorities, national park authorities, police and crime commissioners and the Greater London Authority) and divided this by 2018 total UK government tax revenue from the OECD. Notes: Includes all OECD countries with a population over 10 million and a GDP per capita over $40,000 in 2021. (Fed) signifies federal governments. In the OECD data Spain is classed as a "federation or quasi-federation country". Includes taxes controlled by all subnational governments, including both state and municipal governments in federal countries.

English subnational government's reliance on grants provides less certainty and flexibility

Limited devolution of tax revenue means that local governments in England are disproportionately reliant on grants for the money they spend. These are a mixture of specific grants for specific tasks and generalised grants that are largely spent on tasks mandated by central government, especially the provision of social care, which now makes up almost three quarters of local authority controllable spending.[21] These grants are largely allocated to compensate local authorities for different levels of need and the size of their local tax bases – that is, councils in more deprived areas generally receive larger grants.[22] This makes it easier to deliver a consistent standard of services, but reduces incentives to grow the tax base, as any increased tax take would, over time, be met with a reduction in the size of the grant provided to the council.

Central government grants to local authorities in England, excluding specific grants for non-locally controlled spending (education, the police and public health), fell by 63% in real terms between 2009/10 and 2019/20 (see Figure 12). This included big falls in the block grant that can be spent as local authorities see fit. Local government was a relatively easy target when the coalition government was looking to cut back on government spending because central government could delegate the difficult decisions about which services would experience those cuts to local authorities.

Figure 12 **Local authority spending in England, by source, 2009/10 to 2019/20 (2019/20 prices)**



Source: Local authority revenue expenditure and financing in England: individual local authority data – revenue outturn. Notes: Excludes grants for education services, the police and public health. 2019/20 data includes one month of emergency Covid-related funding (March 2020), which increased the proportion of funding from government grants.

As Figure 12 shows, local government has filled some of the gap left by falling grants with higher council tax (although the government restricted council tax increases during the 2010s, requiring local referenda for big annual increases).[23] Local authorities were also granted the right to retain half of revenues from local business rates in the Local Government Finance Act 2012, although they do not have the right to set rates in their local area, with the exception of small supplements applied for specific projects such as Crossrail in Greater London.[24] This means that, overall, more of local authorities' day-to-day expenditure (for example, on social care and neighbourhood services such as libraries and bin collections) is taken from their own tax revenue.

However, tax revenue and no-strings-attached grants cover only some of local government spending. For most other programmes, including investment projects, skills and other local growth initiatives, local authorities are reliant on earmarked specific grants from central government, most of which require compiling bids and competing against other areas for the money. There is no official list of these grants, or a single total value, but research from the Local Government Association suggests there were more than 400 in the late 2010s, adding up to many billions of pounds of funding for specific projects.[25] Prominent examples include the Levelling Up Fund and the UK Shared Prosperity Fund, but many others are much smaller.[26]

As previous Institute for Government research has highlighted, there are several downsides to this funding model.[27] Funding tends to be based on specific projects with a fixed time horizon, providing little long-term certainty. Compiling bids is time-consuming and expensive; having so much local government resource devoted to a "beauty contest", as West Yorkshire mayor, Tracy Brabin, has described the process,[28] is wasteful. Winning bids are also likely to be those that the centre of government deems most valuable rather than allowing local governments to tailor support to their local area.

This contrasts with how grants often work in other countries, where subnational governments usually receive more no-strings-attached funding or guaranteed shares of the national tax take, allowing them more room to choose which spending to prioritise. In Japan, for instance, there was a move at the time of the trinity reforms at the turn of the century towards more local government self-reliance. To fund the increased responsibilities of local government, local allocation tax (LAT) funding (a predetermined share of national taxes) and central government grants were instated.* Japan does have some grants that are subject to competitive bidding from local authorities, but interviewees stated that competitive bidding was much rarer in Germany and Japan than in the UK.

A different approach would need other mechanisms to ensure a fair distribution of spending and flexibility to respond to economic shocks

A greater reliance on tax revenue to fund local government in England would face two challenges, which would need to be addressed. First, tax revenue will not be evenly distributed across the country so other transfers and grants will need to redress the balance to avoid undue spending power accruing to the most affluent places. Like the UK, both Japan and Germany use grants and tax-sharing arrangements from central government to reduce inequalities between local governments. The LAT in Japan, for instance, allocates funding according to need, with no LAT funding going to areas whose revenues already exceed their perceived financial needs. Germany has a law on fiscal equalisation, requiring that Länder should not have significantly different living

* Local authorities can spend LAT funding as they see fit. In 2015, it covered 38% of all local government spending. Its formula is as follows: 100% of local corporation tax, 50% of liquor tax, 33.1% of income tax, 33.1% of corporation tax and 22.3% of consumption tax.

standards from one another. As a result, subnational government funding from the centre of government is assigned through a predetermined formula to reduce fiscal inequalities between the states, and the richer Länder contribute some of their own tax revenues into a pool from which poorer Länder are funded.

Second, tax revenues not from property fluctuate with the economic cycle, meaning that subnational government would automatically have less revenue during difficult economic times. This could prevent counter-cyclical spending (spending to boost the economy in a downturn) or even require fiscal retrenchment when the economy needs support. In most countries, including Germany and Japan,[29] subnational government has enhanced borrowing powers (relative to the UK) that allow them to continue to spend when revenues are less than expected. During major shocks such as the financial crisis and Covid, subnational government in federal countries has also relied on additional grants from the government to stay afloat.[30]

Conclusion

Government in England is centralised, and unusually so internationally. Several features make subnational government in England an outlier.

The statistic most readily employed to demonstrate England's centralisation is the share of public spending that subnational, as opposed to central, government manages. English subnational government is particularly unusual in having only a small role in – in particular – economic development and the delivery of health care. On the other hand, responsibility for social care is unusually decentralised in England, especially relative to local authorities' limited other responsibilities.

On the revenue side, too, England is unusual. Most tax revenues flow to central government, leaving local authorities reliant on government grants, which, the past decade has proven, can easily be cut. In most other advanced economies, subnational government is entitled to a greater share of revenues, and across a wider set of tax bases than just property taxes, which are the only local taxes in England. The approach followed in other countries provides a more reliable source of income in the long term to be spent as subnational governments see fit. It does though make subnational governments more vulnerable to economic downturns in the short term, so it is important that they have requisite borrowing powers or short-term grants to offset this. But it is important to emphasise that England stands out especially in the *revenue* that is decentralised, rather than tax-setting powers. Most subnational governments have more capacity to set some tax rates, but these taxes typically provide only a small share of local government revenues. In both Germany and Japan, for example, the major source of local tax revenue is predetermined shares of nationally set taxes. England could therefore become less of an outlier by changing how it allocates funding even if it did not devolve tax rates.

Yet more fundamentally than in tax-setting powers or spending responsibilities, the structure of subnational government is unusual. There is a messy patchwork of governing arrangements across England, after successive partial reforms. Across most of England this has resulted in a 'missing middle' – that is, a missing tier of government at the geography of functional economic areas. Whether this is a cause or a symptom of England's centralisation, it is linked to the centralisation of policy and responsibility. In other countries, responsibilities that are centralised in the UK are often devolved to a regional tier or are at least determined at a larger economic geography than local authorities. These 'middle tier' authorities in other countries have both the capacity and the appropriate perspective to make substantive decisions over economic policies. Likewise, where tax levers are devolved in other countries it is more often to higher levels of government than the local authority level, to limit potentially harmful tax competition.

English subnational government is unusual in several respects, many of which are self-reinforcing. Understanding the ways in which England stands out should play an important role in debates about devolution, decentralisation and local government reform.

References

1 HM Government, *Levelling Up the United Kingdom*, CP 604, The Stationery Office, 2022, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1095544/Executive_Summary.pdf, p. 16.

2 German government, 'Federal states of Germany', retrieved 23 November 2022, www.deutschland.de/en/topic/politics/germany-europe/federal-states

3 OECD/UCLG, *World Observatory on Subnational Government Finance and Investment*, 2022, retrieved 26 November 2022, www.sng-wofi.org

4 OECD, 'Regions and cities at a glance 2018 – Japan', 2018, www.oecd.org/cfe/JAPAN-Regions-and-Cities-2018.pdf

5 Ikawa H, *15 Years of Decentralization Reform in Japan*, Japanese Local Government Centre, 2008, www.jlgc.org.uk/en/pdfs/up-to-date_en4.pdf; HM Government, *Levelling Up the United Kingdom*, CP 604, The Stationery Office, 2022, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1095544/Executive_Summary.pdf

6 Department for Education, 'Local authority maintained schools: governance', GOV.UK, 2019, retrieved 23 November 2022, www.gov.uk/government/collections/local-authority-maintained-schools-governance

7 OECD, 'Subnational governments in OECD countries: key data, subnational expenditure and investment by function', 2019, retrieved 26 November 2022, https://stats.oecd.org/Index.aspx?DataSetCode=SNGF

8 Pope T, Shearer E and Hourston P, *What Levelling Up Policies Will Drive Economic Change?*, Institute for Government, 2022, www.instituteforgovernment.org.uk/publications/levelling-up-policies

9 Buehler R, Pucher J and Dümmler O, 'Verkehrsverbund: the evolution and spread of fully-integrated regional public transport in Germany, Austria and Switzerland', *International Journal of Sustainable Transport*, 2019, vol. 13, no. 1, pp. 36–50, DOI: 10.1080/15568318.2018.1431821

10 Rammer C, *Monitoring and Analysis of Policies and Public Financing Instruments Conducive to Higher Levels of R&D Investments: The 'Policy Mix' project: Country review Germany*, European Commission, 2007, https://ec.europa.eu/invest-in-research/pdf/download_en/germany.pdf

11 OECD/UCLG, *World Observatory on Subnational Government Finance and Investment*, 2022, retrieved 26 November 2022, www.sng-wofi.org

12 Overman HG and Xu X, *Spatial Disparities Across Labour Markets*, Institute for Fiscal Studies, 2022, https://ifs.org.uk/inequality/wp-content/uploads/2022/02/Spatial-disparities-across-labourmarkets-IFS-Deaton-Review-Inequality-FINAL.pdf

13 OECD, 'Subnational governments in OECD countries: key data, subnational expenditure and investment by function', 2019, retrieved 26 November 2022, https://stats.oecd.org/Index.aspx?DataSetCode=SNGF

14 Williams K, *Is Manchester Greater? A new analysis of NHS integration*, Centre for Policy Studies, 2022, https://cps.org.uk/wp-content/uploads/2021/09/CPS_IS_MANCHESTER_GREATER.pdf, p. 23.

15 Sandford M, *Combined Authorities*, briefing paper 06649, House of Commons Library, 2019, https://researchbriefings.files.parliament.uk/documents/SN06649/SN06649.pdf

16 Atkins G and Hoddinott S, 'Spending by local authorities in England with responsibility for social care', Institute for Government, 2022, retrieved 23 November 2022, www.instituteforgovernment.org.uk/charts/local-authorities-social-care

17 OECD/UCLG, *World Observatory on Subnational Government Finance and Investment*, 2022, retrieved 26 November 2022, www.sng-wofi.org

18 *Ibid.*

19 Blöchliger H and Pinero Campos JM, 'Tax competition between sub-central governments', OECD Economics Department Working Paper No. 872, OECD Publishing, 2011, retrieved 26 November 2022, www.oecd-ilibrary.org/economics/tax-competition-between-sub-central-governments_5kgb1mfm6jnw-en

20 OECD/UCLG, *World Observatory on Subnational Government Finance and Investment*, 2022, retrieved 26 November 2022, www.sng-wofi.org

21 Atkins G and Hoddinott S, *Neighbourhood Services Under Strain: How a decade of cuts and rising demand for social care affected local services*, Institute for Government, 2022, www.instituteforgovernment.org.uk/publications/neighbourhood-services, p. 9.

22 Phillips D, 'Equalisation, incentives and discretion in English local public service provision', in British Academy, *Governing England: Devolution and funding*, 2018, www.thebritishacademy.ac.uk/documents/238/Governing-England-devolution-funding.pdf, p. 36.

23 Sandford M, *Council Tax: Local referendums*, House of Commons Library, 2022, retrieved 23 November 2022, https://commonslibrary.parliament.uk/research-briefings/sn05682

24 Mayor of London and London Assembly, 'Paying for Crossrail: business rate supplement', (no date), retrieved 23 November 2022, www.london.gov.uk/programmes-strategies/business-and-economy/promoting-london/paying-crossrail-business-rate-supplement

25 TRL Insight, *Fragmented Funding*, Local Government Association, 2020, www.local.gov.uk/sites/default/files/documents/Fragmented%20Funding_final.pdf

26 HM Government, *Levelling Up the United Kingdom*, CP 604, The Stationery Office, 2022, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1095544/Executive_Summary.pdf

27 Paun A, Nice A and Rycroft L, *How Metro Mayors Can Help Level Up England*, Institute for Government, 2022, retrieved 26 November 2022, www.instituteforgovernment.org.uk/publications/metro-mayors

28 House of Commons Public Administration and Constitutional Affairs Committee, *Governing England: Third report of session 2022–23*, HC463, House of Commons, 2022, retrieved 26 November 2022, https://committees.parliament.uk/publications/31418/documents/176171/default, p. 19.

29 OECD/UCLG, *World Observatory on Subnational Government Finance and Investment*, 2022, retrieved 26 November 2022, www.sng-wofi.org

30 De Mello L and Ter-Minassian T, 'Improving subnational governments' resilience in the wake of the Covid-19 pandemic', OECD Working Paper on Fiscal Federalism, OECD Publishing, 2022, retrieved 23 November 2022, www.oecd-ilibrary.org/economics/improving-subnational-governments-resilience-in-the-wake-of-the-covid-19-pandemic_6b1304c8-en

About the authors

Thomas Pope

Tom is the deputy chief economist at the Institute for Government and works within the public finances team. He leads the Institute's work on levelling up. He also leads and contributes to projects on public services, fiscal policy and regulation. He was previously an economist at the Institute for Fiscal Studies. He has an MSC in economics from UCL and a BA in philosophy, politics and economics from the University of Oxford.

Grant Dalton

Grant is a researcher on the Institute's public finances project. He joined the Institute from the Department for International Trade, where he worked in private office as a briefings manager and a ministerial private secretary. Grant previously completed a degree in History at University College, Oxford, before working in fundraising for a school in Oxford.

Maelyne Coggins

Maelyne is a research assistant, working on the Institute's public finances team. She has recently completed a MSc in policy research from the University of Bristol. Prior to joining the Institute, she worked as a learning resources developer at Eastwood Park Training and completed a BA in modern and international history from Staffordshire University in 2018.

The Institute for Government is the leading think tank working to make government more effective.

We provide rigorous research and analysis, topical commentary and public events to explore the key challenges facing government.

We offer a space for discussion and fresh thinking, to help senior politicians and civil servants think differently and bring about change.

Copies of this IfG Insight are available alongside our other research work at:

instituteforgovernment.org.uk

enquiries@instituteforgovernment.org.uk

+44 (0) 20 7747 0400 **+44 (0) 20 7766 0700**

@instituteforgov

Institute for Government, 2 Carlton Gardens
London SW1Y 5AA, United Kingdom

December 2022