

Devolution: a capital idea

The report of the London Finance Commission

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Chair's foreword



London's economic health is important for the whole of the United Kingdom (UK). Almost a quarter of the country's output and broadly 30 per cent of its economy-related tax take is generated in the capital. Any threat to London's economic resilience is also a threat to other regions. The uncertainty which has followed the result of the European Union (EU) referendum is unprecedented in recent times. The robustness of London's outward-looking and globally successful economy is more than ever important to the Exchequer

and to UK economic growth. There is a need for urgency as the UK is likely to have started the process for leaving the EU by the end of the current financial year. The Mayor of London, Sadiq Khan, re-convened the London Finance Commission (LFC) to assess which powers London needs to manage this uncertainty. This report outlines a number of policies which the Commission believes will create the conditions for London to grow.

The LFC's first report, commissioned by the previous Mayor, Boris Johnson, had proposed a modest devolution of tax-raising powers to London. Under these 2013 proposals, council tax, business rates, stamp duty and property-related capital gains tax would have been fully devolved to London's government. The proposed reform was intended to provide incentives for economic growth, to allow the more effective use of taxpayers' resources and to offer the possibility of improving the operation of property taxes.

Subsequently the Government has taken modest steps towards the further localisation of business rates, though there has been no movement on the LFC's other proposals. However, in the same period, Scotland and Wales have been offered a more radical package of devolved tax powers, including the control of part of income tax, while proposals have been made for Northern Ireland to vary corporation tax rates.

The LFC welcomes the steps already taken by the Government since 2013. It is important that the work currently under way in relation to business rates and service devolution continues and that it grows in pace and ambition. Looking ahead, the Commission is concerned with possible further improvements which could immediately build on what is currently being achieved by the Government, the Mayor and the boroughs, not least to support higher rates of economic growth.

It cannot be assumed that the current degree of fiscal centralisation within the UK is the only way of doing things. Whilst successive Governments have been unwilling or unable to take substantive steps towards a more devolved country, global political trends suggest that 'business as usual' is unlikely to prove popular with voters. There are many ways of interpreting the EU referendum vote, though it would be hard to view the 'leave' majority as a ringing endorsement of the current use of centralised power by a small political elite, be it in Brussels or at Westminster. Polling conducted for the LFC and elsewhere shows that the public

is more supportive of sub-national politicians than distant ones within central government.¹ The stakes for democracy, both in the UK and elsewhere in the West, are now very high. The EU referendum result makes the public's view of the operation of UK democracy even more important now than before. If policy steps taken in the near future by the UK government do not meet the expectations of an electorate which has expressed a desire for better and more sensitive public policy, there is likely to be a further political reaction against the traditional institutions and outcomes of Westminster and Whitehall.

In May 2017, elections will be held for new city-regional mayors in several areas of England outside London. A number of the devolution deals recently struck with other localities go beyond the powers already vested in London's government. It has become clear that devolving power to different parts of the UK is a dynamic process where there is step-by-step progress over time. This report seeks to build upon the logic of the Government's recent approach to devolution by outlining a framework which would allow iterative steps to be taken to achieve further devolution of taxation and expenditure to London. The LFC's view is that this will increase economic output in London and the UK.

The vote to leave the EU makes the case for further devolution more acute. The risks and opportunities that the EU referendum result creates affect the country not only at the national level but within its nations, regions, cities and other localities in different ways. These uncertainties are often more effectively and efficiently managed at the local level. London's government is well placed to support business and residents and to prioritise investment in areas that enable economic growth.

The LFC recognises that facilitating London's further economic success could be construed as unfair to the rest of the country. This view risks misunderstanding the role London plays in supporting economic activity across the whole of the UK. There is not a fixed total of UK GDP and the evidence suggests that London's growth and that of the UK as a whole are closely intertwined because of their strong mutual dependencies (in trade, supply chains and so on). Nor is it the case that part of a successful city-regional economy can be moved by diktat from one part of the country to another. Such efforts in the past, particularly the 1960s and 1970s, were not crowned with glory. London attracts international investment which would otherwise go elsewhere in the world – to New York, Singapore or Frankfurt – rather than elsewhere in the UK. Investment in London is investment in the UK. To ensure the capital remains attractive to such mobile resources, the Government needs to ensure the means are provided to sustain the city's attractiveness.

London already contributes significant amounts of the UK's tax revenue – £127 billion in 2013/14. This sum is well in excess of the total public expenditure devoted to London (£93 billion in 2013/14) which means that London generated a net fiscal contribution of £34 billion in 2013/14. The capital also enjoys a positive economic relationship with the rest of the UK, buying and selling goods and services across sectors. Far from isolating London from the UK, devolution has the potential to strengthen the economic integration of different areas of the country by allowing city and county regions to adapt their policies to local circumstances and thus improve outcomes that contribute to economic 're-balancing'.

When London grows, the UK grows. In taking on more fiscal and service responsibility, there would be a stronger incentive for sub-national governments to assess how best to use the resources available to them to generate economic growth. Such resources include investment in London with its leading global position and sectors of relative competitive advantage

1 GLA Intelligence (2016), 'Tax and Public Spending Priorities'.

within the European economy. London's trade with the UK will also grow as the city grows. The capital already trades extensively with other areas of the UK; Transport for London (TfL) contracts alone buy goods and services from Scotland to Cornwall and are worth millions to local companies across the UK. Further devolution offers a new model of economic growth for the UK at a time of significant uncertainty.

Moreover, despite its apparent affluence, London has the largest concentration of deprived communities and households in the UK. At present, the centralised nature of UK government makes it virtually impossible for the Mayor and the boroughs to bring about the required structural change to address the types of inequalities Londoners face, from housing to household income. London's government² works within a structure where Whitehall ministries continue to maintain control over funding for the welfare system, skills, schools, the health service and over much housing policy. This control limits the ability of London's government to tailor provision at the local level or to align funding and delivery to provide high-quality services and achieve greater cost efficiencies. Devolution to London would allow the city's government to develop bespoke policy for its citizens and manage its budget efficiently across areas of policy, rather than be tied to a mix of funding streams channelled through government departments and other agencies. Similarly, further devolution to other city regions would allow them, also, to govern for their needs. The national economic strategy and the many sub-national ones must work together and be consistent.

This report makes the case for a more radical devolutionary settlement for London. It argues that by giving London's government greater power over the tax base and public services, the capital's leaders would be provided with stronger incentives to develop its economy and opportunities to reform public services. The rationale for more devolution should not be seen as an attack on Whitehall. Rather, by giving London and other city/county regions additional fiscal and service powers, it will be possible for central government to concentrate first on delivering a post-referendum settlement and then on making the UK government a more responsive and efficient enterprise.

Particular thanks go to Bradley Few, Julia Harrowsmith, Taher Hussain, Akshay Kaul, James Lee, Luke Rigg, Jeremy Skinner, Matthew Waite, Michelle Warbis and Mark Wingham for their excellent support to the Commission. Without their support, nothing could have been achieved.



Tony Travers

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January 2017

² "London's government" is used throughout this report to mean the Greater London Authority (comprising the Mayor and London Assembly) and London's 33 local authorities together.

Executive summary

PART 1: INTRODUCTION AND BACKGROUND

The Mayor of London, Sadiq Khan, reconvened the LFC in July 2016 to further consider the tax and spending arrangements of the capital, particularly in the wake of the EU referendum result in June 2016 and of the evolving process of devolution in the UK since the first report of the LFC, *Raising the Capital*, in May 2013.

Commissioners were drawn from local government, Parliament, the London Assembly, the Mayor's Office, think tanks, the voluntary sector and business. We met approximately every fortnight over the latter half of 2016 to commission evidence and deliberate. An interim report was published on 11 October 2016.

The Commission learned there have been significant developments in Scotland and Wales with regard to devolution since 2013, when the LFC last reported. Some progress has also been made in English cities, although a number of other commissions and reports since the original LFC have recommended a more ambitious programme of fiscal devolution at the sub-national level. The most significant development is a major proposed reform to business rates, which from 2020 is expected to be fully retained by English local government, albeit subject to complex residual equalisation constraints.

As in the first report, *Raising the Capital*, we agreed to judge any options we were considering against five core principles: accountability, transparency, efficiency & effectiveness and autonomy & fairness. These principles underpin good government and, we believe, are prerequisites for promoting jobs and growth. We have been keen to base all our work on evidence and to develop recommendations with cross-party support.

The main argument set out in our report is that a broader tax base with stronger fiscal controls at the local level will support the delivery of more integrated and efficient services and increased infrastructure investment, while allowing for the reform of individual taxes.

PART 2: EVIDENCE

We sought evidence in a variety of ways. A formal call for written evidence lasted from August until October and received a number of submissions. Four oral evidence sessions were held, two in London, one in Birmingham and one in Manchester. We updated the poll of adult Londoners originally conducted in 2012/13, as well as the international comparison study conducted by the University of Toronto for the first LFC. We also revisited and updated all the original charts and tables in *Raising the Capital* and carried out a further literature review.

Ten key findings arose from this extensive consideration of the available sources of evidence.

1. Londoners support fiscal devolution, irrespective of age, gender, race, location and wealth, both in general terms and with regard to specific tax devolution measures, which includes devolving stamp duty, allowing London's government to reform council tax, and assigning to London's government a small proportion of income tax and VAT.
2. Government in the UK is heavily centralised compared to its international peers. Most other cities have many more tax revenues available to them. The scope and potential for tax devolution to London is therefore significant.

3. Recent evidence from the OECD suggests that fiscal decentralisation can help reduce regional imbalances as it provides a strong incentive to use available economic resources more efficiently.
4. Other international evidence suggests that fiscal devolution also has positive impacts on accountability, business mobility, resilience, fairness and efficiency.
5. Within the UK, evidence from the oral sessions suggested that devolution (including devolution to London's government) commanded widespread support among civic leaders, think tanks and regional business groups. Common themes cited in favour of devolution included accountability, taking control, enabling innovation, focusing on distinct local challenges and incentivising growth, adaptability, governing capacity and fairness.
6. Community groups in London support devolution but warned against bad devolution deals (services devolved with insufficient funding) and the devolution of services to local government that may be regarded as secondary to its main purposes. They also seek devolution below the level of local government, directly to communities and individuals.
7. This chimed with the academic evidence we reviewed, which suggests that different decisions are best made at different spatial scales, from the national to the very local. The weight of evidence suggests that the UK has not yet achieved the most effective distribution of power.
8. The EU referendum result provides an opportunity not just to consider how powers are regained from the EU, but how all governmental powers may be better distributed.
9. Business wants specific protections to prevent unreasonable tax increases as a general condition for supporting devolution.
10. Devolution to London could lead the way for other cities and vice versa.

PART 3: LONDON AND UK GROWTH AFTER 2016

The UK's vote to leave the EU has created significant uncertainty in relation to the country's future economic path. It is our view that, given its combination of economic strengths, the capital is likely to be resilient in the face of the EU referendum result, but its long-term success cannot be taken for granted. Continued success will inevitably depend on good trading relationships and arrangements after the country exits the EU. We believe the post-referendum context strengthens the case for further fiscal devolution to London's government because it will enable the capital to make long-term commitments at a time of uncertainty. Such commitments might range from constructing infrastructure, building new homes and addressing the causes of long-term unemployment. While it focuses on negotiating the UK's exit from the EU developing new trading relationships, UK national government should afford London and other cities more freedom to manage their own affairs through fiscal devolution.

PART 4: FISCAL POWERS

As we outlined in our first report, any devolution of tax powers would be neutral from day one and would not result in tax increases at the point of devolution. Rather, the rationale for fiscal devolution is that it would incentivise London's government to grow its tax base, including by investing in infrastructure. This would diversify the range of taxes at its disposal, allowing it to manage its income and expenditure more fairly and securely – reducing its reliance on business rates. It would also enable London's government to reform the taxes under its control in favour of a more efficient system, for example to promote a better functioning housing market.

Property taxation

Building on the original LFC recommendations, we consider that the case for sub-national control over property taxes in England is even stronger following the successful devolution of tax-raising powers to Scotland and Wales. We continue to recommend the devolution of the full suite of property taxes, including council tax, business rates and stamp duty to the capital.

Potential for additional fiscal powers

The LFC recognises that devolution is a process and not a one-off event. London should benefit from substantial further devolution of services and we would encourage the Government to devolve powers over many areas of domestic policy to London's government, such as health, education, skills, transport and economic development. Other major cities including New York, Tokyo and Berlin are already responsible for a far wider range of services than London. In order to support the devolution of more services, London would need a broader revenue base. The LFC recommends the assignment of a proportion of income tax and VAT yields, increasing as and when services devolution occurs and when major capital projects are agreed. This further reform would have the advantage of incentivising growth in the tax base and it would provide a stable base against which London's government could prudently borrow for capital investment.

We recommend that the Government devolves the proposed apprenticeship levy, due to be implemented from 2017, to London's government, alongside other skills and employment budgets. This change would allow London's government to better design services in line with business needs, and in the longer run the purpose of the levy (and, indeed, whether or not it is needed) should be at the complete discretion of London's government.

Levies on property development

London's government has access to a range of property-related additional charges, including the business rate supplement for Crossrail 1, Section 106 payments and the mayoral and borough Community Infrastructure Levy. We are convinced that if London's government had the power to manage the full suite of property taxes and levies and had permissive powers to develop new mechanisms (subject to consultation with those who pay such revenues), it could develop more consistent, coherent and economically logical approaches, which would foster rather than hinder growth. We recommend full devolution to London's government of such additional charges.

Other minor taxes and levies

The Commission considers that London's government should have access to a range of locally specific taxes and levies designed to support culture and tourism, improve health outcomes, benefit local communities or create a better environment. The possibility of extending the congestion charge exists already, and it will probably be necessary to revisit the issue of a wider charging area in the near future.

Crossrail 2 and other major infrastructure projects

The LFC welcomes the commitment from the National Infrastructure Commission (NIC) and the Government to the Crossrail 2 project. The Government needs as a matter of priority to give consideration to helping London develop other funding sources for the major transport, housing and other capital investments that will be needed to maintain a successful and growing city. For Crossrail 2, the most plausible and acceptable of the many options we have seen to facilitate its funding and financing would appear to be the retention of at least some of the anticipated growth in London's business-rate yield revealed by future revaluations.

The full devolution of all property and minor taxes, as we recommend, combined with the assignment of modest proportions of income tax and VAT will enable greater borrowing for the investment needed to sustain London's growth (even taking into account the additional service responsibility that such a significant transfer of taxes would imply). The same principle could apply to the Greater South East and other areas that are growing economically. There may be scope to consider how a regional package of investment could be funded.

Land value uplift

Short of full property tax devolution, it may be possible and, indeed, necessary to develop mechanisms which tax some of the value uplift on property catalysed by public capital investments, such as in transport or regeneration schemes. As a first step, the Government should work together with the boroughs, the Greater London Authority (GLA) and TfL to develop a consultation paper on the objectives, principles and design options of a land value capture charge. Early analysis suggests such mechanisms could make a material difference to the funding of new transport infrastructure in London.

There is potential to combine property taxation measures with coordinated planning and development to both drive the delivery of transport and housing and to significantly improve the extraction of value from new development around transport hubs. The LFC considers that the GLA and TfL should work with the Government, local authorities and the development industry to improve the consolidation of public and private land for development around major transport investments such as Crossrail 2, including through innovative land pooling and auctioning arrangements, with an equitable sharing of risks and rewards between the private and public sectors.

PART 5: GOVERNANCE AND REFORM IN LONDON

The Commission is very conscious that our proposals, while neither radical by international standards nor in relation to devolution to Scotland and Wales, would represent a substantial break from recent practice and a step change in English devolution. As such, the implementation of these proposals would need an agreed timetable, with careful consideration given to the overall framework for devolution, the governance of decisions and the administrative resources and skills required to manage new powers.

Informal governance mechanisms involving the Mayor and the boroughs have built up over time and reflect a maturity in London's government that respects the two spheres of sub-national governance within the capital. The Commission recognises that more formal governance arrangements will be required to deliver more radical devolution and to facilitate shared decision making on certain issues. As such, we endorse the key principles that have previously been agreed and propose the development of governance mechanisms relating to particular taxes. We recognise the role of the London Assembly in scrutinising the Mayor's actions in relation to existing and any new functions.

If substantial devolution were to be granted, we recommend that London's government explicitly balance growth incentives with equity considerations as part of the governance arrangements. In Scotland, Wales and Northern Ireland, equalisation decisions are made within the nations themselves. We recognise that London would be different, in that there would need to be arrangements to allow both the Mayor and the boroughs jointly to administer matters relating to equalisation and redistribution. But the precedent for the sub-national operation of tax and equalisation has already been set.

PART 6: LONDON, ENGLAND, SCOTLAND, WALES AND NORTHERN IRELAND

The arrangements for devolution in Scotland and Wales have now largely matured, though additional steps are currently being taken to transfer further tax powers to both nations. The question of the English dimension to UK devolution has not been fully worked through. London is the obvious place to begin the process of more radical devolution within England – given that it is the UK's largest city, it was included in the original 1999 devolution settlement and its population is larger than those of Scotland and Wales taken together. The proposals within this report for London should be seen as making the case for a more devolved and better governed England.

Recommendations

DEVOLUTION

1. London's government should continue to work with national government to secure further fiscal and service devolution, including in transport, skills, employment, housing, planning, healthcare, criminal justice and economic development (*Part 4, Chapter 3*).

TAX AND REVENUES

Income tax

2. London should initially be assigned a modest percentage of its income tax yield to increase as and when service devolution occurs or to be hypothecated to fund major capital projects. Such a transfer would mean that grant support could be kept to a minimum or avoided altogether (*Part 4, Chapter 3*).

VAT

3. If a larger share of public expenditure were to be devolved to London, the possibility of assigning a proportion of VAT should also be considered (*Part 4, Chapter 3*).

Property taxes

4. We endorse the recommendations in *Raising the Capital* that the full suite of property taxes should be devolved to London's government – council tax, business rates, stamp duty, annual tax on enveloped dwellings and capital gains property disposal tax (*Part 4, Chapter 1*).

Council tax

5. The operation and setting of council tax should be devolved to London's government. Growth in the tax base should be retained locally as should the power to set rates. Council tax should be a local revenue which, in addition to delivering resources to fund local services, would provide an incentive for London's boroughs and the GLA to build up the tax base. The number of council tax bands and the amount charged from band to band could be reformed to reflect market conditions (*Part 4, Chapter 1*).

Stamp duty

6. Stamp duty on domestic and commercial properties – and related levies – should be devolved to London's government. The amount collected in council tax and stamp duty could be considered together, striking a balance between the annual taxation of property and the taxation of transactions. At the moment they are considered in isolation, in part because they are, to a significant degree, set nationally (*Part 4, Chapter 1*).

Business rates

7. The operation and setting of business rates (including setting the multiplier) should be devolved to London's government. To protect business rate payers, the multiplier should be linked to changes in council tax. London's government should also be granted full control of business rates reliefs, including the flexibility to introduce a more effective relief scheme for small businesses which reflects the capital's higher rental values (*Part 4, Chapter 1*).

A LONDON VALUATION OFFICE

8. A London Valuation Office should be set up that could consider improvements such as annual (or at least more frequent) revaluations to London's local taxes (*Part 4, Chapter 1*).

LAND VALUE CAPTURE

9. Short of full property tax devolution, the Government should work together with the boroughs, the GLA and TfL to develop a consultation paper on the objectives, principles and design options of a land value capture charge (*Part 4, Chapter 6*).
10. National government should work with London's government to trial the operation of a land value tax pilot on undeveloped land (*Part 4, Chapter 2*).

SMALLER REVENUES

11. The apprenticeship levy, due to be implemented from 2017, should be devolved to London's government in order to fund a wide range of skills and employment initiatives in the capital, as decided by London's government. In the longer term, it should be for London's government to decide whether or not to retain such a levy, at what rate and on what to spend it, in consultation with business (*Part 4, Chapter 3*).
12. We recommend the hypothecation of a share of London's contribution to VED (Vehicle Excise Duty) revenue for improvements of nationally strategic roads within the capital, accepting there may need to be other reasonable changes in the tax and revenues system to ensure that fiscal neutrality is achieved, and that there is benefit to London from national roads such as the M25. This would help to avoid unfair (and unfairly perceived) cross subsidisation, both from public transport fare payers to fund the London road network and from London car drivers to fund the road network elsewhere in the country (*Part 4, Chapter 4*).
13. UK government should consider devolving air passenger duty (APD) raised in London to London's government so that it has the flexibility and autonomy to consider making local adjustments to the tax and to provide more diverse sources of revenue. (*Part 4, Chapter 4*).
14. London's government should be able to introduce new smaller taxes and the government should pass permissive legislation that would make such changes straightforward to implement. In particular, we recommend the following smaller taxes for further exploration: a tourism levy, health-related taxes and a community levy (*Part 4, Chapter 3*).
15. National government should work with the GLA, London Councils and other local authorities to consult on the potential operation of a tourism levy and the devolution of the power to set such a tax in the city to London's government, subject to effective consultation and due process (*Part 4, Chapter 3*).
16. In the near term, London's share of the soft drinks industry levy should be retained within the capital, with a longer-term view to devolving it fully, including the ability to set the rate. In the longer term (post 2020), there is a case to devolve other health-related taxes, including a sugar sales tax and a saturate fat tax so that such levies were fully managed by London's government (*Part 4, Chapter 3*).
17. Other minor taxes could include the power to introduce a small community levy to fund discrete projects 'owned' by Londoners. This could approximate to existing models, such as Business Improvement Districts (BIDs), allowing the creation of 'Community Investment Districts'. Such levies would possibly be more modest in scale than BIDs but would be the

result of a democratic process in which London's diverse communities play an active role in initiating, endorsing and ensuring accountability. It could be used to leverage additional funding to increase the overall investment opportunity (*Part 4, Chapter 3*).

GRANT REDUCTIONS TO OFFSET NEW TAX POWERS

18. Any new tax powers for London should be neutral on 'day one' – with arrangements in place to guarantee this neutrality. Thereafter, London's newly-strengthened governance arrangements would have to assume responsibility for ensuring there was negotiated fairness between individual boroughs and the GLA (*Part 5, Chapter 3*).

FEES AND CHARGES

19. London's government should have permissive powers to develop new mechanisms for managing charges on property development (*Part 4, Chapter 2*).
20. Local authorities should be able to recover the full costs of services, even for charges currently set at the national level (*Part 4, Chapter 4*).
21. Central controls should be removed on planning application fees, building control charges, land searches and licencing fees. Such fees and charges should be audited locally to avoid cross-subsidisation of other functions (*Part 4, Chapter 4*).

INFRASTRUCTURE FUNDING

22. The GLA, TfL and London Councils with their counterparts in the rest of the South East, should consider developing a strategic transport and infrastructure funding proposal for submission to the Government by the time of the 2017 Autumn Budget. These organisations should also work with the National Infrastructure Commission to collect evidence for the National Infrastructure Assessment (NIC) (*Part 4, Chapter 6*).
23. As an interim measure, prior to full devolution, the Government should consider extending the principle of tax increment finance (TIF) to other taxes, including stamp duty (*Part 3, Chapter 2*).

GOVERNANCE AND EQUITY

24. If substantial devolution were to be granted, London's government should explicitly balance growth incentives with equity considerations as part of the governance arrangements (*Part 5, Chapter 1*).

LONG-TERM INCENTIVES

25. Any future reforms made to London's fiscal and financing arrangements should not be negated by central government periodically adjusting grant resources available to the city beyond the reduction required at the point of original tax reform. An agreed formula would need to make certain that there is no undue and unsustainable shift of resources between London and the rest of the UK in the longer term. Such arrangements would resemble those required for Scotland and Wales when income tax is partly devolved (*Part 5, Chapter 3*).

1 Introduction and Background

In Part 1 we explain the circumstances in which the LFC was re-established, detail how it approached its work, compare the progress towards devolution in Scotland and Wales to that in other areas of England, and discuss the various similar reviews that have taken place since the first LFC report in 2013.

PART 1, CHAPTER 1

Introduction and background to the Commission

1. The LFC was reconvened to help the Mayor and London boroughs improve London's tax and public spending arrangements in order to promote jobs, growth and greater equality.
2. Professor Tony Travers of the London School of Economics and Political Science (LSE) chaired the LFC. Its members were drawn from different political parties, the private sector, London's communities and relevant professions from across and outside London.³
3. The terms of reference include a number of objectives: to review and assess existing arrangements for government funding of London, to examine the relative scale and distribution of London and the UK's public expenditure, to examine options for change as the UK's relationship with the EU is renegotiated, to set out the advantages and disadvantages of a number of options and to make recommendations which are in the best interests of the UK as a whole.
4. The LFC's work builds on its first report, *Raising the Capital*, which focused on the need for infrastructure investment to support the capital's growth. Stronger fiscal powers – starting with the devolution of the full suite of property taxes and the relaxation of restrictions on borrowing for capital investment (while retaining prudential rules) – would provide additional opportunities for capital expenditure in London's infrastructure to support economic growth. The Commission continues to make this case but makes further proposals in relation to the devolution of revenue funding and spending on services. The main argument set out in this report is that a broader tax base with stronger fiscal controls at the local level will support the delivery of more integrated and efficient services and increased infrastructure investment.
5. No one should be naïve about the likelihood that a Commission of this kind will immediately convince the Government of the need for change. 2016 was the 40th anniversary of the publication of the Layfield Committee's report⁴ which made proposals to reform the financial basis of British local government – but from which very little change resulted. There have been many similar reports since, including recent ones making proposals for reform in England, in Scotland and in Wales. Governments in London, Edinburgh, Cardiff and Belfast appear to remain unconvinced that we should move from the existing highly centralised arrangements to ones that would be more locally sensitive. But unless change comes, weaknesses in current systems will become ever more obvious and the risk of unexpected electoral and political reaction all the greater.

3 Official observers were: John O'Brien (Chief Executive, London Councils), Martin Clarke (Executive Director – Resources, GLA), Jeff Jacobs (Head of Paid Service and Executive Director, GLA), Akshay Kaul (Principal, Commercial Finance, TfL), Guy Ware, (Director of Finance, Performance and Procurement, London Councils), Julian Ware (Senior Principal, Commercial Finance, TfL). Secretariat: James Lee (Senior Policy Officer, Economic and Business Policy, GLA), Jeremy Skinner (Head of Economic Growth, GLA).

4 Layfield Committee (1976), 'Layfield Report of the Committee of Inquiry into Local Government Finance'.

PART 1, CHAPTER 2

UK Devolution: Scotland, Wales, Northern Ireland and England's city regions

1. This chapter provides an update on the devolution arrangements in Scotland, Wales, Northern Ireland and England's city regions since the publication of *Raising the Capital*, in 2013. It also makes brief reference to the Northern Ireland Assembly.
2. Political events, most notably the EU referendum, the Scottish independence referendum and the creation of city and city-region devolution deals have raised the profile of devolution and have increased the pace of delivery. Developments in devolving further powers to Scotland, Wales and the English city regions have increased as the UK government has become more confident that such deals will enable greater accountability and decision-making through localised planning and delivery.
3. It is in this context that we set out the rationale for London to secure more devolved powers.

SCOTLAND

4. Following the Scottish independence referendum result to stay in the UK, the UK government set up the Smith Commission. Smith reported in November 2014 and recommended a series of additional devolutionary changes for Scotland, such as increased borrowing powers and the ability to set income tax rates and thresholds.
5. The Smith recommendations focused on increasing the accountability of the Scottish Government. There was also an implicit growth incentive behind the move to devolve further powers to Scotland, including indexing future growth to reductions in the block grant. The fiscal framework agreement between the two Governments made this explicit: *"Both the Scottish Government and the UK government are committed to financial responsibility and democratic accountability, incentivising the Scottish Government to increase economic growth while allowing Scotland to contribute to the United Kingdom as a whole."*⁵
6. Changes to funding in Scotland are significant. From 2016, a new Scottish rate of income tax is calculated by reducing the basic, higher and additional rates of income tax levied by central government by 10 pence in the pound and adding a new equivalent Scottish rate set by the Scottish Parliament. From April 2017, the Scottish Government will have full control over income tax rates and thresholds for non-savings and non-dividend income.
7. A new Scottish land and buildings transaction tax replaced the UK stamp duty land tax in 2015, as well as a new Scottish landfill tax to replace the UK equivalent. In addition, the receipts raised in Scotland by the first 10 percentage points of the standard rate of VAT will be assigned to the Scottish Government's budget, starting in 2019/20. The Scotland Act 2016 also allows for new taxes to be created in Scotland.

5 UK Government (2016), 'The agreement between the Scottish Government and the United Kingdom Government on the Scottish Government's fiscal framework' https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/503481/fiscal_framework_agreement_25_feb_16_2.pdf

8. The Scottish Government will also be reforming council tax from April 2017 with the introduction of higher multipliers for properties in Bands E to H. This is expected to raise approximately £100 million. The additional revenue will be invested in schools through future local government settlements.
9. The block grant, still calculated according to the Barnett formula, will be reduced by an amount equivalent to the revenues from devolved taxes, most notably the Scottish rate of income tax. Therefore, the deal should not affect overall spending levels in Scotland but should diversify the sources of funding and transfer more power to the Scottish Government. Moreover, the Government's command paper relating to the Smith Commission made it clear that devolving fiscal powers, in this case to a Scottish rate of income tax, would incentivise growth and consequently offset the reduction in income from the central government block grant:

*"The Scottish Government is therefore incentivised to grow the Scottish economy (using all of its tax and spending policy levers) as this has a direct impact on its budget, but it is shielded from UK-wide shocks that the UK Government is better placed to manage."*⁶

WALES

10. The Silk Commission, established by the UK government, reported in two parts: on devolved fiscal recommendations for Wales in November 2012 and on the wider powers of the National Assembly for Wales in March 2014.
11. The recommendations in both parts of the report formed the basis of the Wales Act 2014, which devolved stamp duty, landfill tax and business rates to Wales, along with a series of devolved constitutional and governance powers. The Act also established powers to set a Welsh income tax rate, subject to a referendum.⁷ The Commission made clear its recommendations reflected a rationale that future devolution would incentivise growth in the country and therefore benefit the rest of the UK.
12. The UK government issued a command paper in February 2015, *Powers for a Purpose: Towards a Lasting Devolution Settlement for Wales*. This set out a blueprint for the future of devolution in Wales to make the Welsh settlement clearer and more stable and long lasting. It acknowledged that the set of fiscal powers devolved to the Welsh Government represented 'a package tailored for Wales and the specific circumstances of Welsh devolution'.⁸
13. Since April 2015 the Welsh government has had full responsibility for the administration of business rates including setting the multiplier, offering business rates reliefs and holding its own revaluations conducted by the Welsh arm of the Valuation Office Agency.
14. The Wales Bill, currently before Parliament will, if passed, remove the requirement for a referendum for the transfer of powers to set income tax rates in Wales.

NORTHERN IRELAND

15. The regional rate (domestic and commercial) and air passenger duty (for direct long-haul flights) have been devolved, along with some additional borrowing powers.

⁶ UK Government (2015), 'Scotland in the United Kingdom: An enduring settlement'

⁷ The requirement to hold a referendum is removed in the Wales Bill currently before Parliament.

⁸ UK Government (2015), 'Powers for a Purpose: Towards a Lasting Devolution Settlement for Wales' https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/408587/47683_CM9020_ENGLISH.pdf#page=6,

16. Northern Ireland does operate its own business rates system and uniquely has retained a domestic rating system which was abolished in the rest of the UK in the late 1980s/early 1990s. The valuation of domestic and non-domestic properties, as well as the billing of ratepayers, is conducted by the Land and Property Services arm of the Northern Ireland Government's finance department. For both taxes there is a regional rate set by the Northern Ireland Government paid at the same rate across the province and a local rate set by the 11 local district and city councils.
17. The Northern Ireland Corporation Tax Act 2015 devolved the rate-setting power for corporation tax in Northern Ireland to the Northern Ireland Assembly for trading profits only, subject to a commencement order. The Assembly has the power to set a Northern Ireland corporation tax rate and it is expected that the new rate will change to 12.5 per cent from 1 April 2018. This measure was seen as necessary to address the common objective of the UK government and the Northern Ireland Executive to rebalance the Northern Ireland economy, to increase the size of the private sector and to drive faster economic growth in Northern Ireland.⁹ It was also seen as necessary to allow Northern Ireland to compete with lower corporate tax rates in the Republic of Ireland.
18. The Northern Ireland Assembly maintains its devolved powers over welfare policy and legislative matters excluding those expressly reserved to the UK government.

LONDON

19. The Mayor of London and London borough leaders have driven a programme of work in pursuit of devolution and reform of public services in London.
20. In 2016 the Mayor and the Chancellor agreed to a process of negotiations between the GLA, London Councils and HM Treasury officials in the run up to the Autumn Statement. The discussions focussed on the following key areas: fiscal devolution, housing and planning, skills, transport, criminal justice and health. The latter followed the signing in 2015 of the London Health and Care Collaboration Agreement between the Mayor, London Councils and other health partners. This established five devolution pilot schemes which are being run in the capital.
21. The Autumn Statement 2016 signalled progress in some of these areas, confirming the devolution of the post-19 Adult Education Budget and the Work and Health Programme. The Government also committed to continue "to work with London to explore further devolution of powers over the coming months". Discussions are ongoing with HM Treasury and this report of the LFC provides a further stimulus to discussions on fiscal devolution.
22. London's government has proposed ambitious reforms for a devolved London business rates retention system in response to the Government's proposals for 100 per cent business rates retention across local government by 2020. In the meantime, London will be one of five areas in the country chosen to pilot elements of the reforms from April 2017, ahead of the full implementation expected in April 2019.
23. The Government has confirmed that TfL's capital grant and the GLA's revenue support grant – totalling over £1.1 billion – will be financed from locally retained business rates. This will increase the locally retained share in London from 50 per cent to more than two thirds with a progression to 100 per cent expected before the end of this Parliament.

⁹ UK Government (2015), 'Corporation Tax: Devolution of rate-setting power to Northern Ireland' <https://www.gov.uk/government/publications/corporation-tax-devolution-of-rate-setting-power-to-northern-ireland/>

24. Ultimately the ambitions of London's government, like those of the LFC, lie in a broader approach to fiscal devolution that would allow the management of risk, economic growth and fiscal reform through a balanced package of devolved revenue streams.

ENGLAND'S CITY AND COUNTY REGIONS

25. The retention of 50 per cent of business rates to local authorities in 2013 was followed by a commitment to retain 100 per cent of rates by the end of the current Parliament, expected to be 2020. This reform will represent a full transfer of business rates from central to local government, with more autonomy given to local authorities to incentivise business growth by increasing the size of the business rate base.
26. In January 2016 the Cities and Local Government Devolution Act was given Royal Assent and thus initiated the formation of combined authorities and city regions, creating a stronger governance arrangement which, in the Government's view, would allow the devolution of further powers to city and county regional areas consisting of groups of councils. The Government also required that these new groupings should be led by a directly elected mayor.
27. In the remainder of this section, we consider the detail of the devolution deals accorded to different English cities. It should be noted that none of these deals include any significant fiscal devolution.

GREATER MANCHESTER

28. The UK government agreed a devolution deal with Greater Manchester's 10 districts in November 2014. The deal began to devolve powers to the newly created Greater Manchester Combined Authority. Since then the devolution deal has expanded and in its present form covers health and social care expenditure worth £6bn and a 30-year investment fund worth £900m. The deal also changes the governance arrangements in Greater Manchester, including through the creation of a directly elected mayor for the region who will take office in May 2017. The mayor will also be the police commissioner for the area.
29. The devolution deal includes the transfer of powers from the UK government to the region's new directly elected metro mayor and combined authority in relation to transport, further education, skills, housing (a £30m per year Housing Investment Fund), business support and integrated health and social care.

LIVERPOOL

30. A devolution deal was confirmed by the UK government for the creation of a Liverpool City Region in November 2015, with extended powers confirmed in March 2016. The deal included the creation of a directly elected city-regional mayor who will take office in May 2017, though in contrast to neighbouring Greater Manchester the mayor will not be the police commissioner.
31. The devolved powers available to the area's directly elected mayor cover housing, further education, skills, transport and planning, with additional responsibilities to plan for health and social care integration.

SHEFFIELD

32. The Sheffield City Region devolution deal was launched in December 2014, with extended

powers confirmed in October 2015. At present, the deal represents a 30-year investment fund worth £900 million and directly-elected-mayoral powers encompassing transport, housing, further education, skills and additional responsibilities to plan for health and social care integration.¹⁰

WEST MIDLANDS

33. The West Midlands Combined Authority was formed by means of a devolution deal signed in November 2015. The agreement will allow the region to create an investment fund of over £1 billion through a 30-year revenue stream and locally raised finance. The new arrangement will involve a directly-elected mayor for the region in May 2017 and a transfer of powers over the transport budget, bus franchises and the adult skills budget.

CAMBRIDGESHIRE AND PETERBOROUGH

34. The Cambridgeshire and Peterborough Combined Authority, working with the directly elected Mayor from May 2017, will have devolved a new £600 million fund to support economic growth, development of local infrastructure and jobs, including major investment in transport schemes. Further to this, powers over strategic planning will be devolved, along with control of a £170m housing and infrastructure fund, the responsibility to create a non-statutory spatial framework for Cambridgeshire and Peterborough, transport powers including bus franchising and the ability to develop with the Government a Land Commission to inform the work of a new Cambridgeshire and Peterborough Joint Assets Board.
35. These funds will include control of a new additional £20 million a year funding allocation over 30 years, to be invested to the Cambridgeshire and Peterborough Single Investment Fund, to boost growth. Recognising the exceptional housing market conditions in Greater Cambridge, Government will provide the Combined Authority with an additional £70m over five years ring fenced for Cambridge to meet housing needs in addition to £100m for affordable housing and associated infrastructure across Cambridgeshire and Peterborough as a whole.
36. The Combined Authority will have responsibility for chairing an area-based review of 16+ skills provision, the outcomes of which will be taken forward in line with the principles of the devolved arrangements, and devolved 19+ adult skills funding from 2018/19. Joint responsibility with government and working with Norfolk and Suffolk to co-design the new National Work and Health Programme designed to focus on those with a health condition or disability and the very long term unemployed.
37. The Combined Authority will work more effectively with Government to boost trade and investment through agreement of a Joint Export Plan.

OTHER CITY AND COUNTY REGIONS

38. Devolution deals were also secured for city and county regions in England, including the Tees Valley, Cornwall, Greater Lincolnshire and Bristol (West of England). These deals generally involve powers such as the adult skills budget, mayoral development corporations and a consolidated transport budget, along with additional funding for investment in infrastructure.

¹⁰ Following a High Court judgement in December 2016, further consultation is being carried out in Chesterfield on the proposed governance changes. It is expected that the Sheffield City Region Mayoral election will be delayed as a result.

PART 1, CHAPTER 3

Recent reviews within the UK

COMMUNITIES AND LOCAL GOVERNMENT SELECT COMMITTEE, 2014

1. The Communities and Local Government Select Committee undertook an inquiry into devolution in England which examined the potential for the Government to adopt an approach to local government financing more akin to the fiscal powers being transferred to Scotland and Wales. It concluded that a system of further devolution should recognise spending needs while balancing incentives for local areas to build up their economies; that fiscal powers should be devolved to groups of local authorities; that place-based budgets should be allocated to cover a recognisable large-scale area; and that all of these recommendations would require a strong, locally agreed governance model.
2. The Committee recommended that local areas should be able to set and vary the business rate multiplier, combined with the power to vary the rate for specific projects and categories of business. It went further in outlining a number of suggestions for devolved areas – including London – and recommended establishing new council tax bands and a new levy to address disproportionate growth in devolved taxes. It also recommended that Government should consider options for local areas to retain a share of national taxes, such as income tax and VAT.

ROYAL SOCIETY OF ARTS (RSA) CITY GROWTH COMMISSION, 2014

3. The RSA's City Growth Commission was a 12-month independent inquiry, chaired by Lord O'Neill of Gatley, more recently Commercial Secretary to the Treasury, to examine how the UK's major cities could maximise growth and respond to future economic challenges. The Commission focused on city 'metros' – city regions which constitute a functional economy of cities, suburbs and surrounding areas with more than 500,000 people. Its ambition was to see complementary growth between London and other cities. In order to achieve this, the Commission considered the fiscal powers and governance arrangements needed and how public service reform could start to make cities more fiscally sustainable. Recommendations included the operation of planning, housing, science and innovation, skills and transport powers at the city-regional level. It agreed with the recommendations of the first LFC and argued strongly that to compete on the global stage UK metros need sufficient decision-making powers and flexibilities to become financially self sustainable.

SMITH COMMISSION, 2015

4. The Smith Commission was a cross-party commission set up under Lord Smith of Kelvin to conduct cross-party talks and put forward recommendations for further devolution of powers to the Scottish Parliament. The Commission was established as a result of a commitment from the three main Unionist parties (made during the independence referendum campaign) to devolve further powers to Scotland. The recommendations focused on strengthening the power of the Scottish Parliament through delivering more financial, welfare and taxation powers. The fiscal policy recommendations included the ability to set a Scottish rate of income tax, increased borrowing powers and the assignment to Scotland of a proportion of locally raised VAT.

5. The UK government put forward a bill based on the recommendations of the Smith Commission, which became the Scotland Act 2016.

THE INDEPENDENT COMMISSION ON LOCAL GOVERNMENT FINANCE, 2015

6. The Independent Commission on Local Government Finance was set up by the Local Government Association and the Chartered Institute of Public Finance and Accountancy. It was chaired by Darra Singh OBE. The Commission set out a programme for reform to support a local government funding system which would be stable for the long term, stimulate economic growth and enable local people to invest in the priorities for their community.
7. The Commission published its report, *Financing English Devolution*, in February 2014. The report recommended a series of reforms for all parts of the country, including the freedom to set council tax and council tax discounts and the retention of 100 per cent of business rates and business rate growth. It also adopted a differential approach by recognising the ability and willingness of some sub-national areas (city or county regions) to adopt a more ambitious reform programme. For these 'pioneer' areas, the Commission recommended additional powers, including single place-based budgets covering a full range of public services, the ability to vary council tax bands and to undertake revaluations as well as assignment of additional taxes, such as stamp duty, airport taxes and tourism levies. The Commission also recommended that the Government should work with local authorities to agree a timetable for fiscal devolution, adopting the Smith Commission's principles as a basis for reform.

COMMISSION ON LOCAL TAX REFORM, 2015

8. A commission, appointed jointly by the Scottish Government and the Convention of Scottish Local Authorities, considered the possibility of reforming local government taxation in Scotland. Its report argued that the current system of council tax should be abolished, with any replacement designed to be fairer and more progressive. It considered a number of different systems of local taxation, including a local income tax, radical changes to council tax and forms of land value tax. The potential impact and administration of these possible reforms was modelled in detail. However, the report did not advocate any particular alternative to the present arrangements, highlighting that "there is no one ideal local tax". Having made significant efforts to examine reformist options, the Commission observed:

"In contrast with previous attempts at reform, we are not persuaded that a single tax instrument can simultaneously deliver greater equity for taxpayers and autonomy for Local Government whilst also being efficient and readily implementable. A replacement system, therefore, would benefit from including multiple forms of tax which would allow local taxation as a whole to be fairer."

REFORM, DECENTRALISATION AND DEVOLUTION ALL PARTY PARLIAMENTARY GROUP (APPG), 2016

9. The Reform, Decentralisation and Devolution APPG, which comprised members of the House of Commons and the House of Lords, undertook an inquiry to investigate how devolution could be better achieved across the whole of the UK.
10. The Inquiry recommended changes to arrangements for devolved national, local-authority

and central-government powers in the UK. Under the Reserved Powers Model, it was argued that consensus should be sought on what functions should remain at a UK level. The Inquiry's other recommendations included further devolution to London to give local areas the freedom to determine their own governance structure, with or without a directly elected mayor, and the devolution of fiscal powers to local government.

PUBLIC ACCOUNTS COMMITTEE, 2016

11. The House of Commons Public Accounts Committee launched an inquiry, which focused on creating clear objectives and alignment among the UK's various city devolution deals. The Committee sought to clarify and recommend local scrutiny arrangements, ensuring accountability to the taxpayer.
12. The Committee published its report, *Cities and local growth* in July 2016, which made a series of recommendations to improve accountability and oversight of devolution deals. Specifically, it recommended that the UK government should be clear about the purpose and expectations of devolution deals and fully prepare local areas to ensure they have sufficient capacity and capability to deliver their objectives.

INDEPENDENT COMMISSION ON LOCAL GOVERNMENT FINANCE IN WALES, 2016

13. This Commission was appointed by the Welsh Local Government Association and the Chartered Institute of Public Finance and Accountancy. It proposed that business rates be retained in full by local authorities and that city regions and other sub-national groupings of authorities be given the power to introduce a supplementary business rate to pay for capital projects. It also proposed a revaluation of council tax as soon as possible and at least every five years thereafter and suggested that city regions or other sub-national groupings of authorities be given the power to reform bandings and the ratio of council tax payable from band to band. The Welsh Government was encouraged to legislate to introduce a permissive list of small local revenues for councils to use at local discretion. Finally, the Commission proposed that a locally retained share of Welsh Government income tax should be considered again, while local authorities should be given greater discretion over the range and level of fees and charges.
14. The Commission adopted a rather different approach from the 2015 Scottish commission. Whereas the Scottish report was radical in intent but suggested that politicians should consider which parts of the report they could reasonably implement with public support, the Welsh Commission was more pragmatic and incremental. This choice is one that all UK commissions of this nature face.

100 PER CENT RETENTION OF BUSINESS RATES: COMMUNITIES AND LOCAL GOVERNMENT (CLG) SELECT COMMITTEE JUNE 2016

15. The move to 100 per cent retention of business rates by 2020 is fundamental to the future of local authority growth and subsequent revenue. With this significant transfer of power, the Committee found that flexibility over the application of business rate retention would enable local government to increase rates as well as reduce them, as well as providing an effective lever to stimulate and foster economic growth. Additionally, extending the infrastructure premium beyond mayoral combined authorities would further encourage economic activity in local authorities.
16. Crucially, the Committee recommended that the move to full business-rate retention should help ensure that local authorities promote local growth and the wellbeing of

residents. Further devolution of fiscal powers to local authorities (including the ability to alter the multiplier, both to vary the level and to adjust it according to business types) would stimulate local economic growth. More generally, it was recognised that wider devolution of fiscal powers, including council tax, business rates and property taxes would assist local authorities in growing their economies and funding increased demands for services.

CONCLUSION

17. The growing body of reports described in this section demonstrates increasingly strong and broad support for fiscal devolution in England. While mindful of the relative inaction over many decades, we consider the wider discourse about fiscal devolution to strengthen the calls we make here.

PART 1, CHAPTER 4

Principles adopted in making recommendations

1. Our recommendations aim to improve governance in London, and we consider the duty to promote growth an integral part of good governance. While economic development is not an inevitable consequence of constitutional change, the system operated by sub-national governments should be such that the tax-setting authority can use it to encourage economic growth. We believe that the financial arrangements in place at present constrain economic growth and our recommendations seek to redress such constraints. We found no compelling evidence that the devolution of financial powers would risk reducing economic growth or success.¹¹
2. We also believe there are powerful democratic arguments for plurality of power within a modern democracy. At present, virtually all taxation in the UK is determined by central government. Only council tax (and, in England from April 2013, a proportion of business rates) can be seen as local taxation and even this tax is subject to cumbersome controls, including referendum procedures specified by central government (to which central government is not subject when adjusting its own tax rates if local authorities want to increase the tax rate). A democratic system where the centre determines virtually 100 per cent of taxation and imposes such constraints on local government fails by the standards of best practice in most OECD countries. See Table 1 below, which shows sub-national taxation as a proportion of GDP in a number of OECD countries. The UK is a significant outlier. We have approached our work mindful of this weakness in British democratic practice.

Table 1: Taxation revenue attributable to sub-national and central/federal government as a percentage of GDP, 2013

	Local government	State/regional government	Local and state/regional	Federal or central government	Social security	Total
Canada	2.8	12.1	14.9	12.7	2.9	30.5
France	5.8	0.0	5.8	15.1	24.0	45.0
Germany	3.0	8.0	11.0	11.5	13.9	36.5
Italy	7.1	0.0	7.1	23.6	13.1	43.9
Spain	3.2	4.5	7.7	13.8	11.1	32.7
Sweden	15.8	0.0	15.8	21.4	5.5	43.7
United Kingdom	1.6	0.0	1.6	24.9	6.2	32.9
United States	3.7	5.1	8.8	10.5	6.1	25.4
OECD total	3.9	4.9	8.8	20.4	8.4	34.2

Source: OECD Revenue Statistics

3. We have based our recommendations on an objective appraisal of evidence, both academic and that submitted by stakeholders, as appropriate.

¹¹ GLA Economics (2017) Working Paper 84: 'Relationships between devolution and economic growth' for a summary of the evidence and further analysis.

4. As was the case for the first LFC, we have adopted five principles to aid thinking and assess options systematically. Many are shared with other previous commissions on devolution and can be applied generally to assess good governance. They are not specific to London or sub-national government.

Principle 1: Accountability

There should be a link between spending decisions and taxes raised. The impact of spending decisions by government should be clear to taxpayers and should be clearly linked to local wellbeing, for example in the promotion of local jobs and growth.

Principle 2: Transparency

The financing system should be as simple as possible. It should not be so complex as to be incomprehensible.

Principle 3: Efficiency and effectiveness

Decision-making by sub-national government should be such as to ensure the preferences of citizens are better met than if the same decisions were made by national government. The use of public money should avoid waste, in the sense that inputs should be minimised in relation to outputs and outcomes. Arrangements should minimise administration costs, economic distortions and tax avoidance.

Principle 4: Autonomy

Sub-national government should have choice about how much to spend and on what, such that it is not blocked from promoting local interests. A higher percentage of funding raised locally would be more likely to deliver autonomous sub-national government than a lower one. The capacity to raise resources in this way is an important element in the constitutional balance between different spheres of government within a country.

Principle 5: Fairness

The overall funding system should operate in a way that ensures all parts of a country or city receive acceptably fair service provision and face acceptably fair tax burdens. Matters of fairness are also relevant between individual taxpayers in different parts of a country or city, as well as matters of inter-generational equity. The assumption has been made that any proposed reform should not lead to a redistribution of resources to or from London at the point the reform occurred – ie, in the year change took effect, London would neither be better nor worse off, a principle that also applies to individual boroughs.

2 Evidence

In Part 2 we summarise the evidence we received from stakeholders and set out the findings of our academic literature review and the research we commissioned.

PART 2, CHAPTER 1

Summary of written and oral evidence

1. We called for both written and oral evidence from a range of experts and interested parties in the capital and other cities, including from representatives of a number of London's community groups. All submissions are available on the LFC website.¹²

WRITTEN EVIDENCE

2. The LFC's call for written evidence ran for seven weeks and requested responses to a series of questions. The call for evidence received 17 submissions from a range of organisations – business and professional bodies, London boroughs, BIDs, equality groups and members of the public.
3. There was broad agreement that stronger fiscal powers for London would provide better growth incentives and lead to greater accountability of decision makers. For example, London Councils stated:

"Devolving more taxes (and other revenue streams) would help build a joint, city-wide approach that can incentivise, prioritise and manage the public services and infrastructure investment London needs to continue its contribution to the public life and economic success of the UK."
4. The City of London set out four interrelated benefits from devolution, which ran through a majority of the submissions.

"The first is that London's regional and local government is likely to be better able to focus on the distinct challenges and opportunities facing the capital. Second, London's government is more directly accountable to Londoners for decisions that predominantly affect the capital. Third, London's government is likely to be more responsive to changing local circumstances and needs, as well as to evidence of the local effects of its policies. Fourth, devolution would allow greater innovation in the delivery of services, thus allowing different approaches to be tried out and the most successful to be identified."
5. A number of submissions highlighted the different uses of the term devolution. For example, the London Borough of Richmond Upon Thames warned against half-hearted devolution.

"Where a significant element of decision making remains set at a national level (as is currently the case with business rate proposals and has been the case with services such as the 'localisation' of council tax benefit), there is a risk, proven in practice, that allegedly 'devolved' powers will not be adequately funded and on occasions this may be a way for central government to transfer blame for often necessary cost reductions to local authorities, undermining confidence in local government as a whole".
6. This was echoed more broadly by London Councils, which argued strongly that current arrangements are not adequate.

"[There] is a lack of any real control over taxation, which means local government

¹² London Finance Commission, GLA: <https://www.london.gov.uk/what-we-do/business-and-economy/promoting-london/london-finance-commission>

lacks important tools to manage and promote economic growth. This also blurs local accountability, as the politicians responsible for spending decisions are not those really responsible for raising resources. We believe devolution would facilitate reform of both taxes and services, including greater integration of public services at the local level, leading to better outcomes and greater accountability”.

7. The Federation of Small Businesses (FSB) further endorsed a more robust view of devolution, basing this:

“[...] on a belief in the principle that local people and local businesses are best placed to make decisions for their areas in most, but not all circumstances”.

8. The inference here to subsidiarity – that decision-making and income streams should be devolved when there is no clear rationale for them being centrally retained – was picked up by a number of submissions. London Councils argued that:

“[...] this means finding the appropriate spatial level which will necessarily be different for different services and taxes. Devolution to the “Mayor and the London boroughs” therefore does not necessarily mean devolving everything to city-wide collective management, but should be to the level that best aligns responsibility and accountability, be that borough level, sub-region, or city-wide”.

9. The London Borough of Richmond upon Thames argued strongly for the localisation of powers as far as possible. It argued that issues around raising tax and charging for services locally should be devolved. The borough believes that:

“[...] where possible, such responsibility should be devolved to individual boroughs to ensure true local accountability. We do not believe that the Mayor should have any enhanced powers to impose additional burdens on local taxpayers”.

10. This view was shared by the Labour Land Commission which argued that:

“Local decision-making should encourage local business and community involvement in policy making and that would lead to greater understanding and scrutiny by all.”

11. The Inner London BIDs drew attention to the growing consensus across the UK in support of greater devolution and its benefits. It argued that:

“[in] an increasingly complex economy, facing major challenges not only from Brexit but also from the UK’s chronic low productivity and other issues, London (and all other regions) needs the discretion, flexibility, “fleetness of foot” and ability to take decisions rapidly, while at the same time consulting properly on them first”.

The Inner London BIDs concluded that Whitehall just does not have the capacity to achieve this outcome.

12. The argument that local areas were better placed to manage complex situations and respond with greater speed and accuracy – and to do so democratically with the consent and support of local residents and business – was made by a number of other organisations. For example, the New West End Company BID outlined what it saw as the unbalanced nature of centralised decision-making in the UK. Citing a proposal of the West End Partnership for investing in the improvement of the West End, it highlighted how the sign off of any deal will be determined by central and not by London’s government.

“As such re-investment in the West End of London is judged by the Treasury alongside local

regeneration projects across England, even though it is qualitatively different and would meet the needs of a global city. NWEF believes that, as a world city, London should be able to make its own investment decisions and determine its priorities and should not have to beg central government to retain just a small proportion of the billions of pounds of tax revenue it produces annually.”

13. The rationale for devolving tax and service powers to London’s government was considered by many to be more urgent following the UK’s vote to leave the EU. The London Borough of Harrow thought that:

“[any] devolution that can help strengthen local economies to make them more resilient to the adverse impacts of Brexit must be encouraged. As London boroughs all differ in their make up, the impact of Brexit is likely to be different across London. Therefore further devolution could help local authorities respond quicker to the needs of their residents and business communities. However if there is a regional / London issue as a result of Brexit, for example the workforce, it may warrant still being looked at at a high level to ensure no disproportionate impact.”

14. The City of London Corporation put forward a similar rationale.

“The devolution of significant power would, however, enable London’s government to go beyond mere ‘cheerleading’—important though that it is—and make concrete demonstrations of London’s commitment to remain the world’s leading international finance and business centre”.

15. The Federation of Small Businesses (FSB), while endorsing the principle and practice of devolution, made a strong case for including protections for business. The concern, outlined by other submissions, was that business should not be viewed as an easier source of tax income.

“We remain certain that the Mayor should have greater fiscal autonomy in setting rates across the capital with strong protections in place to protect businesses from any perceived risk of unreasonably high rate increases, in consultation with business[...] The message should be clear: greater fiscal autonomy should not lead to disproportionate increases by using business as a ‘cash cow’ for rate setting.”

16. The Camden Town Unlimited BID also recognised the business case for London’s government to have stronger fiscal powers.

“Handing wider fiscal responsibilities to the GLA would naturally bring decision making on taxing and spending closer to the capital’s residents and businesses. In the case of the latter, we would cautiously welcome further devolution.”

17. This view was echoed by the New West End Company. It made the case that:

“London competes globally for investment and visitors, both of which are vital for its continued economic success. The current taxation and funding systems put it at a disadvantage compared with its global competitors. London needs the ability to make decisions about its future and needs the funding powers to deliver what it believes is necessary for its economic wellbeing. New West End Company strongly supports measures to give the Mayor and the boroughs the powers to retain and spend a greater proportion of the taxes raised from London businesses for the benefit of both London and the UK economy”.

18. A number of submissions identified other tax and service powers London’s government should receive. London Councils supports the LFC’s calls for devolution of:

“the Apprenticeship levy and permissive powers to establish alternative taxes and levies and would be willing to explore more widely the idea of assignment of national taxes (income taxes and VAT). However, this would have to be in the context of broader agreement about significant shift in responsibilities”.

19. The London Borough of Camden suggested that further fiscal powers should include removing the ceiling on council tax bands and greater discretion in relation to charges for empty homes to address the chronic local housing shortage. It also supported the power for London to introduce a tourism or hotel levy. This would be in part to provide funding for local services which experience greater pressure as a result of large numbers of visitors but also to boost London’s cultural offer to those visitors. In addition, it was thought that this would enable co-investment in skills provision:

“[...] that would improve firms’ productivity, increase the number and quality of apprenticeships in the sector, and develop clear progression pathways for low-income workers”.

20. The Visitors’ Art Foundation (VAF) agreed that a tourism levy would be desirable. It highlighted the important role cultural attractions play in making London a leading tourism destination, stating that:

“45 per cent of overseas visitors state that the primary reason for visiting the capital is the city’s considerable offering of museums, galleries and exhibitions”.

21. VAF also noted that a tourism levy is not uncommon in other major European and international cities. New York, Paris, Berlin, Rome and Amsterdam all operate this type of tax. It estimated that in London overseas visits account for 82 per cent of bed nights spent in the capital. If the rate of a hotel or tourism levy was set at £2.50 per night, this would generate around £102 million per year. Cruise ships, Airbnb and similar websites could also be included within the scope of such a levy.

22. VAF has found support within the hotel industry for the concept of a tax or levy. The industry’s concern is that, were a tax to be brought in, it should be mandatory rather than an opt-in offer. They want to associate it with initiatives supported by the revenue generated and recommend a strong government lead to discourage ‘free-riders’. VAF proposed that the revenue in addition to current public funding and used to support to strengthen London’s cultural offer. In particular, the funds raised should be invested in:

“the 138 free entry charitable or public bodies in London’s 32 boroughs; [that they should be] awarded in the form of grants; [and that] priority should be given to projects that involve and support artists, scientists, writers, crafts-people and curators, in order to support the continued creative vitality of the city”.

23. The FSB made the case for a more robust approach to skills devolution to London’s government, particularly following the vote to leave the EU. It highlighted London’s exposure to the referendum result with its large non-UK population and the need to remain open to global talent. According to the FSB, devolution is an important factor in being able to respond to the needs of small businesses. The view that the referendum result makes devolution of powers to London more necessary was echoed by a number of other respondents. London Councils, for example, argued that:

“[d]ifferent economic and political solutions during this period of uncertainty may therefore be appropriate for the capital, and the economic uncertainty and the risk to London and

the UK's wider economy, highlights the need for fundamental reform of taxes that are closely linked to the economy, such as business rates. We also support the arguments set out in the LFC's interim report for re-patriating powers (eg European skills funding) directly to London local government, rather than to Whitehall".

24. A majority of submissions endorsed the view that devolution would enable public resources to be used more efficiently and effectively. The Inner London BID's agreed:

"[...provided the arrangements for transparency and accountability are fully effective, the more decisions that impact local areas or the whole of London are taken locally or regionally, the more likely those decisions will be the right ones and be implemented well [...]. Whitehall, whatever the position in the past, just does not have the capacity any more to meet the different needs and expectations of different parts of the country in this way".
25. The City of London Corporation expressed a similar opinion in noting that:

"in general, the benefits of devolution in the form of greater local focus, accountability, responsiveness and innovation are likely to outweigh any economies of scale that may be hoped for in a uniform national approach".
26. London Councils supported this view. Stronger fiscal and service powers would drive and be driven by greater transparency and accountability for raising and allocating resources.

"... if London's government were responsible for operating a wider range of taxes, it could modernise and improve them...That would aid a more cost effective preventative approach to many complex issues, rather than paying for the consequences of failure. [It would also] result in greater transparency and accountability for raising and allocating resources".
27. However, there were notes of caution. One related to properly assessing the level of need in the capital before devolution of key services and tax controls. Inclusion London expressed concern over what it saw as current levels of under-funding for public services in London. This was thought to underestimate the level of need in the capital and, along with a growing older population, would place too great a strain on devolved tax revenue.

"[Devolution of tax revenues] may entrench the current underfunding and could also encourage regional differences in the quality of services. Also additional responsibilities such as funding Attendance Allowance will put too great a burden on local government, especially because the population is increasing and ageing."
28. While the argument was regularly made that devolution enables local areas to address complex issues, the Royal Institute of Chartered Surveyors (RICS) cautioned against fragmenting the tax system.

"RICS is broadly supportive of the principles of devolution, in particular for allowing local and regional authorities to retain locally generated taxes and spend in line with local needs. This should be implemented within a defined national approach to property taxation and working within a national tax framework that is clear, transparent and simple".
29. However, the uniqueness of London's property market was identified as a clear reason for devolving property taxes. This acknowledged the distorting effects of certain national taxes, in particular stamp duty, on London and concerns around an over-reliance nationally on London's property tax contribution. London Councils supported the LFC's original and interim findings about devolving and reforming property taxes more generally. It outlined further powers which it considered should be devolved to London's government.

“National property taxes do not work well in the city. The capital contributes an increasingly unsustainable proportion of the national business rates yield. Council tax is regressive and hasn’t kept pace with property price inflation. [... Stamp duty] hits London disproportionately and is a drag on labour market movement. Vacant land is untaxed, discouraging efficient land use. Overall, being set and run nationally, they are virtually un-reformable and inhibit London’s economy from growing”.

30. Similarly, the Labour Land Commission identified issues with the current property taxation arrangement in London, and the market distortions that result.

“Land speculation is encouraged by the present tax system which leads to higher land prices for homes and business premises.”

ORAL EVIDENCE

31. The LFC held four oral evidence sessions – two in London, one in Birmingham and one in Manchester. Each had three sub-sessions with evidence from think tanks, business representatives and local government. A set of six questions was used at each session. One of the sessions was for London communities and covered different questions, drawing evidence from a range of representatives and community members.

32. There was a broad consensus that the Government’s devolution trajectory was right. In all three cities, contributors recognised the value of local decision making and the benefits this brings for local communities.

“There is a lot of evidence about how empowered places can make a very clear difference in terms of not just growth and investment but also in the way in which they can transform people’s lives.... new arrangements and new policies around how you support people who have been disconnected, say, from the labour market – in some cases, for generations [...] through different public service provision that can only be co-commissioned at a local level”.

Sir Howard Bernstein, Chief Executive, Manchester City Council

“What we can offer is a solution that says, “actually, greater devolution will lead to greater increase in taxes overall, greater revenue overall”. It can help challenge some of the longstanding social problems that the UK has failed on recently – tackling the housing shortage etc – which is still being looked at from a national level and not manifesting itself really on a local level”.

Henrietta Brealey, Director of Policy and Strategic Relationships at the Greater Birmingham Chambers of Commerce

“[Devolution] needs to be seen not as just London versus the rest. Of course, many of the issues that have been highlighted post the referendum in terms of the rest of the country are also there in London, but because we tend to think of the City and the financial district we often overlook the fact that London is an incredibly diverse city as well and there are very poor areas, lots of areas of London that need to be addressed”.

Dr Gerard Lyons, International Economist, Independent Consultant

33. Although there was broad support for the Government’s moves towards greater devolution, this was viewed as being in its infancy. Dr Enid Slack gave an international perspective when comparing London to other world cities.

“London is at the bottom of the list [of fiscal devolution] by far with council tax and now the supplementary business rates. New York has 20 taxes. I am not saying that 20 is

the right number or that those are all great taxes, but it does have a lot more room to manoeuvre with those taxes”

Dr Enid Slack, Director of the Institute on Municipal Finance and Governance at the University of Toronto

34. The limits to the Government’s current position on devolution within England were reinforced in the other sessions.

“Real devolution must include fiscal devolution simply because without that, you are still stuck in that kind of supply chain[...] where we are just delivering what central government wants us to deliver”.

Tony Smith, Policy Executive, Birmingham City Council

35. This view was reiterated in Manchester and again in London. Sir Richard Leese commented:

“I suppose the obvious thing is that where we do get small bits of devolution, it is to demonstrate that we are doing a better job than was done previously; although, having said that, one of the bits of devolution that we have is a bit of devolution around the Work Programme, where we are commissioning Working Well at a Greater Manchester level. It is demonstrably operating better than the national programme is operating but we are still, as we look at the Work and Health Programme, having exactly the problem [...] which is the unwillingness to allow us to continue to commission in an unfettered way, even though the rhetoric of the Government says that it will be commissioned by us at a local level”.

Sir Richard Leese, Leader, Manchester City Council

36. Responding to a question on whether devolution would incentivise growth, Baroness Couttie stated that:

“It certainly would as long as, when the services and things are devolved, there are not going to be so many tick boxes that we are constrained as to what we can do. Devolution has to be proper devolution that gives us freedom to deliver how we think is best for our areas. If we are given those freedoms and the money to do it, we could make a huge impact, particularly in London”.

Baroness Couttie, Leader, Westminster Council

37. Both Manchester and Birmingham recognised the value of London as a leading global city and that growth in London was a good thing.

“London is a huge boost to our economy, a huge part of our economy, and actually our relationship, Birmingham with London, is extremely productive for us and we think it is going to become even more productive over the next 10 years”.

Tony Smith, Policy Executive, Birmingham City Council.

“We are well aware of the fact that our economy depends to a certain extent upon London’s economy and we are also well aware of the fact that devolution does not mean we go away and do our own thing, irrespective of what happens in the rest of the country. The question is how that complements, how this plays out, and how incremental the process is over time on account of things that maybe we do not have time to talk about here. However, that detail is critical in terms of whether it is going to be successful, both for Manchester and for London”.

Phil Cussack, Chair of Greater Manchester Chamber of Commerce and Council Member, University of Salford

38. Differences emerged around the nature and extent of that growth and the opportunities for London to extract more out of fiscal devolution.

“Fiscal devolution is to me absolutely fundamental to making real sense of devolution deals that are done already[...] but the technical dimension fundamentally has to be about how we allow fiscal devolution without London running away with the crown jewels. That is the fundamental trick that we have to try to pull off. I think that can be done technically, we can find a way over a 20 to 30-year period, whereby we could see fiscal devolution to different places through different revenue streams and we would slowly but surely re-gear our nation”.

Ed Cox, Director, IPPR North

39. A similar position was outlined in one of the Birmingham sessions. It was argued that the centralisation of economic activity in London such as company registration and financial services gave the capital more fiscal opportunities. For example, pensions contributions from around the country end up being managed by funds in London and a majority of corporation tax is paid by companies registered in London which also have regional offices.

“My pension fund is managed in London. The people who manage that get paid for it and they pay tax. However, it is my activity that is driving the tax bill in London. My argument essentially is that with that system, any form of fiscal devolution is really just tinkering around the edges. You put that with what I have already said about corporation tax and what you are left with are business rates”.

Professor Nigel Driffield, Warwick Business School

40. The view was expressed that devolution provided an opportunity for London to demonstrate its value to the UK, not only through direct net fiscal contribution, but through supporting productive economic growth across the country. Suggestions included London sharing its expertise – its global reach, research and innovation, financial services etc – and assets through partnerships with other areas. Across the multiple excellences London has, the argument would be that the capital could:

“offer some of the value it has as a kind of joint venture with [other] areas... [For example], can we use London’s peculiar and enormous land-value market in order to hedge and create the type of guarantees, so we get partnerships between localities? That would be the type of win/win for a recent industrial policy that this Government would love”.

Phillip Blond, Director, ResPublica

41. All contributors across the three cities agreed that the vote to leave the EU did strengthen the arguments for devolution.

“With Brexit, I am not saying that European cities are completely restrained from competing with us by the Treaty, but they will be completely unrestrained without the Treaty, and we risk leaving cities in this country with far fewer tools in the box to compete with those cities. It is not a level playing field. They have much more control over resource, taxing spend, how they direct that, much more fleet of foot in attracting business and trade and so on, so there is a massive risk that we leave our cities, including London, out of the game”.

Chris Murray, Director, Core Cities

42. Evidence taken in all three cities identified the value of devolution in providing the ‘policy tools’ to respond to challenges, including withdrawal from the EU, and to tailor investment, taxes and services around local priorities. The powers and benefits of being able to shape things locally was a strong theme throughout.

43. In addressing long-term unemployment:

“there are a lot of mental health issues, substance abuse, depression and sometimes physical disabilities that an individual has. Again, it goes back to the granularity. The sort of support that you have to give that individual is really quite intensive, but the pound back you get for the pound spent is so worthwhile and it transforms people’s lives. You can do that only at a very local level, although the entry into jobs may have to be a bigger grouping”.

Baroness Croucher, Leader, Westminster Council

“Those issues [constraining growth] are not properly understood by Westminster or Whitehall, they are not the priority for Westminster and Whitehall that they should be here, and they should be for the Mayor, whoever that might be. For me, this devolution debate is about giving the people here elected the responsibility for making some priorities and some decisions about the most profound challenges we have, and having the ability to allocate resources in the most effective way to address it and they are held to account for doing that. If we align objectives and incentives in the right way, we have got a better chance of improving the quality of decision-making, I think, and interventions than we have today”.

Richard Parker, Partner, PwC

“[We need to communicate clearly to central government that:] “actually, we want devolution and these are the reasons why. This may mean us having greater authority and greater control of our own tax collections”. It would be good to have autonomy on fiscal powers[...] We do have tools that we can utilise, like business rates and council tax, to collect revenues from Birmingham people or West Midlands people for West Midlands’ needs”.

Ahmed Farooq, Chair, Birmingham Professional Services

LONDON COMMUNITIES

44. The London Communities session addressed a different but related set of questions. There was an early consensus around the value of devolution.

“We would be all in favour of having more control over making our own[...] investment decisions with the obvious proviso that we would need to know that we had some security and some means of repaying such investments”.

Jeremy Crook, Chief Executive, Black Training and Enterprise Group

“...speaking for London Citizens, we are absolutely in favour of devolution of tax and spend powers to London and towards London’s communities, because we think the money probably would be better spent and more accountable to the issues that our membership is facing”.

Matthew Bolton, Deputy Director, Citizens UK

45. However, a number of contributors highlighted the need to address the ‘why’ of devolution and its core principles and outcomes.

“Devolution in itself is not the end game, it is a means to an end. If it can be done properly then there are advantages [...] We should think about identifying some core principles for devolution. One of those would be about making sure that the needs of the citizens are the primary principle, or one of those principles. It should be sustainable, adequately resourced and not about shifting the blame from central government to local government and passing on the cut”.

Imran Hussain, Director of Policy, Rights and Advocacy, Child Poverty Action Group

46. There was strong support for housing to be a priority for London’s government’s use of stronger powers, in particular social and affordable housing.

"[Affordable housing] as a priority, that is going to be something that you would expect a mayoralty to think about and it is something that really does need to happen... Again, that is the type of thing that I would hope that if London got more of its money a mayor would be able to make a priority".

Tunde Banjoko, Chief Executive, Making the Leap

"There was a huge devolution of the housing budget, the financial aspect, to London through the Mayor, but no corresponding devolution of the power to address the very special circumstances of London on housing. We would like to see the work of this Commission actually not just be about tax and spend, but be about [devolution of power to address the very special circumstances of London on housing] and [...] the great importance of the devolution of social policy so that the Mayor of London does have the powers to respond to the huge housing crisis, which many of us feel is the biggest problem facing London at the moment".

Richard Lee, Co-ordinator, Just Space

47. A number of participants raised the importance of involving the community in deciding how stronger fiscal powers would be used.

"If these powers were going to be devolved we would not want them just to be devolved to be exercised by the Mayor and the boroughs. We would want them to be exercised through involvement of community organisations, tenants' organisations, trade unions and all the other people that are very often not consulted, and we would like them to be involved from the very start of discussing matters and not at some late stage when everything appears to have been already decided".

Pat Turnbull, London Tenants' Federation

"Talking about physical infrastructure, before anyone starts building anything the communities have to be asked whether it is something they want and that is beneficial to their area."

Lisa Redding, Acting Chief Executive, London Voluntary Service Council

48. The discussion was placed in the wider context of the need to address growing inequalities within the capital, of which housing was an important part.

"Inequality in terms of the areas [of London] of deprivation is actually quite significant and, therefore, we need to achieve greater accountability for that and, therefore, we need to take control of some of those resources".

Peter Estlin, Commissioner, London Fairness Commission

"... [the] principle around devolution, and I think this came out very strongly from the Fairness Commission's polling of Londoners, is that taxation needs to be more progressive and it is not now. Any devolution needs to address many of the inequalities that we have talked about, particularly around council tax".

Graham Fisher, Chief Executive, London Fairness Commission

49. Several participants noted the opportunity for devolution to link up budgets, providers of services and voluntary organisations so as to be better able to address local needs.

"It is what we [London] do with the devolved powers, particularly from the point of view of the immigrant population feeling welcome and included. It is not just about money."

Zrinka Bralo, Chief Executive, Migrants Organise.

“[In using the example of a person with health and social care needs] the opportunity that devolution provides is actually pulling those [bodies commissioning services] together and actually making those decisions as a whole system, recognising the different responsibilities. That is how we will address the accountability deficit. At present who does that [person] blame for the fact that they are not getting the support they need? “Sorry, it is not my fault. That is because the NHS England has not funded your GP service”. You have that opportunity for accountability if you begin commissioning in pathways”.

Michael Bell, Director, Michael Bell Associates Research and Consultancy and Chairman of Croydon Health Services NHS Trust

PART 2, CHAPTER 2

Academic and international evidence: an update

1. We commissioned an update to the first LFC's 'Working Paper on International Comparison of Global City Financing'. This work was carried out by the Institute of Municipal Finance and Governance at the Munk School of Global Affairs, University of Toronto. The Institute also provided a literature review which is included in the working paper.¹³

INTERNATIONAL COMPARISONS

2. Most academic authors point to the difficulties in measuring and comparing both the extent of official devolution and its effects. Capital and operating expenditures/revenues are treated differently in different cities. The focus of the Toronto paper is on operating (approximately 'current') expenditures and revenues since these are the most readily available and the most straightforward to compare across cities. Operating expenditures also give an indication of the range of services delivered in a municipality.
3. The paper we commissioned sets out information on the municipal finances of seven cities: London, Paris, Berlin, Frankfurt, Madrid, Tokyo, and New York. It finds that London still remains an outlier by international standards when it comes to own-source revenues. This is despite having one of the higher rates of expenditure per capita.¹⁴
4. London only has the ability to levy the council tax and a supplementary levy on the business rate. Moreover, both tax rates are capped by central government, and even on the administration of these taxes, London's government has limited controls. For example, the city is not responsible for the valuation of property and has virtually no capacity to vary the operating rules. Whatever tax or taxes are chosen at the local level, the most important element of fiscal autonomy is the ability of local governments to set their own tax rates.¹⁵ Local tax rate setting also provides predictability for local governments and gives them the flexibility to change rates in response to different circumstances.
5. Whereas London has limited control over own-resource revenues, other cities are able to levy a residential property tax and a non-residential property tax and generally have access to a much wider range of taxes than London. New York sources 27 per cent of its revenues from the property tax (residential and non-residential), it also receives over 10 per cent from sales and related taxes, 24 percent of revenues from income taxes and another four percent from other taxation. The City of Paris receives its revenues from property taxes (including a residence tax with an increase for second homes, a business owners' property tax and a commercial floor area tax) as well as a contribution on business value added. Tokyo levies a wide range of taxes; the largest is the fixed assets tax (almost 18 percent of general fund revenues) followed by the 'metropolitan inhabitants tax' for corporations (14 per cent), the metropolitan inhabitant tax for individuals (13 per cent) and the enterprise tax, paid by corporations (11 per cent).

13 Slack, E. University of Toronto (2016), 'International Comparisons of Global City Financing'.

14 The paper notes that the higher expenditure in London is, to a large extent, as a result of transport expenditure being part of the city government's budget.

15 Blochliger & Rabesona (2009), 'The Fiscal Autonomy of Sub-Central Governments: An Update'. In some countries (such as Norway, Korea, and Japan) where sub-central governments have the authority to set tax rates, they set the same tax rate across the country.

6. Both the control over own-resource revenues and the range of taxes at a city government's disposal are important. Whatever tax or taxes are chosen at the local level, the most important element of fiscal autonomy is the ability of local governments to set their own tax rates.¹⁶
7. A more diversified revenue structure, perhaps unsurprisingly, results in higher municipal revenues overall. An analysis of government revenues for 109 central cities in the US (combining city, district, and county taxing authorities) found that a more diverse revenue portfolio (one that is less dependent on property taxes) allows a city to raise more revenue.¹⁷
8. The University of Toronto evidence supports the view that access to a mix of taxes would provide London with stability (through the property tax) and greater buoyancy (through income, sales or business taxes).
9. Where the tier of government that makes the spending decisions (in this case the local government) is not the same as the tier of government that raises the revenues to pay for them (national or state government), accountability is blurred.¹⁸
10. Evidence suggests that sub-national governments are more likely to carry out their expenditure responsibilities in an efficient and responsible way if they have the autonomy to raise the revenues to pay for them. Governments should face the political consequences of levying their own taxes to cover at least part of the cost of the services they are providing.¹⁹
11. The range of taxes available to a number of the other cities in the comparative research undertaken for this Commission include both income and sales taxes. For example, Berlin, Frankfurt and Madrid all share in the income tax and VAT collected by state or federal levels of government. These sources of funding may be tied to the financing of infrastructure and there is evidence such allocations are an effective use of hypothecated funding.²⁰
12. Although expenditure per capita are relatively high in London compared to the other cities,²¹ taxes per capita (including the council tax and business rates) are much lower. Per-capita taxes differ in part because of the number taxes levied and in part because of the dependence on intergovernmental transfers. This has, in part, led to London having a relatively higher proportion of its own-source income through fees. User fees (sales, fees, congestion charge and other charges including fares) account for almost 9 per cent of total operating revenues of the GLA and boroughs combined. These are linked in the main to areas of public transport but suggest an over-reliance on and control over small, limited forms of own-resource funding.
13. The paper we commissioned from the University of Toronto made an assessment of London's current portfolio of own or shared taxes and fees, and a 'fiscal health audit', which indicates that property tax (council tax) is an appropriate tax for local

16 Slack, E (2016).

17 Chernick, H., Langley, A., & Reschovsky, A. (2010). 'Revenue Diversification and the Financing of Large American Central Cities'. Working Paper, Lincoln Institute of Land Policy, Cambridge, MA.

18 Slack, E. (2015). 'Local Finances and Fiscal Equalization Schemes in Comparative Perspective' in R. Geibler, F. Knupling, S. Kropp, & J. (. Weiland, Das Teilen beherrschen, Analysen zur Reform des Finanzausgleichs 2019, (pp. 283-312). Berlin: Nomos.

19 Mikesell, J. (2013). 'Administration of Local Taxes: An International Review of Practices and Issues for Enhancing Fiscal Autonomy'. In W. J. McCluskey, G. C. Cornia, Walters, & C. Lawrence, A Primer on Property Tax: Administration and Policy (pp. 89-124). Chichester: Wiley-Blackwell.

20 Kitchen, H., & Slack, E. (2016). 'More Tax Sources for Canada's Largest Cities: Why, What, and How?' Toronto: Institute on Municipal Finance and Governance, University of Toronto.

21 In part due to transport expenditure included in London's budget. In other cities it is either national or a separate body.

governments. However, given that it is relatively lacking in buoyancy (ie it does not grow automatically as the economy grows) and that it is highly visible and politically contentious, it is unlikely to be sufficient to fund the complex and increasing demands of London. Moreover, it may not be the most appropriate tax to pay for services such as social care or housing. This analysis suggests that a mix of taxes would give London more flexibility to respond to local conditions such as changes in the economy (for example the impacts of leaving the EU), evolving demographics and expenditure needs, changes in the political climate and other factors.

EXISTING ACADEMIC EVIDENCE

14. GLA Economics updated its review of the academic literature as part of our work.²² As was reported in *Raising the Capital*, the academic evidence is inconclusive regarding the impact of devolution on economic growth or, indeed, on other possible effects. Studies variously show negative, positive and neutral relationships between devolution and growth. GLA Economics also carried out a rudimentary analysis which could draw no clear conclusions on the relationships between levels of fiscal devolution and productivity.²³ However, there is evidence that stronger fiscal powers have other positive impacts.

Accountability

15. International experience suggests the most responsible and accountable local governments are those that raise their own revenues and set their own tax rates.²⁴ Unless local governments can alter the tax rates, they will not have local autonomy or the accountability that comes with it.

Business location decisions

16. According to studies²⁵ that have been undertaken on different industries, where there are advantages to locating near similar activities property taxes will be less important in business location decisions than in those cases where business is relatively mobile. Generally, business decisions to locate within London or not have in the past tended to be influenced more by, for example, the quality of its infrastructure, access to skilled labour and other factors, rather than the level of property taxes. This observation highlights the importance of the primary argument of the LFC's first report that fiscal control will enable London's government to make additional investments in its infrastructure which, in turn, will attract employment.

Fiscal resilience

17. The types of taxes that a city levies will determine, in part, its responsiveness to changes in the economy. In Central and Eastern European countries,²⁶ found that the property tax was much more robust than the personal income tax in times of economic crisis. The evidence also indicates that a more diversified revenue structure (one that is less dependent on property taxes) can allow a city to raise more revenues overall. Using data from 1997 to 2008, an analysis of government revenues for 109 central cities in the US (combining city, district, and county taxing authorities) found that per capita revenues in a city with a relatively diversified tax base (in the 75th percentile) were about 10 percent higher than a city in the 25th percentile.²⁷

22 See GLA Economics (2017) Working Paper 84: 'Relationships between devolution and economic growth'.

23 Analysis based on the OECD Productivity Database.

24 Bird, R. (2011). 'Subnational Taxation in Developing Countries: A Review of the Literature'. *Journal of International Commerce, Economics and Policy*, 2(1), 139-161.

25 See Slack, E (2016).

26 Davey, K. (2011). 'Local Government in Critical Times: Policies for Crisis, Recovery and a Sustainable Future'. Council of Europe.

27 Chernick, H., Langley, A., & Reschovsky, A. (2010).

18. Critically for London with its agglomeration strengths and service/knowledge economy, local fiscal autonomy for a metropolitan area is an important factor in making it more attractive to residents and businesses. This is because it can raise the additional revenues needed to provide the goods and services to be internationally competitive.²⁸ The ability to attract and retain skilled workers, particularly in the wake of the EU referendum vote, will help London retain international businesses and sustain its comparative advantage.²⁹ In addition, a broader range of fiscal controls would allow London to benefit from revenue growth from some taxes, revenue stability from others, and to pursue greater equity overall.

Fairness

19. The fairness of local taxation is important. A broader tax base available to local areas allows for 'burden sharing', without one group feeling it is being targeted as an easier source of income. Along with fiscal controls, it allows local areas to reform and adjust taxes to respond to changing circumstances and carry a democratic mandate for the investments it proposes.

Efficiency

20. It is self-evident that to raise a given amount of revenue, using many sources of revenue means that the local government can set lower tax rates for any single tax. Since the 'excess' burden of a tax increases with the tax rate (ie the distortions increase as the tax rate increases – such that residential property tax can discourage investment in housing improvements, or a retail sales tax can discourage consumption of goods), a more diversified system should yield any given amount of revenue more efficiently (with a smaller negative impact on the overall tax base – ie a mix of taxes can keep overall tax rates relatively low).³⁰ In a complex economy, these resources are advantageous. The University of Toronto paper notes that, in its current form, stamp duty is an example of a property tax which has a distorting effect on the market. These points were reflected in the Mirrlees Review which also concluded that stamp duty provides a disincentive for people to move, thereby resulting in potential inflexibilities in the labour market and encouraging people to stay in properties of a size and location that they may not have otherwise chosen.³¹
21. There is evidence that fiscal devolution can lead to efficiency gains in the management of taxes and in public spending.³² There is also evidence that it leads to reductions in regional economic disparities. This is the main finding of the OECD Working Paper, *Fiscal Decentralisation and Regional Disparities*.³³ It found that economically lower performing regions reduced the gap with higher performing (intra-country) ones following fiscal decentralisation. The authors argued that stronger fiscal powers and incentives meant that all regions gained through being able to attract resources – ie they became more competitive. However, the reductions in regional disparities came through lower performing areas also identifying and activating previously unused resources. These gains were less for regions that were already performing well, ie those already activating local economically productive resources.

28 OECD. (2006). 'Competitive Cities in the Global Economy'. Paris: OECD.

29 Brown, R. (2016). 'Strange Days -- London After the EU Referendum'. London: Centre for London.

30 Chernick, H., Langley, A., & Reschovsky, A. (2010).

31 Institute for Fiscal Studies, 'The Mirrlees Review (2011)', p403.

32 For example, Chernick, H., Langley, A., & Reschovsky, A. (2010); Blochliger, H., & Pinero-Campos, J. (2011).

'Tax Competition Between Sub-Central Governments'. Paris: OECD.

33 Bartolini, D., Stossberg, S., & Blöchliger, H. (2016) 'Fiscal Decentralisation and Regional Disparities'. Paris: OECD.

LONDON'S ECONOMIC EVIDENCE BASE

22. In 2013-14 it is estimated that London raised £34 billion more in taxes than was spent in London from public expenditure. This is the highest amount of any region or country of the UK (with the South East and East of England the only other regions to make a positive contribution to the Exchequer). To put this figure in context, public deficits are usually represented as a proportion of annual GVA/GDP. In 2013-14 London's net fiscal *surplus* was equivalent to around 10 per cent of London's GVA, at a time when public sector net *borrowing* for the UK as a whole was running at almost 6 per cent of GDP. Indeed despite the economic downturn in 2008-09 London continued to generate a fiscal surplus for the country as a whole – and has done for at least the past two decades or so.³⁴
23. The growth of London's economy has profound effects on inter-regional trade with other parts of the UK. Evidence suggests that London and the rest of the UK grow in conjunction with each other, as the correlation coefficient between growth in London and the other regions of the UK is positive.³⁵ Improved economic activity in the capital leads to improved economic activity in other regions of the UK.
24. Specifically, London's economy has significant implications for supply chains in the wider UK economy. In particular sectors of the UK economy, namely construction and transport, developments in the capital can generate twice as much GVA and job creation outside London than within it. TfL's supply chain alone supports 60,000 jobs across the UK – from Scotland to Cornwall.³⁶ TfL estimates that 60 per cent of its spending, through the supply chain, goes to suppliers outside the capital.³⁷ There is a strong correlation between London's growth and the rest of the UK, and the reverse would be true if London's growth was at its expense.³⁸
25. London's successful trade position with the world further highlights the correlation between London's economic success and the wider UK's economic growth. As London runs a trade surplus with the rest of the world, its boosted economy, through supply chain linkages, steers economic activity across the UK. Indeed, as London increases its trade with the world, the wider UK is likely to reap the benefits and experience more economic activity.³⁹
26. London is the UK's main asset in attracting foreign direct investment and is consistently in the top 3 global cities for the number of inbound FDI projects.⁴⁰ Overall, London remains the most important location for investment in the UK and Europe, with 57 per cent of the 1,469 business leaders sampled in the EY 2016 European Attractiveness Survey stating that London was amongst the top three cities for FDI in Europe.⁴¹ Analysis by Deloitte shows the importance of London as a base of operations for European and global operations. This found that of Fortune 250 companies, London was the global or regional headquarters for 40 per cent of these, significantly ahead of any other European city.⁴²

34 GLA Economics analysis based on data from the City of London Corporation (see London's Finances and Revenues, at <https://www.cityoflondon.gov.uk/business/economic-research-and-information/research-publications/Pages/Londons-Finances-and-Revenues.aspx>) and national public finance figures, from the ONS.

35 GLA Economics (2014), 'Growing Together II: London and the UK Economy'.

36 Regeneris data in Transport for London Annual Report 2015/16.

37 Transport for London (TfL) data submitted to the London Finance Commission.

38 GLA Economics (2016) 'Economic Evidence Base for London'.

39 GLA Economics (2016).

40 GLA Economics (2016).

41 'EY's Attractiveness Survey – Europe 2016' in GLA Economics (2016).

42 'Deloitte London Futures Report, 2014' in GLA Economics (2014).

3 London and UK growth after 2016

Part 3 of the report considers two key factors affecting London's future growth – leaving the EU and levels of investment in the city. We argue that the decision to leave the EU has strengthened the case for devolution. Meanwhile, London's investment needs are likely to remain great irrespective of the impact of EU withdrawal. Thus the argument of the first LFC – the need to devolve funding streams to finance additional capital investments to sustain growth – remains as valid as before.

PART 3, CHAPTER 1

The EU referendum: economic uncertainty and potential impacts

INTRODUCTION

The Mayor of London's decision to reconvene the LFC was in part a response to the result of the EU referendum held in June 2016. To a large extent, the rationale for devolution to the capital remains unchanged – that it incentivises economic growth, strengthens democratic accountability and allows for a more equitable tax system. However, the transition from membership of the EU to a future relationship with the EU inevitably brings a period of uncertainty in the medium term. London, as the most internationally focused part of the UK, might expect to be more exposed to this uncertainty but also to be able to drive post-EU national growth through its leading global position. In this context, reliance on property taxes, and in particular the retention of business rates, is inadequate as a full devolutionary solution. London's government needs a broader tax base to secure the investment in infrastructure that will underpin its long-term economic growth and deliver public services to Londoners. This will send a clear message that London intends to remain one of the world's leading cities and that the UK is a destination for global investment, trade and opportunity.

LONDON'S RESILIENCE

London's continued success will inevitably depend on good trading relationships and arrangements after the country exits the EU, given that it has been through trade that London has specialised and grown. Although a significant disruption to the UK's trading relationship with the EU would have negative impacts on the capital's economy, London is able to draw on deep and diverse resources. Its attractiveness for business, inward investment and international and domestic in-migration rests on inherent and long-standing factors,⁴³ which will make the capital more likely to be resilient across the range of Brexit scenarios.

DEVOLUTION AND THE NEED TO ADAPT

The impact of EU withdrawal on London's economy will depend on the nature of the trading relationships the Government establishes and on the UK's future immigration system. A number of sectors, including tech and creative, have grown in London, in part, through being able to attract talent from across the continent as a result of EU freedom of movement. This is not to make a political point; rather, it is to note that transitioning from EU membership to future trading relationships may have a differentiated impact across sectors, depending on the types of agreements the UK negotiates. Other factors include the regulatory environment after leaving the EU, the impact on FDI into the capital, any impact on London and the UK's reputation as a place to do business, the funding of projects in the capital currently funded by the EU and so on. Given the multitude of factors at play, forecasts of the future impact of EU withdrawal on the UK economy have come up with a variety of different outcomes depending on how, exactly, these factors are accounted for, which means that the long-term impact of leaving the EU on London's economy is still to be determined.

⁴³ These include the capital's highly skilled population (the proportion of London's workforce that is tertiary educated is higher than in any other comparable city), rule of law, tolerance, low levels of crime, an extensive transport network, good schools, excellent universities, existing agglomeration, advantageous time zone, English legal system, use of the English language, cultural assets, extensive retail offer and an entrepreneurial culture.

We believe the context of the UK leaving the EU strengthens the case for devolving further fiscal powers to London's government, irrespective of the city's long-term economic prospects post EU withdrawal. It will enable London's government to provide long-term commitments to Londoners at a time of uncertainty. This will range from major infrastructure projects to boost productivity, building new homes and addressing the causes of long-term unemployment. Meanwhile, there is a strong argument in favour of rebalancing power by devolving some tax and spending away from Whitehall to local government and to the communities they serve. The short-term risks, administrative challenges and economic uncertainties posed by leaving the EU also make the case for devolution stronger. The UK national government will be too busy negotiating EU withdrawal terms and developing new trading relationships – it must give London and other cities much more freedom to manage their own affairs and provide them with the fiscal powers to do so.

PART 3, CHAPTER 2

Funding infrastructure and incentivising growth

1. London is currently experiencing the most significant absolute population growth in its 2,000 year history. Over the last two decades a population equivalent to Birmingham has been added within its boundaries. From 2016-2030, a further 1.4 million people will live in the city, meaning London will be home to over 10 million people in 2030. Meanwhile, the number of jobs has grown from 4.6 million in 2000 to 5.7 million in 2016 and is projected to be above 6.2 million by 2030.
2. In 2013, the LFC, recognising the significant implications of this growth, recommended that the city produce a strategic capital investment plan. Accepting this recommendation, in 2014 the GLA published the 2050 London Infrastructure Plan (LIP).⁴⁴ It showed that in order to support the growth in jobs and people expected, around 1.5 million new homes would be required over the period 2015-2050. To sustain the capital's economic growth, substantially but not exclusively in central London, an increase in public transport capacity of around 70 per cent would be required, and to develop the city sustainably, both environmentally and socially, there would be significant 'green' and social infrastructure requirements (eg additional school places equivalent to approximately 600 new schools). The overall requirements were set out and costed, and work is currently ongoing to update these requirements and consider the nearer-term needs in more detail.⁴⁵
3. While there continues to be debate over the merits of specific projects, the overall magnitude of investment required has not been disputed and no counter evidence has been put forward either that London's projected scale of growth is unlikely or that the substantial investment outlined in the LIP is not needed. Indeed, the requirements set out were based on a mid-range projection of growth to 11.3 million inhabitants by 2050, but there was an upper-range projection, based on a higher rate of job growth, of 13.4 million. National government, the Mayor and London's boroughs have a duty to continue to work together to plan and fund the investment required to support the capital's growth.

FUNDING TRANSPORT INFRASTRUCTURE

4. Decisive planning of transport schemes and allied land uses is the primary requirement to help London grow. Confidence that new transport routes and capacity will be delivered supports planning for new housing and commercial developments. These, in turn, allow for more certain preparations for utilities and social infrastructure. But unfortunately, the funding for major transport projects has been dogged by uncertainty, which therefore cascades throughout the long-term preparations by the public and private sector for the rest of the city's capital investment.
5. Crossrail 1 is the most obvious example of this collective indecision. It was first proposed in the 1970s (and arguably, in a different form, earlier), developed in the early 1990s, cancelled by Parliament in the early 2000s, required a major lobbying campaign in 2004-8 to reinstate it, and was threatened with cancellation again in 2010. But for an amendment proposed by Baroness Valentine and carried during the third reading of the Bill in the

⁴⁴ GLA (2015), 'London Infrastructure Plan 2050'.

⁴⁵ GLA (2014), 'The cost of London's long-term infrastructure'.

House of Lords, Crossrail's Business Rate Supplement would have been subjected to the further uncertainty of a ballot of prospective rate payers. Thus right up until 2011, the scheme was far from 'certain' – even though the Crossrail Act had granted the powers to construct the scheme in 2008.

6. Looking forward, the capital is planning a raft of new transport investments to cope with forecast growth. The LFC recommends that the financial cases for individual major schemes are resolved as early as possible to provide them with the certainty they need so that delivery and other critical issues can be resolved.
7. It cannot be stressed enough that the city has only relatively recently entered a new era of net population growth, the first time since 1939. Its future infrastructure and housing requirements are therefore likely to exceed greatly the collective experience of the capital's needs since the Second World War. Recent past experience is not, in this case, a good guide to the future.

FISCAL DEVOLUTION

8. The LFC believes that fiscal devolution can play a part in providing the certainty that transport and other schemes such as improvements to the public realm need. Having access to a range of revenues will enable the city to focus on those schemes that are likely to deliver growth and fiscal revenues. We welcome the decision of the Government to decentralise business rates to cities from 2020, which should enable more tax increment finance schemes like the Northern Line Extension to come forward. **As an interim measure, prior to full devolution, the Commission recommends that the Government should consider extending the principle of tax increment finance (TIF) to other taxes, including stamp duty.**
9. The next chapter considers the need for more comprehensive fiscal powers (over and above TIF) to support London's growth and fund its public services.

4 Fiscal Powers

Part 4 considers in detail a number of options that would diversify London's revenue streams and afford it the autonomy to cater for its own spending needs in future. It makes a number of recommendations to improve London's financing system, including through devolving property taxes and assigning a proportion of income tax and VAT.

PART 4, CHAPTER 1

Localising and improving property taxation in London

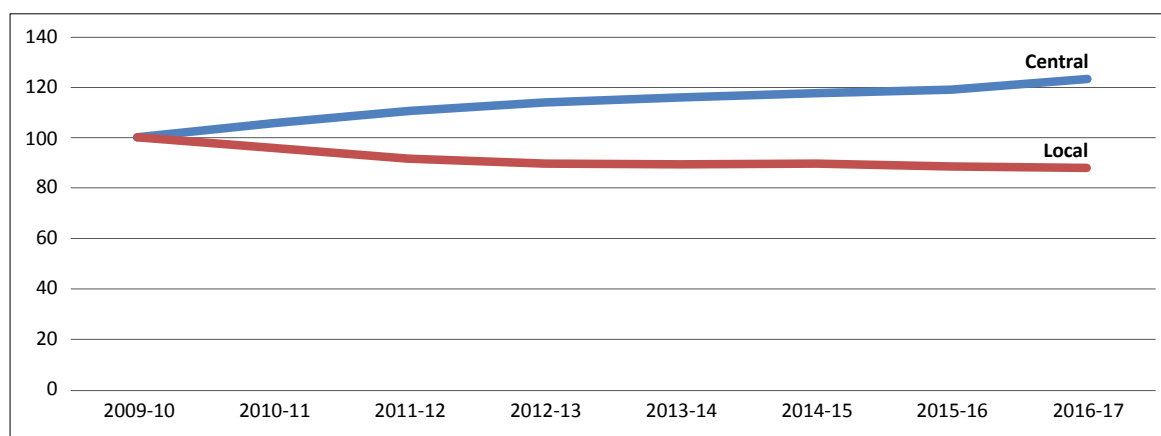
1. **We endorse the recommendations in *Raising the Capital* that the full suite of property taxes should be devolved to London's government – council tax, business rates, stamp duty, annual tax on enveloped dwellings and capital gains property disposal tax.**
The report argued that: “property taxes are suitable for local control because of their immobile bases, the fact they are easy to collect and enforce, and insofar as they relate to land, they are economically efficient. In the international cities we have reviewed, property taxes are largely devolved to sub-national government”. See Annex 4.
2. These arguments remain true. However, almost four years on from the original LFC report, the case for sub-national control over these taxes (and possibly others) is even stronger – in part because of devolution accelerating in other parts of the UK and because of EU referendum-related changes to our political landscape, but also because it has become increasingly clear that the main British property-related taxes are badly administered. It is this third issue that we consider in this part of the report.
3. Council tax, business rates and stamp duty are outdated and it appears to be beyond the Government's capacity to reform them. Each property tax is operated without reference to the others. Their sole current purpose is to raise resources, rather than being considered a lever to make the use of property more rational and efficient or to address London's housing shortage and infrastructure needs. The Mirrlees Review of UK taxation, published in 2010/11, included the following observations about the taxation of property and land:
 - **Land**, whether used for business or residential property, can be taxed at an arbitrarily high rate on economic efficiency grounds.
 - **Business property** is an input into the production process and, on efficiency grounds, should not be taxed.
 - **Owner-occupied housing** combines the features of an investment and a consumption good, and we should consider its taxation from both these points of view.
 - **Rental housing** is an investment good from the point of view of the owner and a consumption good from the view of the renter. Overall, there is a presumption in favour of taxing it at a similar level to owner-occupied housing.⁴⁶
4. Mirrlees supported a move to land value taxation and a modern ‘housing services tax’. The report was highly critical of both business rates and stamp duty.
5. Subsequently, little has changed. Stamp duty was reformed by HM Treasury to remove the ‘slabs’ which had meant that housing transactions faced big tax differentials for a £1 change in the selling price. The UK government decided to introduce the modification only after the Scottish government had decided to reform stamp duty after it had been devolved. HM Treasury also initiated a review of business rates in England, though the initiative concluded with very limited proposals. The most radical changes to be made included an aim to hold three-yearly revaluations and the exemption of over 600,000 small businesses from paying any rates.⁴⁷

46 Mirrlees, J et al. (2011), ‘Tax by Design’, Chapter 16 ‘The Taxation of Land and Property’ p369.

47 UK Government, ‘Budget 2016’, paragraphs 1.160-1.164.

6. UK ministers appear to be unwilling to risk reforms to property tax which have any significant distributional consequences. The ease with which property taxes are perceived means national politicians are, in effect, afraid to modernise or reform them. Exempting business ratepayers or not holding a council tax revaluation avoids a change where there is a redistribution of burden. Businesses with higher rateable values (some of which are actually quite small in London) and homes which have relatively declined in value are left subject to unreformed systems.
7. The LFC's proposals, if enacted, would make it possible for London's government to consider improvements to several elements of the property tax system in the city. In summary, these might include the following:
 - Determining the appropriate balance between the amount to be yielded by each tax within the overall total of property taxes to be collected.
 - Operating the different property taxes in such a way as to deliver policy objectives (such as securing mobility within the housing market or reflecting businesses' ability to pay) in addition to collecting revenue.
 - Modernising tax bases so as to reflect contemporary property market conditions.
 - Moving to annual (and certainly more frequent) revaluations of tax bases.
 - The avoidance of ad-hoc interventions in the operation of property taxes.
8. These changes may sound straightforward and simple, but they are not. The UK government has long been unwilling to intervene to reform or improve the system of property taxes. It would be easier for London's government (or, indeed, the government of other city or county-regions) to propose and bring forward improvements because the political impact would be constrained within the sub-national area and a nationwide political and media reaction would be less likely. Politicians in London and other cities have considerable experience of delivering complex and necessary, although not always universally popular, changes. Local authorities in England have had to manage a significant reduction in their resources since 2010. Central government, by contrast, has protected most of its programmes and spending (see Figure 1 below). Sub-national political institutions appear to be capable of and responsive when managing change.

Figure 1 Central government (UK) and local government (England) current expenditure (cash), 2009/10 to 2016/17



Sources: (i) Central government – HM Treasury, *Public Expenditure Statistical Analyses 2016*, Cm 9322, Table 6.2 and *Public Expenditure Statistical Analyses 2014*, Cm 8902, Table 6.2

(ii) Local government - DCLG, *Local authority revenue and financing England*, successive statistical bulletins, annual, 2009/10 to 2016/17, figures adjusted to take account of schools' transfers to academy status, transfer of public health and accounting adjustments). Excludes police and fire & emergency services.

9. The main property taxes and their current problems are briefly considered below.

COUNCIL TAX

10. Council tax was a hastily put-together alternative to the community charge. It was introduced in 1993, on the basis of 1991 capital values, with homes placed in one of eight bands, to reflect broad differentials of price. The ratio of tax paid from Band A to Band H was 1:3. The UK government has never held a revaluation or made other substantive changes in England, though the Welsh Government has revalued the tax base while also introducing a ninth band for higher-value homes.
11. The London property market has changed significantly since 1991. Many homes have seen their values increase considerably faster than others. Some will have fallen, certainly compared to the London average. Neighbourhoods have changed dramatically in the 25 years since 1991, yet the council tax base has never been revalued. Evidence suggests that domestic property has increased in value faster than commercial property over this longer-term period. Yet there has been no adjustment between the national total collected in council tax and business rates to reflect this difference.
12. Council tax has proved impossible to modernise. It is regressive, in that it generally takes a larger share of disposable income from lower-income households than those with higher incomes. It operates on the basis of 25-year-old valuations. Because an easy-to-understand bill is issued each year, most householders know how much they pay, even though it represents less than £1 out of every £20 paid in UK taxation. National politicians have, from time to time, exploited this ease of perception for short-term political gain.
13. This has resulted in an arguably regressive and inequitable system. For example the maximum council tax Band H property in the City of Westminster – where homes can cost over £75 million – is £1,368 (or below £1,000 if the occupier is eligible for a single person discount). This is lower than the Band D council tax paid by a two-person household in half of the 32 London boroughs where average property prices are much lower.⁴⁸
14. **The LFC recommends that the operation and setting of council tax should be devolved to London's government. Growth in the tax base should be retained within London, as should the power to set rates. Council tax should be a local revenue which, in addition to delivering resources to fund local services, would provide an incentive for London's boroughs and the GLA to build up the tax base. The number of council tax bands and the amount charged from band to band could be reformed to reflect market conditions.**
15. Once council tax had been devolved, London's government could consider improvements and could also operate council tax alongside other property-related taxes. For example, the amount collected in council tax and stamp duty could be considered together, striking a balance between the annual taxation of property and the taxation of transactions. Similarly, the number of tax bands and the amount charged from band to band could be reformed to reflect changed market conditions.
16. But none of this can happen now. The LFC is recommending simply that the operation and management of council tax be transferred from central to London's government and doubtless over time to other city and county regions. As part of the localisation of the tax, further reforms could be envisaged, including the sub-national operation of the Valuation Office Agency. Scotland and Wales are to have their own tax departments, so there can be

⁴⁸ More details on the operation of council tax in London and potential options for its reform can be found in GLA Economics (2017), Working Paper 80: 'Council Tax in London.'

no 'in-principle' barriers to reform. The Valuation Office Agency, under Whitehall control, has proved slow to adapt to the opportunities provided by modern technology and the availability of large new property data sets. **A London Valuation Office should be set up that could consider improvements such as annual (or at least more frequent) revaluations.**

17. It would be possible to operate council tax in a far better and fairer way. Devolving it to London would provide an opportunity for greater rationality in its operation. In the short term there would be no change, except for the local control and retention of the tax. Improvement would be for the Mayor and the boroughs to consider once control had been transferred.

BUSINESS RATES

18. London produces a substantial and growing share of the national total of business rates. The 2017 revaluation will increase this share further. Indeed, the 2017 revaluation provides a salutary reminder of the weaknesses of business property taxation in England. Many London businesses, including small ones, face a sudden and unpredictable hike in their bills. Because central government chose to delay the revaluation due in 2015, it will have been seven years since the tax base was previously updated. This means that business and other business rates payers in many cases face an increase of 100 per cent or more in their bills. The infrequency of revaluations leads to a far larger scale of change than would be the case with more frequent ones. Annual revaluations, if introduced, would create a system where rising rateable values affected rentals and, in turn, moderated movements in tax bills.
19. Business rates have been operated as a national tax since 1990-91. The yield has been an assigned revenue which has been distributed per capita to local authorities. Arrangements for periodic revaluations and appeals against values have been determined by central government. From 2013-14, 50 per cent of the yield has been retained locally, though the arrangements to achieve this have been cumbersome to the point of incomprehensibility. Because of appeals and the operation of mechanisms designed to achieve inter-authority redistribution, it has proved virtually impossible to gauge the impact of the reform. Crucially, the business rate multiplier is set nationally, as is an RPI cap on its annual uplift, features of the system which combine to create huge local distortions in business rate bills following revaluations. Plainly, it is no longer a tax that is accountable to or works well for local areas and incentives are hard to perceive.
20. The Mirrlees Review, quoted earlier, was critical of property tax on business. Indeed the Layfield Committee, reporting in 1976, had also been unenthusiastic about business rates. Criticisms include the fact that business rates are a tax on inputs, are unrelated to profitability and, more recently, that they treat property-dependent businesses differently to those which trade mostly online. HM Treasury has recognised the problematic nature of business rates by exempting large numbers of institutions with lower rateable values from paying the tax. Of course, London businesses, which tend to have higher property values, are less likely to benefit from such exemptions than those elsewhere in the country, regardless of turnover and profitability.
21. **The Commission also proposes that the operation and setting of business rates, including setting the multiplier, should be devolved to London's government. To protect business rate payers, the multiplier should be linked to changes in council tax. London's government should also be granted full control of business rates reliefs including the flexibility to introduce a more effective relief scheme for small businesses which reflects the capital's higher rental values.**

22. Devolution would also allow London's government to consider a more radical reform of business rates. A number of proposals have been made in recent years by business organisations which believe the current system is flawed. Despite a review in 2015-16, it has not proved possible to come forward with any proposals for change. London's government could, working with business representatives, consider the introduction of a better form of local business taxation – for example a sub-national tax on turnover or a property tax with different characteristics.
23. It would also be possible to consider whether or not the balance between domestic and non-domestic taxation was fair and appropriate. As property prices change over time, it would be reasonable to reflect such changes in the relative totals paid by domestic and non-domestic taxpayers. In recent years, residential property values have risen faster than commercial and industrial values in many parts of London, so there would be economic-efficiency grounds for changing the balance of domestic and non-domestic property tax yields over time. Evidence produced for the LFC shows that a high-end flat in central London is likely to pay a relatively small amount in council tax compared to the business rates bill of modest businesses in the same neighbourhood.⁴⁹

STAMP DUTY

24. London pays 46.7 per cent of the UK stamp duty yield (on residential properties).⁵⁰ The central London boroughs of Kensington & Chelsea, Westminster and Wandsworth paid 17.2 per cent of the national yield (for England) in 2015/16. This total has increased in recent years, partly as a result of relatively rising property values in Inner London and partly because of changes to tax rates.⁵¹ In 2015, the then Chancellor significantly increased stamp duty on the most expensive homes, which appears to have led the top end of the London market to stall and then decline. Changes were also made to reduce the attractiveness of 'right-to-buy' investments.
25. Stamp duty on housing for many years operated on the basis of a 'slab' system, whereby a change in the tax percentage charged on a property applied to the entire value as its price took it from one band to another. The Scottish Government removed this undesirable way of operating the tax when it was devolved. The Welsh Government proposes to do the same. The UK government responded to the change in Scotland by removing the slab-based system in England.
26. **We recommend that stamp duty on domestic and commercial properties – and related levies – should be devolved to London's government. The amount collected in council tax and stamp duty could be considered together, striking a balance between the annual taxation of property and the taxation of transactions. At the moment they are considered in isolation, in part because they are in effect set nationally.**

49 GLA Economics (2017), Working Paper 80: 'Council Tax in London'.

50 London contributed the most residential stamp duty of any UK country or region, at £3,370 million (46.7 per cent of the English yield). London similarly contributed the most non-residential stamp duty of any UK country or region at £1,395 million (42.7 per cent of the English yield).

51 GLA Economics (2017), Working Paper 81: 'Stamp Duty Land Tax in London'.

PART 4, CHAPTER 2

Property levies on development

1. London's government has access to a range of property-related additional charges, including the business rate supplement for Crossrail 1 and the Community Infrastructure Levy (both set by the Mayor of London for the city as a whole and by individual local authorities). Businesses in London (and elsewhere) can develop proposals to create BID, which are subject to a ballot of prospective rate payers. There are currently over 50 BID in London. Members of BID usually pay a small supplement on their business rates for additional services such as marketing, security and training.
2. While these measures provide some freedoms for local areas to develop and grow, they have been introduced in an ad-hoc way without reference to other taxes. For instance, the Mayor's and the boroughs' CILs were allowed to be set independently and have no enforced time limit, which means that the proportion of London-wide versus borough-level 'infrastructure' cannot now be reviewed easily except by mutual agreement among all the boroughs and the Mayor. There are also notable gaps, such as the current inability for local government to tax undeveloped land to incentivise its development - and, indeed, the inability even to trial a more general land tax, which may in some situations prove to be a more efficient form of property taxation.
3. Along with the full suite of property taxes and levies **we recommend that London's government has permissive powers to develop new mechanisms for managing charges on property development.** We are convinced that if London's government had the power to manage these, it would develop more consistent, coherent and economically logical approaches, which would foster rather than hinder growth. **We also recommend that national government should work with London's government to trial the operation of a land value tax pilot on undeveloped land.**

PART 4, CHAPTER 3

The potential for additional fiscal powers

Introduction

1. London's government has very little fiscal autonomy when compared with major cities in other countries. The centralisation of power within the UK has recently been somewhat lessened by the transfer of new tax-raising powers to Scotland, Wales and Northern Ireland, but in England there has been only marginal change. Council tax, a small revenue compared with, say, income tax has been capped for many years. Business rates have been partly reformed, allowing local authorities to retain half of the yield. But sub-national tax-raising powers in England are minimal by international standards.
2. In this report, we have already reiterated the calls of the first LFC for the full devolution of all property-related taxes. Furthermore, this second Commission is committed to going further. Not only should legislation be enacted to allow London's government to access a number of smaller revenues, but steps should be taken to devolve part of the yield of more substantive taxes to the capital.
3. The LFC envisages a process of further devolution in the coming years, possibly extending to services such as the commuter rail network, health and education. With this in mind, we recommend that buoyant revenues such as income tax and VAT be partially assigned to London. Such reforms could move from a position where, assuming 100 per cent retention of business rates, only around seven per cent of the tax revenue raised in London is retained in the city⁵² to one where, over time, up to 50 per cent was retained. This, broadly, is where Scotland is headed.
4. Fiscal powers are not needed for their own sake. Rather, they are required to ensure that pressures for efficiency and effectiveness are perceived at the London level. The same arguments apply, of course, to other city and county regions. Better government will result from the Mayor and the boroughs managing a larger proportion of tax revenue.
5. The Commission recommends that London's government should continue to work with national government to secure further fiscal and service devolution, including in transport, skills, employment, housing, planning, healthcare, criminal justice and economic development.

Income tax and VAT

6. Income tax is a relatively stable tax and raises a significant amount of revenue in London (£38.6 billion in 2013/14).⁵³ It would be a good financial foundation for a more radical move towards the devolution of services, eg health, education and skills, and major infrastructure investment. We recommend that London initially be assigned a percentage of its income tax yield, increasing as and when such service devolution occurs or when major capital projects are agreed. This would have the advantage of incentivising growth in the tax base (ie moving more people into paid – and more highly paid – employment). This is a relatively modest proposal compared to previous recommendations (such as the Layfield Report in 1976) and very modest compared to the position in Scotland and Wales.

⁵² GLA Economics calculations based on 2014/15 data.

⁵³ GLA Economics (2017), Working Paper 82: 'Devolving other national taxes to London'.

7. Similar arguments apply to VAT as to income tax. The Commission also recommends that, should a larger share of public expenditure be devolved to London, the possibility of assigning a proportion of VAT be considered. The UK, because of EU regulations, has not been able to allow different VAT rates or systems within UK-wide arrangements. Once the UK leaves the EU it would, presumably, be possible to have different arrangements in different parts of the UK.
8. In having a stake in national taxes such as income tax and VAT, London's government would enable a broader and more stable fiscal base from which to finance high-quality services and infrastructure. It would give London's government a larger stake in the success of the economy overall. It would also encourage investment only in those projects that would lead to higher economic growth, feeding into tax revenues. Table 7 on page 88 shows that the devolution of a proportion of income tax and VAT would allow, for example, London to fund all health or education from its tax revenues. The proportion of sub-national services funded from London's own tax base could rise from under 10 per cent to 40 or 50 per cent if larger taxes were assigned.
9. The LFC notes that such a proposal would not alarm Londoners. In a recent poll, just under half of Londoners (49 per cent) surveyed said they would support retention of a small amount of income tax (five pence in every one pound) for London's government (versus 21 per cent who disagreed and the rest who did not know or neither agreed nor disagreed).
10. A benchmark could be set to ensure that London's retained tax yield did not grow disproportionately if the capital's economy grew significantly faster than the UK as a whole. Such a benchmark could be set, for example, by reference to the recent trend in tax-base change as compared to the national change. If London had been increasing its tax base by, say, an average of 'x' per cent faster than the national percentage increase, then any growth above 'x' per cent would be shared between London's government and the Exchequer. The precise shares could be determined by agreement, but the logic would be that both London and the UK generally shared in any above-trend, incentivised, additional yield. An arrangement has already been put in place by the UK and Scottish governments to determine adjustments to the Barnett Formula following the devolution on income tax and VAT to Scotland.⁵⁴
11. **We recommend that London's government should initially be assigned a modest percentage of its income tax yield (eg a number of pence in the pound of income), to increase as and when service devolution occurs or to be hypothecated to fund major capital projects. Such a transfer would mean that grant support could be kept to a minimum, or avoided altogether.**
12. **If a larger share of public expenditure is devolved to London, the possibility of assigning a proportion of VAT should be considered.**

Apprenticeship levy

13. The Government will introduce an apprenticeship levy from April 2017, which the LFC considers should be devolved to London's government (and almost certainly to other local authorities). At a minimum, significant parts of the capital's contribution to the levy should be assigned to London. London's employers have made significant strides in increasing the number of apprenticeship positions in the economy. A hypothecated tax stream such

⁵⁴ The agreement between the Scottish Government and the United Kingdom Government on the Scottish Government's fiscal framework, HM Government and the Scottish Government Raighaltas na h-Alba, February 2016, <http://www.gov.scot/Resource/0049/00494765.pdf>

as this should be devolved alongside existing skills and employment budgets. There are stronger rationales for such an approach in light of the EU referendum result; London's economy requires it to have the ability to target resources at sectors with the potential for shortfalls in labour once the UK leaves the EU; and London's government is likely to be more responsive to business needs in the capital, both in terms of its detailed design and operation and the deployment of the funds raised.

14. **The proposed apprenticeship levy, due to be implemented from 2017, should be devolved to London's government in order to fund a wider range of skills and employment initiatives in the capital, as decided by London's government. In the longer term (post 2020), it should be for London's government to decide whether or not to retain such a levy, at what rate, and on what to spend it, in consultation with business.**

Minor taxes and levies

15. Finally, as recommended in its first report, the LFC considers that London's government should have access to a range of locally specific levies, which might include visitor levies to support culture and tourism, or environmental levies.⁵⁵ The possibility of extending the congestion charge exists already, and it will probably be necessary to re-visit the issue of a wider charging area in the near future.
16. **London's government should be able to introduce new smaller taxes, including those outlined below. The government should pass permissive legislation that would make such changes straightforward to implement. In particular, we recommend the following smaller taxes for further exploration: a tourism levy, health-related levies and a community levy.**
17. **We recommend that national government work with the GLA, London Councils and other local authorities to develop a consultation on the potential operation of a tourism levy and of the power for London's government (and other authorities outside the capital) to set such a taxes in the city to London's government.**
18. In line with priorities in other areas of public policy, we recommend that a range of sumptuary taxes are considered. In the near term (2018) London's share of the soft drinks industry levy should be retained within the capital, with a longer-term view to devolving it fully, including the ability to set the rate. In the longer term (post 2020), London's government should also consider other health-related taxes, including a sugar sales tax and a saturate fat tax where these to be devised and fully managed by London's government. These are important policy levers to address public health priorities in London, such as child obesity, which is relatively high in the capital – both by influencing behaviour and raising additional funds to invest in health and related services.
19. Other minor taxes could include the power to introduce a community levy to fund discrete projects 'owned' by Londoners. This could approximate to existing models, such as BIDs, in enabling Community Investment Districts. These would probably be more modest in scale but be the result of a democratic process where London's diverse communities play an active role in initiating, endorsing and ensuring accountability. It could be used to leverage additional funding to increase the overall investment opportunity.

⁵⁵ GLA Economics (2017), Working Paper 83: 'Options for a tourism levy for London'.

PART 4, CHAPTER 4

Fees and charges

1. At present local authorities are able to levy charges on discretionary services if no profit is made and providing they are not prohibited by other legislation. This logic is sound but ignores the fact that in many important cases legislation states that fees and charges will be capped, set centrally or prohibited. Previous evidence showed strong support for discretion around service charges.⁵⁶

PLANNING APPLICATIONS FEES

2. Centrally imposed caps on planning application fees continue to be seriously problematic for local authorities and for some businesses. Local authorities should be able to set fees that allow full cost recovery. Indeed, in line with our 2013 evidence, we still consider that many businesses would be willing to pay the additional cost of swift, clear and high-quality advice from experts, as the cost of advice being given slowly and ineffectively is detrimental to business.
3. The Department for Communities and Local Government maintains that its 2011 Localism Act represents a significant shift of power to local areas, yet in our view, localism will underachieve if Whitehall can still exercise the power to set single national levels of charges for services delivered by local authorities, in the face of clear demand from local businesses and locally elected leaders. The Mayor of London has the power to set transport fares, despite their salience and scale of yield. Local authorities should have the same ability to control the fees they charge for discretionary services and recover full costs, and they should be able to offer differentiated services where appropriate, for example if consultations show that small and large businesses wish to make different choices about planning applications. Though local authorities should be able to recover full costs, due regard must be given to the impact of increased fees on economic activity and especially the impact on small and medium-sized businesses. **We recommend that local authorities should in principle be able to recover the full costs of local services for which they are able to charge.**
4. We continue to support the prioritisation of charges for building control, land searches and licencing for deregulation. **Central controls should be removed on planning application fees, building control charges, land searches and licencing fees. Such fees and charges should be audited locally to ensure there is no cross-subsidy of other functions.**

OTHER CHARGES

Congestion charge

5. We do not expect any major extension of congestion charging or road pricing to be a likely option in the short term. However, we recognise that any extension of road pricing in London could generate high yields, due to the significant traffic volumes. There is a possibility, with the long-term need to reform the taxation of vehicles and fuel, that central government could move to a new national charging system which would see

⁵⁶ Much of the analysis and many of the recommendations in this section are the same as those set out in the original Raising the Capital report, although it has been updated to take account of some significant changes that have occurred since 2013.

revenues going to the Exchequer. We believe that such charges should be set and administered locally to best reflect local circumstances, with yields retained at the London level for use on roads and transport. Such a scheme could also be an important tool in delivering other outcomes, including improving air quality. For this reason, it would be preferable for any new road-user charging scheme in London to be introduced by the Mayor, rather than imposed by central government. The Ultra-Low Emission Zone coming into force in 2020 is an example of how such a scheme could be brought in by the Mayor.

Vehicle Excise Duty and Air Passenger Duty

6. The Government has committed to hypothecating revenue raised from Vehicle Excise Duty (VED) in England to a new national roads fund and to invest taxes on motorists directly back into the strategic road network. At present, VED raised by London-registered vehicles (around £500m) will almost all be spent on roads outside the capital despite the fact that 90 per cent of Londoners' journeys take place entirely on London's roads). Unlike for the devolved administrations, no separate funding will be provided. Consideration therefore needs to be given as to how this nationally hypothecated tax can work best in London. Reasonable arrangements need to be put in place to avoid London fare payers subsidising drivers. London drivers need to be treated equitably with those in the rest of the country, but the tax take from London should allow London drivers both to fund the maintenance of London roads and also to make a fair and not excessive contribution to road maintenance outside the capital. **We recommend the hypothecation of a share of London's contribution to VED revenue for improvements of nationally strategic roads within the capital, accepting there may need to be other reasonable changes in the tax and revenues system to ensure that fiscal neutrality is achieved, and that there is benefit to London from national roads such as the M25. This would help to avoid unfair (and unfairly perceived) cross subsidisation, both from public transport fare payers to fund the London road network and from London car drivers to fund the road network elsewhere in the country.** Devolution of the powers to set VED to London's government could enable 'smart' road pricing to be introduced. It could also enable the consideration of the role of VED in addressing other challenges such as air pollution.
7. Air Passenger Duty (APD) is, at present, determined and collected by the UK government, but since the publication of the Smith Commission's recommendations in 2014, it will be devolved fully to the Scottish Parliament, to come into effect from 1 April 2018. As a consequence, the Scottish Government has since indicated a desire to reduce the overall burden of the tax by 50 per cent with a view to abolishing it when resources allow. However, the UK government has announced that APD will not be devolved to the Welsh Assembly – and that control of the tax will be maintained at a UK level. On balance, **we recommend that the UK government should consider devolving APD raised in London to London's government so that it has the flexibility and autonomy to consider making local adjustments to the tax and to provide more diverse sources of revenue.**

PART 4, CHAPTER 6

Fiscal autonomy and infrastructure delivery

1. The first LFC argued that an important rationale for fiscal devolution to London was its ability both to incentivise growth in London and to enable London's government to borrow more within its own prudential borrowing framework to deliver additional investment.⁵⁷
2. Since the LFC's first publication, prospective additions to the transport network have been outlined in the Mayor's vision document for London *A City for All Londoners*, especially Crossrail 2 and the Bakerloo Line extension as well as five new river crossings.

Crossrail 2

3. Our terms of reference include a subsidiary aim to help assess the options for funding Crossrail 2 and other major infrastructure.
4. Crossrail 2 is a proposed new railway that will connect the National Rail networks in Surrey and Hertfordshire via new tunnels between Wimbledon and Tottenham Hale/New Southgate. It will link with London Underground, Crossrail 1, the Overground and national and international rail services, and it will relieve several specific major rail bottlenecks in London. It was categorically endorsed by the National Infrastructure Commission in March 2016,⁵⁸ which highlighted the very significant benefits it would provide to the region.
5. The National Infrastructure Commission (NIC) also endorsed the Government's original target that London should contribute more than half of the project's costs, but within that context the National Infrastructure Commission recommended that the "Government should work with TfL and the GLA to explore new funding options, which could include consideration of further devolution." It went on to note that "even without such devolution, HM Treasury should be in a position to recoup significant receipts from the added Gross Value Added benefits and the rising value of property in London."
6. TfL has so far identified five primary funding sources, four of which would be raised by the GLA and TfL: the project's net operating surplus (ie fares less operating costs); development of land and property required for the construction of the scheme; an extension of the existing pan-London business rate supplement from around 2033 for around 30 years, after existing borrowings for Crossrail 1 have been repaid; and a Mayoral Community Infrastructure Levy from 2019 for about 20 years, again after commitments to Crossrail 1 have been met. A final source would be grant funding from national government.
7. The LFC agrees with the National Infrastructure Commission's recommendation that new funding options, including devolved sources, should be explored. Local funding streams are currently very limited, as our report has shown, and a key source, the Business Rate Supplement, is tied up repaying Crossrail 1 debt until around 2033, so only becomes available when Crossrail 2 opens, rather than from the start of construction. This creates a significant problem in raising finance and affording debt service during construction.
8. It is inconceivable to us that Crossrail 2 alone will suffice to meet London's projected growth. Nor have we seen any evidence to suggest that the scale of Crossrail 2's benefits

⁵⁷ The London Finance Commission (2013), 'Raising the Capital', Part 3: Chapter 2, 'Funding and incentivising growth' p47.

⁵⁸ The National Infrastructure Commission (2016), 'World class infrastructure for a world city'.

can be met by combinations of alternative projects. In our view, London as it grows will need Crossrail 2, a significant amount of other new infrastructure, (including that set out in *A City for all Londoners*), and a programme of renewal and maintenance of existing infrastructure assets, which was comprehensively costed in the previous London Infrastructure Plan to 2050.

9. For these reasons, as a matter of priority the Government needs to give consideration to further fiscal devolution along the lines set out above, together with other funding sources for the additional major transport, housing and other capital investments that will be needed to maintain a successful capital. For Crossrail 2, the most plausible and acceptable of the many options we have seen to improve its funding and financing would appear to be the retention of at least some of the anticipated growth in London's business rate yield resulting from future revaluations.

Investment funded by growth

10. The full devolution of all property and minor taxes, as we recommend, combined with the assignment of small proportions of income tax and VAT will enable greater borrowing for the investment needed to sustain London growth (even taking into account the additional service responsibility that such a significant transfer of taxes would imply). In effect, this would extend the principle of TIF to a much wider range of revenue sources. In simple terms, if the Government allowed London's government to capture enough of the tax generated by economic growth, the capital could invest to make further growth occur. The same principle could apply to the Greater South East and other areas that are growing economically. Further analysis is clearly required to assess the total amount of unfunded investment required, the growth potential of different projects (individually and in combination), the additional tax that could be generated and the extra local government borrowing that would be permitted under the prudential borrowing code – but the principle is clear.

Land value capture

11. In addition, it may be possible (and necessary) to develop mechanisms which tax some of the value uplift on property brought about by public capital investments, such as in transport or regeneration schemes.
12. In general, people are willing to pay a premium for property located in areas with good accessibility to jobs, schools and recreational areas. Similarly, businesses are willing to pay for properties which are well connected to workers and customers. This is particularly evident when the quality of public transport in an area is dramatically increased – for example through the extension of an underground line. Such public transport investment, usually paid for through fares and taxes, results in localised property price rises and new development. The benefit of the increased value currently flows mostly to landowners fortunate enough to own the land along the route. The public sector can seek to capture some of this windfall gain using land value capture mechanisms, and can use it to help fund investments which cause land value uplift in the first place.
13. Evidence presented to the Commission by TfL shows existing value capture mechanisms extract only a small fraction of land value gains from transport investment, in an ad-hoc and poorly-targeted manner. Significant value catalysed by public transport schemes in the past (eg the Jubilee Line extension) has not been captured, which represents a significant lost opportunity. Looking ahead, modelling for TfL predicts that future transport schemes in London are also likely to produce large land value uplifts, both in increasing the value of existing properties and by inducing new development. A sample

of eight prospective TfL projects that cost around £36 billion (including Crossrail 2, the Bakerloo Line Extension and the DLR extension to Thamesmead) could produce land value uplifts of about £91 billion. Under existing arrangements, local transport schemes capture less than five per cent of this uplift in value.

14. Stamp duty already captures some of the uplift in value (albeit for the Exchequer) when a property is sold and bought. The LFC considers that the Government should work with the Mayor to develop a framework for localising the portion of stamp duty attributable to transport-catalysed value uplift, so that such projects become easier to fund at a local level. This could be done either through a wider devolution of stamp duty to London, or in the interim through more localised, zonal retention mechanisms. This change would make it easier to fund transport-led housing expansion in London.
15. Business rates retention offers another potential model for extracting value uplifts, for instance to fund transport improvements that service large commercial developments – which our recommendations on business rates would enable. Interim measures, short of the full devolution of the business rates system, could also assist, such as allowing the growth in the business rate yield following (more regular) revaluations in particular zones – from large transport corridors to small and specific regeneration improvement schemes (such as public realm improvements in local high streets).
16. However, the majority of land value uplift occurs in the residential property sector, and stamp duty (even if localised) captures only a very small proportion of this. The LFC recommends the Government work with the Mayor of London to explore the feasibility, effectiveness and acceptability of new charges levied on new purchases or rentals in the residential property sector directly related to the uplift in value catalysed by public-sector capital investment, to be used to fund new capital investment. **Short of full property tax devolution, the Government should work together with the boroughs, the GLA and TfL to develop a consultation paper on the objectives, principles and design options of a land value capture charge.** Early analysis suggests such mechanisms could make a material difference to the funding of new transport in London.
17. Finally, there is potential to combine property taxation measures with coordinated planning and development to both drive delivery of transport and housing, and significantly to improve the extraction of value from new development around transport hubs. The LFC considers that the GLA and TfL should work with the Government, local authorities and the development industry to improve the consolidation of public and private land for development around major transport investments such as Crossrail 2, including through innovative land pooling and auctioning arrangements, with an equitable sharing of risks and rewards between the private and public sectors.

Infrastructure and the Greater South East

18. The LFC notes the good progress that is being made in relation to the duty to cooperate between the GLA and councils in the rest of the Greater South East⁵⁹ in establishing a set of key infrastructure requirements for the whole region. Given this, **the Commission recommends that the GLA, TfL and London Councils should consider developing with their counterparts in the rest of the Greater South East a strategic transport and infrastructure funding proposal for submission to the Government by the time of the 2017 Autumn Budget. These organisations should also work with the NIC to form evidence for the National Infrastructure Assessment.**

⁵⁹ That is, the South East and the East.

5 Governance of Reform within London

In the previous sections, we have set out ambitious proposals to strengthen London's ability to invest in its future growth. These measures require fair, robust and resilient governance structures and mechanisms to ensure that the distribution of tax burden and benefit falls equitably across London's residents and businesses.

PART 5, CHAPTER 1

Fiscal devolution and London governance

BACKGROUND

1. The fiscal devolution envisaged in this report would require appropriate mechanisms to ensure that robust, timely and accountable decisions can be taken to raise and distribute tax revenues. Both Londoners and central government will require reassurance that London is capable of governing such a system collectively.
2. London is well placed to develop such a collective governance model based on its unique structure of city-wide and local governance, which was introduced 16 years ago. London has a city-wide, directly elected Mayor, held to account by a separately elected Assembly. The 32 boroughs and the City of London are themselves powerful and influential leaders of local public service in their individual places, in sub-regional and other geographical groupings and, working with the Mayor and other partners, across the city as a whole via London Councils.
3. Over the past decade this model has evolved in a largely informal way. This evolution has been motivated by a genuine desire to ensure that both tiers of London's government find a way of collaborating effectively to bring their respective powers, influence and resources together to tackle some of London's most pressing public service and wider challenges.
4. A series of joint mechanisms has been developed at a political level – reinforced by a much more extensive network of official joint working – to promote a coherent approach. Some of these have elements of statutory underpinning, but mainly they are voluntary in nature. They include the Congress of Borough Leaders and the Mayor, and the Congress Executive (London Councils Executive and the Mayor). These bodies have provided joint oversight to London's bid for greater devolution and public service reform.
5. The London boroughs and the GLA have worked collaboratively on a number of programmes. These include:
 - a. European Funding: for the 2014-20 ESF programme, the LEP, through the GLA, London Councils and other local partners, developed a comprehensive package of ESF provision to meet local needs. Over a period of around 18 months the LEP designed 30 different strands of activity, with a combined value of £200m. As part of the development process for each programme, the LEP undertook a comprehensive needs analysis and brought together a range of stakeholders, including boroughs, voluntary and community sector (VCS) organisations, co-financing organisations (CFOs), providers, researchers and others to learn lessons about what works and to discuss how best to support each target group. These programmes are now in the process of being procured by the national CFOs, including the Department for Work and Pensions (DWP), the Skills Funding Agency (SFA) and the Big Lottery Fund.⁶⁰
 - b. New Homes Bonus (NHB): the process for developing and evaluating borough proposals has been undertaken jointly between the GLA, London Councils and boroughs and included a co-designed quality threshold framework for the programme and co-

⁶⁰ Further details are at: <https://lep.london/publication/european-social-fund-proposed-opt-organisation-provision>

assessment of proposals by GLA and London borough officers. Evaluation panels on each of the seven themes for the LEP NHB Programme consisted of GLA, borough and London Councils officers.⁶¹

FUTURE DEVELOPMENT

6. There is a shared recognition that more devolution to London will require further development of the largely informal arrangements described above. This will require provision for some shared decision making where both parts of London's government are key to securing outcomes for Londoners.
7. The first LFC report identified the need for more formal governance arrangements and the principles on which shared decision making might be based. These principles were further developed, and jointly agreed and set out in a letter to the Communities and Local Government Select Committee by the then Mayor of London in April 2014. These governing principles are as follows:⁶²
 - **Each element of London's government should have a stake:** *elected leaders of all London local authorities and the Mayor of London must be able to feel confident about the governance arrangements for the new finance system.*
 - **No exclusion:** *no one borough or group of boroughs can be excluded from the benefits of London's success or become disempowered from addressing local needs.*
 - **No over-riding:** *the interests of the Mayor cannot be overridden by the boroughs or vice versa.*
 - **No deadlock:** *arrangements must prevent or break deadlock. We believe that this can be achieved through suitable voting arrangements and clarity about which tier of government is responsible for decision-making, as reflected in the principles below.*
 - **Enforcement:** *the system must enforce binding decisions and these decisions must reflect a clear initial consensus – even if there are disagreements from time to time about individual decisions.*
 - **Simplicity and clarity:** *the reformed system should be as simple as possible. It should avoid the need for annual decision-making between different sections of London's government. It should seek to distinguish clearly the responsibilities of the GLA, boroughs and the London Assembly.*
 - **Stability:** *Existing responsibilities should be maintained where possible.*
 - **... But potential for reform:** *provisions in the 'devolution settlement' should enable, by agreement, periodic property tax reform and changes to any within-London distribution arrangements. Such reforms would be distinct from the 'day one' operation of a devolved system. There should also be a presumption that the more significant reforms proposed are, the longer they would be phased in.*
 - **Practical operations:** *decisions would be taken by the Mayor or borough politicians as appropriate. However, a joint GLA and London Councils Officer Group would provide standing technical advice and support for politicians to decide matters where there is significant joint interest under the above arrangements. This might be independently chaired.*

61 Further details are at: <https://www.london.gov.uk/moderngovmb/documents/s40436/05c%20New%20Homes%20Bonus%20Programme.pdf>

62 Extract from a joint letter from Boris Johnson, Mayor of London and Mayor Jules Pipe, Chair of London Councils to Clive Betts MP, Chair of the Communities and Local Government Committee, 10 April 2014, submitted as evidence to the Committee's review of Fiscal Devolution.

- **Decision rules:** *any new system would require a set of decision rules, some of which would be reflected in legislation. For instance, Parliament might legislate for periodic property revaluations to be carried out by devolved authorities. There are various options for the rulebook governing changes within London following devolution but here is one example:*
 - the Mayor would need to agree any decision and by converse would have a veto
 - the boroughs would need to agree to any decision by their own rules (eg two-thirds majority)
 - The London Assembly would retain its existing powers to amend or reject the Mayor's tax and spending decisions, which would be enhanced commensurate with the increase in the Mayor's powers.
8. There is no desire to circumscribe the existing powers of either the Mayor or boroughs. Both should remain sovereign in terms of existing responsibilities. However, mechanisms will need to be established to bring together those responsible for the executive leadership of London public services (ie not scrutiny), to open such collective leadership to the voice of citizens and taxpayers, including London's businesses, and to decide approaches and actions where devolution of resources and functions requires formal joint agreement.
 9. These mechanisms are likely to include some overarching political structure based upon the Congress arrangements that have been developed informally in recent years.
 10. In many cases it is envisaged that the Mayor and borough leaders would work consensually on providing oversight to a broader range of devolved responsibilities. In a number of specific, reserved instances, however, there would need to be provision for voting to determine decisions. There would, in effect, need to be two parties to these decisions – the Mayor of London and borough leaders collectively – with the view of the latter being determined by voting rules that protect a range of party and sub-regional interests.
 11. By the same token, the decision rules would need to reflect the principle of avoiding deadlock. It would be possible to write into the initial agreement – or even into legislation if necessary – a default presumption that where no agreement can be reached within given deadlines, the status quo ante prevails.
 12. The scale and formality of the arrangements required will depend on the level of fiscal devolution envisaged. The greater the degree of autonomy, the more frequent – and more significant – the decisions required. But greater autonomy also provides a greater incentive for London's government to develop and commit to practical and effective collective governance arrangements – and a greater incentive for citizens and taxpayers to involve themselves in the debate and to hold London's government to account.
 13. **If substantial devolution were to occur, we recommend that London's government should explicitly balance growth incentives with equity considerations as part of the governance arrangements.**

DEVOLVED BUSINESS RATES

14. Joint discussion of the mechanism for devolved governance has been most recently articulated in the joint Mayor of London and London Councils submission to the consultation on business rates retention. The broad approach set out there was also largely reflected in the agreement reached by borough leaders and the former Mayor in respect of the broader devolution agenda in 2015. This envisaged different classes of decision or collaboration for London's government to address:

- **Initial set-up:** decisions and agreement with Government on the scheme design, including the level of retention, responsibilities transferred, the basis and frequency of revaluations and resets, the allocation of resources between the GLA and boroughs, the multiplier(s), the framework for discounts and reliefs, the distribution of growth proceeds, the operation of a regional safety net and a regional list. Such decisions would need to be taken collectively – and unanimously – by the Mayor of London and borough leaders, reflecting the views of London’s citizens and taxpayers.
 - **Ongoing tax-setting and resource allocation:** annual decisions such as setting the multiplier(s) and allocating the collective growth pool, and periodic decisions such as agreeing revised baselines and changes to the needs formula. These decisions would need to be taken collectively by the Mayor and leaders, building on the existing Congress arrangements, with appropriate voting and other principles built in to ensure the appropriate protection of the Mayor’s and boroughs’ interests. Such decisions fall into two broad categories:
 - **setting the tax:** for example, if there were to be a single rate multiplier, this would need to be agreed collectively by Mayor and boroughs; if there were to be two – a borough rate and a separate Mayoral rate – this would require different decision mechanisms.
 - **distributing revenues:** for example, agreement to any change to the formula used to calculate top-ups and tariffs to redistribute resources between boroughs, or the allocation of the rewards of growth, which could be used collectively to incentivise contributions to London’s overall economic success. Similarly, agreement to enterprise zone or TIF-type arrangements would effectively hypothecate revenues that would thus be unavailable to support other investment priorities in the capital. Such arrangements would therefore require collective agreement.
 - **Technical underpinning and review:** it may require two independent technical commissions to manage ongoing work around valuation (including the performance of a regional Volunteers Office Agency) and the operation of the tax, and around maintaining the needs formula and distribution model. Political oversight of these commissions could be undertaken by the governance structures described above.
15. Where collective decision making is required, in the absence of statutory ‘combined authority’ arrangements, it will be important to clarify the powers and responsibilities of the Mayor and individual borough leaders to pool their sovereignty. For example, leaders might be asked to prioritise investment in infrastructure projects which contribute to the overall sustainability of London’s economic and social wellbeing. Such decisions should not be open to legal challenge on the basis that they do not directly benefit one leader’s own borough. Such clarification may require statutory underpinning.

OTHER TAXES

16. The governance mechanisms required will reflect the degree of autonomy granted. For example:
- **Council Tax:** setting the local tax and precept would remain the separate responsibility of individual boroughs and the Mayor as at present, and no collective governance would be required unless proposals for significant change – such as a revaluation and/or changes to tax bands – were developed. The approach to such reform would follow that set out for business rates, ie unanimity required for initial re-design and periodic review with appropriate majority decision-making for ongoing operation of the reformed tax.

- **Other property taxes:** devolution of all property taxes would present the opportunity for coordinated and coherent reform. This would require unanimous agreement and subsequent collective management as described for business rates and council tax. If more limited devolution or decentralisation were envisaged – for example, substituting stamp duty revenues for existing GLA investment responsibilities, then it might be appropriate for management responsibilities to remain with the relevant tier of government rather than to be operated collectively.
- **Consumption taxes:** these kinds of taxes would probably require city-wide or at least sub-regional collective governance on the principles set out above.
- **Assigned national taxes:** as tax rates and allowances would remain the responsibility of national government, no London governance would be required in relation to setting the level of revenue to be collected. Rather, the need for collective decision-making around the allocation of revenues would depend on the terms of any assignment. If assigned taxes were hypothecated to fund existing responsibilities, no governance would be required, whereas if the revenues were to support significant changes to the way services were run, then appropriate decision-making structures would apply.

SCRUTINY

17. Clearly, such a governance system would need to be balanced by effective and appropriate scrutiny arrangements. Borough arrangements are already in place to scrutinise outcomes in local areas. The London Assembly has a scrutiny role in respect of the Mayor of London and, by extension, would be reviewing the Mayor's action in respect of these functions.

CONCLUSION

18. Both the Mayor and borough leaders recognise the need to develop these overall arrangements, as well as working with other relevant partners and stakeholders, to develop governance arrangements that are effective, transparent and accountable to the citizens and taxpayers of London. The current informal governance arrangements provide an effective foundation for the collective management of a greater share of London's tax raising and distribution. However, greater autonomy will both demand – and encourage – commitment to pooled sovereignty coupled with a clear definition of the retained powers and responsibilities of each part of London's government.

PART 5, CHAPTER 2

Management of London taxation

1. The earlier sections of this report considering the arguments for the local control of property-related taxation argued that central government has allowed these revenue sources to become out-of-date and under-managed in recent decades. It is now a quarter of a century since council tax values were set, while business rates are about to be revalued for the first time for seven years. Relative domestic and non-domestic values have changed dramatically in recent years and the operation of both taxes has not kept up with such relativities. In addition, long periods without a revaluation risks creating an element of retrospective taxation at the point when such irregular revaluations take place. It would be possible to operate the bases of these taxes in a more effective and up-to-date way. Data bases about changing property values, both capital and rental, are now widely available.
2. Stamp duty has been reformed, both in terms of its structure and tax rates, in recent years. But it remains a levy on transactions, which impedes efficient market operation. In addition, there have been a number of one-off changes to tax rates which appear to have had negative impacts on both the market and on yield.
3. If London's government were to assume responsibility for property taxes, it might be possible to build a requirement for more timely revaluations. Of course, it would be important not to face taxpayers with unfair and/or partly retrospective demands. If changes were to be made, there would need to be protection for those who might otherwise face excessive increases in tax. Even if there were no new requirements about the operation of any new locally controlled taxes, London's government would be able to make its own decisions about how better to operate and modernise them.

PART 5, CHAPTER 3

Incentives and Equalisation

1. There are several reasons for devolving fiscal power to London and other city and county regions. These include greater accountability, democratic pluralism and (as argued above) better administration. But the devolution of a number of tax bases to London would also create stronger incentives for the city's government to build up these tax bases by being more efficient and pro-business. The Government itself argued the case for such incentives when it proposed allowing councils to retain the business-rate yield from 2013.⁶³ The intended impact of the Government's original decision to allow councils to keep the income from business rates was that "business rates retention will provide a clear incentive for local authorities to embrace[...] growth." If, as the Government believes, councils are incentivised by local retention to increase their business rates tax base, it is logical to assume that additional local tax retention will have an analogous impact.
2. **Any future reforms made to London's fiscal and financing arrangements should not be negated by central government periodically adjusting grant resources available to the city beyond the reduction required at the point of reform. An agreed formula (as exists for Scotland and Wales) would need to make certain that there is no shift of resources between London and the rest of the UK.**
3. A more complex issue is that of within-London equalisation. Business rates and stamp duty have yields which are very heavily concentrated in a small number of central boroughs, notably Westminster, Kensington & Chelsea, Camden and the City. In the past, a London Rate Equalisation Scheme (LRES) was used to redistribute rate income from a number of central boroughs to all the rest.⁶⁴ The LRES was operated by central government and ran alongside the equalisation grants which operated at the time.
4. **Any new tax powers for London should be neutral on 'day one' – with arrangements in place to guarantee that neutrality. Thereafter, the governance arrangements would have to assume responsibility for ensuring there was negotiated fairness between different boroughs and the GLA.** Thus, for example, if a new revenue such as a tourist levy were to be introduced it would be necessary to determine the balance of London-wide receipts to be available to each borough and to the GLA. Even if the yield were heavily concentrated in a handful of boroughs, it might be deemed appropriate to distribute some of the resources to other boroughs in recognition of the integrated nature of the London economy. However, the boroughs with the largest yield would also have to be treated fairly in recognition of the demands put on their services by the economic activity which generated the tax. Equally, the GLA might be expected to share part of the total yield. An agreement would be needed at the point the new tax was being introduced to determine the immediate and ongoing rules for its collection and distribution.
5. Another way of dealing with the challenge of a new tax which has a particularly uneven base would be for the GLA to assume control of much or all of the yield. The Mayor of London's precept on council tax already operates in this way, as will a proportion of

63 Department for Communities and Local Government (2012), 'Business rates retention scheme: The economic benefits of local business rates retention', (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/11472/2146726.pdf)

64 See, for example, Ministry of Housing and Local Government (1968), 'The Greater London Rate Equalisation Scheme'.

fully retained business rates from 2020. The distribution of City-Hall taxes occurs by its spending pattern from area to area across the city. Stamp duty, if it became a London revenue, might be more easily managed at the city-wide level, though this is not to say that the boroughs might not receive a share of their local yield. Again, agreement would be needed, through the new governance arrangement, about the precise details of the tax and its operation.

6. With a more devolved fiscal structure, London's government would also have to manage the equalisation of changing expenditure needs and, possibly, tax resources. For decades, the Rate Support Grant and Revenue Support Grant have delivered a degree of equalisation of needs and resources across England. Complex negotiations have taken place between central government departments and local authorities in relation to grant totals and needs formulae. As and when London assumed control of a wider tax base, the proposed new governance arrangements would have to assume control of such distributional decision-making.
7. In Scotland, Wales and Northern Ireland, equalisation decisions are made within the nations themselves. London would be different, in that there would be arrangements to allow both the Mayor and the boroughs jointly to administer matters relating to equalisation and redistribution. But the precedent for the sub-national operation of tax and equalisation has already been set.

6 London, England, Scotland, Wales and Northern Ireland

In Part 6, we have considered how our changes would affect the rest of the country.

PART 6, CHAPTER 1

London and ‘English devolution’

1. The devolution process within the UK started in 1999. The arrangements for Scotland and Wales have now matured, though further steps are currently being taken to transfer tax powers to both nations. The question of the ‘English dimension’ to UK devolution has not been fully worked through. An English Parliament has, effectively, been ruled out, though a version of ‘English votes for English laws’ has been implemented. In parallel, the Government has taken steps towards limited devolution within England’s cities and counties.
2. London was given a measure of devolution in 2000, with the creation of the Mayor and Assembly. An attempt to introduce regional government in the North East was rejected in a referendum held in 2004. Subsequently, legislation allowed the creation of combined authorities and city and county regions. In May 2017, a number of new mayors will be elected in these combined authority areas.
3. The first LFC recognised that other city regions had made progress which in some cases had gone beyond the original London devolution settlement in 2000. Between 2013 and today, the process of devolution within England has progressed further, albeit in an ad-hoc fashion. In making proposals for the devolution of tax-making and other powers to London, the LFC recognises that the arguments which apply to London could equally apply to Greater Manchester, the Birmingham/West Midlands, Liverpool or other city regions.
4. English cities and counties have a common interest in moving devolution forward. It will be necessary to phase reforms, if for no other reason than to provide central government with the confidence that new forms of institutional machinery will work effectively. London needs to make common cause, both economically and politically, with other city and county regions.

PART 6, CHAPTER 2

England within the UK

1. London is the UK's largest city. Its population is bigger than those of Scotland and Wales combined. Its economy is more extensive than the total of Scotland, Wales and Northern Ireland's. Yet Scotland, Wales and Northern Ireland now have devolution settlements with law-making powers and, increasingly, devolved taxation. The Commission supports devolution of this kind but observes that England is still highly centralised. London is certainly large enough and powerful enough to manage more of its own taxes and public expenditure. The proposals made in this report for London should be seen as making the case for a more devolved – and better governed – England.

Annexes

ANNEX 1

Biographies

THE COMMISSIONERS

PROFESSOR TONY TRAVERS

Director of LSE London

London School of Economics



Tony Travers is director of LSE London, a research centre at the London School of Economics (LSE). He is also a professor in the LSE's Government Department. Key

research interests include public finance, local/regional government and London's government. He chaired the first LFC (2012-13), the Independent Commission on Local Government Finance in Wales (2015-16) and is an advisor to the Communities and Local Government Select Committee. In 2004 he published *The Politics of London: Governing the Ungovernable City* and, last year, *London's Boroughs at 50*.

ALEXANDRA JONES

Chief Executive, Centre for Cities



Alexandra Jones is Chief Executive of Centre for Cities, the only independent think tank dedicated to understanding and improving UK city economies, through

research, policy, events and work with cities. She is an influential voice in the cities debate, regularly providing advice for senior policymakers in national and local government. Other roles include chairing the London Stansted Cambridge Consortium and being a Commissioner on the Cardiff Capital Region Growth Commission.

NICHOLAS HOLGATE

Town Clerk, Royal Borough of Kensington & Chelsea



Town Clerk at the Royal Borough of Kensington & Chelsea since October 2013; Nicholas joined the Royal Borough in November 2008 as Executive Director for Finance, Information Systems and Property.

An economics graduate and accountant, his previous posts include: Chief Operating Officer at the Department for Culture, Media and Sport (2004-08); Director of Welfare Reform at HM Treasury (2001-04); and Work on the Government's education and training policies (1998-2001).

JOHN DICKIE

Director of Strategy and Policy, London First



John Dickie is Director of Strategy and Policy at London First, where he is responsible for all of the business membership organisation's policy work.

He was previously the Head of Corporate Affairs at the BBC (2003-8); Regulatory Affairs Director of the European Competitive Telecommunications Association (2000-2003); and has over 10 years' experience in public policy consultancy, initially with Prima (1989-1998) and then GPC (1998-2000), providing political and policy advice to major international businesses.

John has degrees from Oxford University and the London Business School. He is a former Deputy Leader of Camden Council in London.

BEN ROGERS**Chief Executive, Centre for London**

Ben Rogers is a writer and political thinker with a particular interest in cities and citizenship. Prior to founding Centre for London in 2011, Ben was Associate Director of IPPR

from 2003 – 2007 and has subsequently led strategy teams in Haringey Council, DCLG and The Prime Minister's Strategy Unit. He has written several acclaimed books on philosophy and history.

LEN DUVALL OBE**Assembly Member, London Assembly**

Len has dedicated his working life to local government and the voluntary sector. Between 1992 and 2001 he served as Leader of Greenwich Council. Since 2000, he has

represented Greenwich and Lewisham on the London Assembly and serves on the Police and Crime, Oversight and the Budget & Performance Committees.

Len has chaired the London Labour Party since 2002. He is a founder member of the New Local Government Network and the Thames Gateway London Partnership, and was awarded an OBE for his contribution to local government.

Cllr. CLAIRE KOBER**Chair, London Councils**

Claire Kober was elected as a Haringey Councillor in May 2006 and became Leader of the Council in December 2008. She first became involved in politics as a student, believing

it was the means to achieve change for a better, fairer and more just society. Her professional career has been rooted in the voluntary sector, working in policy roles for a number of national charities.

In her time as Leader, Claire has prioritised

improving education outcomes for all children in the borough, wide-scale regeneration and delivering better housing. Claire's focus will continue to be on securing £1 billion of extra investment in Haringey, building new homes, securing new jobs and providing residents and businesses with new opportunities to succeed.

Claire is the Chair of London Councils – the regional body that brings together the capital's 32 boroughs to lobby for fairer funding and a better quality of life for Londoners. Claire also represents the region on the London Economic Action Partnership and plays a senior role at a national level as Chair of the Resources Board and portfolio holder at the Local Government Association.

COUNCILLOR TERESA O'NEILL OBE**Vice Chair, London Councils**

Chairman, Bexley Health and Wellbeing Board, former Mayoral Adviser for Outer Borough Relations, Vice Chairman, Executive Member responsible for Devolution &

Public Sector Review and Leader of the Conservative Group on London Councils, Councillor O'Neill is also an LGA London Peer Lead.

Councillor O'Neill's background is in the Financial Services Sector.

NICK BOWES**Mayoral Director, Policy, Mayor's Office**

Nick Bowes is the Mayoral Director of Policy, having previously been Director of Policy on Sadiq Khan's campaign to be Mayor of London. He has worked in

senior roles in public affairs and policy for 15 years, including spells with the CBI, EEF and Royal Society, where he was Head of Secretariat for the Advisory Committee on Mathematics Education.

Between 2010 and 2015, Nick was the

Special Adviser to Sadiq Khan as Shadow Secretary of State for Justice. He has a degree in Mathematics and Geography from the University of Newcastle-upon-Tyne and a Ph.D. in Geography from the University of Sheffield.

COLIN STANBRIDGE

Chief Executive, London Chamber of Commerce and Industry



Colin Stanbridge became Chief Executive of the London Chamber of Commerce and Industry in November 2002. He is responsible to the Board for all aspects of the

Chamber's work.

Prior to joining the Chamber, Colin was Managing Director of Carlton Broadcasting, the London weekday ITV Company from 1996, having joined Carlton as Controller of Regional Affairs in 1993.

TONY PIDGLEY

Chairman, Berkley Homes,



Tony left school at 15 to form his own company and in 1975 launched Berkeley Homes. The business was listed 10 years later and voted Britain's Most Admired Company in

2011. Over this time, Tony has gained a national reputation for his judgement of the markets and his pioneering approach to place making. He is now President of the London Chamber of Commerce and Industry and in 2016 was nominated New Londoner of the Year for his contribution to housebuilding across the capital.

JULES PIPE

Deputy Mayor for Planning, Skills and Regeneration, Mayor's Office



Jules Pipe works on key priorities for the Mayor, including major regeneration projects across the capital, providing young people with skills for their future careers, ensuring London's infrastructure needs are delivered to benefit all Londoners and revising the London Plan. The first directly elected mayor of Hackney in 2002 and Chair of London Councils since June 2010, Jules Pipe has unrivalled knowledge of London's government.

BHARAT MEHTA

CEO, Trust for London



Bharat Mehta is CEO of Trust For London, one of the largest charitable foundations tackling poverty and inequality in the capital. He is a member of the Home Group Board, a former

Trustee of the Joseph Rowntree Foundation and a non-executive director of North Middlesex University Hospital NHS Trust. In 2016 Bharat was appointed CBE in the Queen's 90th birthday honours for services to Finance in the Charitable and Voluntary Sectors.

ROBERT NEILL

MP for Bromley & Chislehurst, UK Parliament



After graduating from LSE, Bob Neill spent 25 years as a criminal barrister. He has served as a councillor in Havering and a London Assembly member, during

which time he led the Conservative group. Elected as the MP for Bromley and Chislehurst in 2006, his roles have included Local Government Minister and Deputy Chairman of the Party. Since 2015, he has chaired the Justice Select Committee and the APPG for London.

SUE KERSHAW,
Programme Director of Major Projects
Advisory and the UK Head of Infrastructure
Programme and Project Management at
KPMG.



A current Board member of the Association for Project management, Sue has held a number of positions, including Director of Rail for CH2MHILL, Director of Programme

Management for Grosvenor Britain and Ireland and prior to this, Deputy Director of Transport for the Olympic Delivery Authority, responsible for all rail and road transport for the Games and the programme management of the wider portfolio.

Sue is a Civil Engineer, an avid promoter of programme management as a discipline, is passionate about improving the performance and visibility of the profession. She has a keen interest in regeneration, is a great supporter of improving London as a city for the future, and is a member of the London Economic Action partnership.

She is an advocate for the equality, diversity and inclusion agenda in her professional and voluntary work, and actively supports initiatives to raise awareness of these issues.

Sue also fully supports the engagement of industry, the engineering professions and education sector in working together to plug the critical skills gap in engineering and programme management we have in the UK.

ANNEX 2

Terms of Reference

PURPOSES

The Mayor of London has re-formed the 2016 LFC to review, refresh and revise its original recommendations in the light of changed circumstances; in particular the referendum vote to leave the EU, the Mayor's new priorities, and the progress on devolution that has been made since the 2013 *Raising the Capital* report. As before, the Commission is to help the Mayor and London's local authorities improve the tax and public spending arrangements for London in order to promote jobs, growth and greater equality. He wants the Commission to examine the potential for greater devolution of both taxation and the control of public expenditure (capital and revenue) to achieve this goal.

OVERALL APPROACH

The Commission will hold a short initial inquiry and report by early 2017. This will include publishing interim findings and developing an evidence-based approach to its recommendations. Subsequent work by the Commission or others may then be requested by the Mayor, depending on its findings.

OBJECTIVES

The objectives of the initial inquiry of the 2016 LFC are to:

- Review and assess existing arrangements for government funding of London, including capital and revenue. This exercise should assess how they compare to other countries, regions and cities internationally and within the UK and how revenues raised are distributed locally, regionally and nationally. The position in 2016 will be compared to 2013, as will the wider context of devolution within the UK and the significant democratic and constitutional changes since 2013.
- Examine the relative scale and distribution of London and the UK's public expenditure, within the context of the Wider South East region, with a view to considering the plausibility of a ring-fenced settlement for the capital.
- Examine options for change within the changing context of the UK and its relationship with the EU, including the potential to devolve to London's elected leaders both more of the taxes that Londoners and London businesses pay and greater control over public expenditure decisions. Appropriate checks, balances and accountabilities will apply and the roles of the different tiers of local government will be considered.
- Set out the advantages and disadvantages of a number of options and make recommendations.
- Ensure the Commission's recommendations are in the best interests of the UK.

The Commission should take account of the existing Government consultation on reforms to business rates. The Commission will refresh the data from the original report to bring it up to date.

The key outcome to achieve is a devolution agreement in the Government's Autumn Statement and in subsequent fiscal events. A subsidiary aim is to help assess the options for funding Crossrail 2 and other major infrastructure.

SCOPE

The Commission may consider all taxes raised and government expenditure incurred within London and make recommendations as it sees fit for improvements in accountability and local control. These reforms considered will be sequenced according to priority. The scope of the review will not be limited other than by the purposes and objectives set out above.

MEMBERS

Chair: Professor Tony Travers, Director of LSE London, London School of Economics and Political Science

Dr Nick Bowes, Mayoral Director of Policy, GLA

John Dickie, Director of Strategy, London First

Len Duval⁶⁵, London Assembly Member, GLA

Nicholas Holgate, Town Clerk, Royal Borough of Kensington & Chelsea

Alexandra Jones, Chief Executive, Centre for Cities

Sue Kershaw, Programme Director of Major Projects Advisory and the UK Head of Infrastructure Programme and Project Management, KPMG

Councillor Claire Kober, Chair, London Councils

Bharat Mehta⁶⁶, Chief Executive, Trust for London

Bob Neill MP, for Bromley and Chislehurst

Councillor Teresa O'Neill, Vice Chair, London Councils

Tony Pidgley, Chair, Berkeley Homes

Jules Pipe, Deputy, Mayor for Planning, Regeneration and Skills, GLA

Ben Rogers,⁶⁷ Chief Executive, Centre for London

Colin Stanbridge, Chief Executive, the London Chamber of Commerce and Industry

OBSERVERS

Martin Clarke, Director of Finance, GLA

Jeff Jacobs, Head of Paid Service, GLA

Akshay Kaul, Principal, Commercial Finance, TfL

John O'Brien,⁶⁸ Chief executive, London Councils

Guy Ware, Director of Finance, Performance and Procurement, London Councils

Julian Ware, Senior Principal, Commercial Finance, TfL

SECRETARIAT

James Lee, Senior Policy Officer, GLA

Jeremy Skinner, Head of Economic Growth, GLA

⁶⁵ Gareth Bacon, London Assembly Member, GLA, attended 2 LFC meetings on behalf of London Assembly Members

⁶⁶ Mubin Haq attended one Commission meeting on Bharat Mehta's behalf.

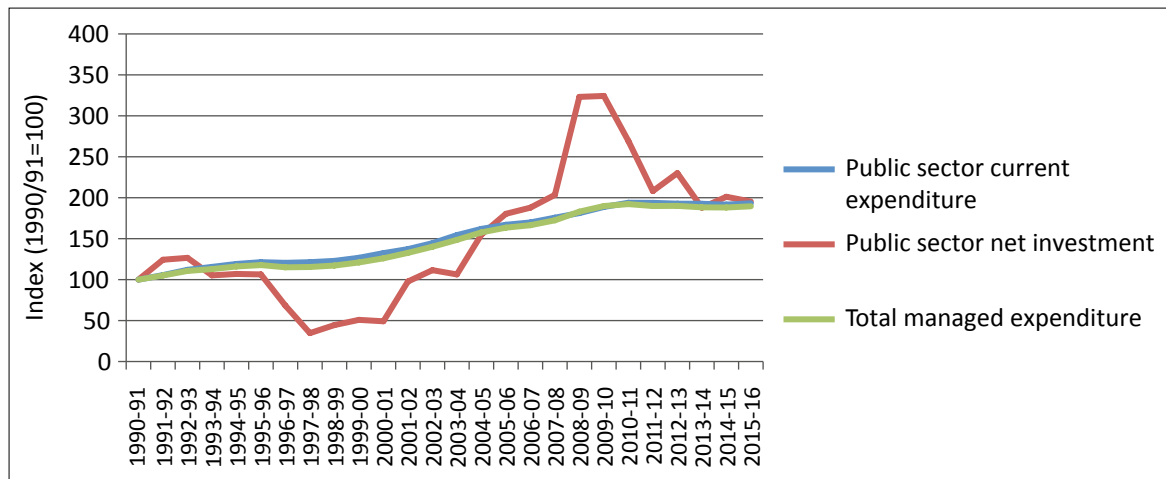
⁶⁷ Richard Brown (Director of Research, Centre for London) attended one Commission meeting and the Manchester oral evidence session on Ben Rogers' behalf.

⁶⁸ Dick Sorabji (Corporate Director: Public Affairs, London Councils) who attended 3 LFC meetings on John O'Brien's behalf.

ANNEX 3

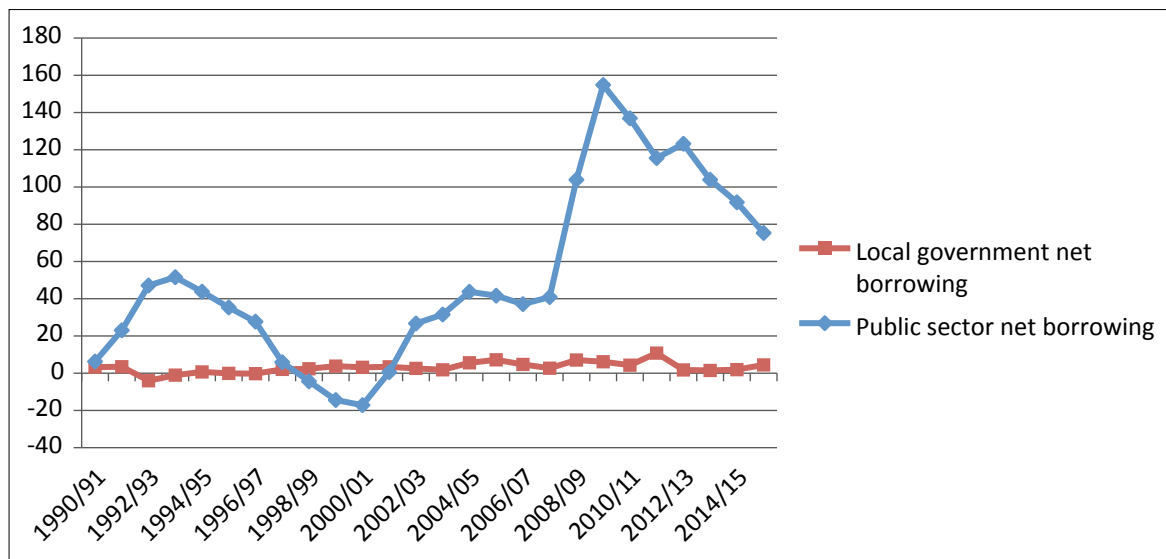
London's tax and spending

Figure 2: Real Government capital investment and expenditure over time, 1990/91 to 2015/16 (Index 1990/91=100)



Source: Office for National Statistics (Public Expenditure Statistical Analyses (PESA), 2016)

Figure 3: Annual public sector and local authority borrowing, 1990/91 to 2015/16



Source: Office for National Statistics, Local government net borrowing and Public sector net borrowing (excluding public sector banks), 2016

Table 2: Selected forecast tax yields in London and the UK for 2015/16, £ million

	London ²	UK ¹	London %
Council tax	3529	28800	12
Business rates	6837	27800	25
Residential Stamp duty land tax	4484	10700	42
Annual tax on enveloped dwellings	158	178	89
Capital gains property disposal tax	4065	1332	80

Sources: HM Treasury and Office for Budget Responsibility, HMRC, CIPFA, London Councils Council Tax Monitor, GLA Economics calculations

¹UK data is forecast by the Office for Budget Responsibility and taken from the March 2016 Budget and supplementary fiscal tables. Capital gains property disposal tax is estimated as a share of total capital gains tax, as reported in the Budget, using 2012/13 (last available data) share of capital gains tax from disposal of residential assets.

²Data for London is calculated by applying London's share of UK tax for the latest year of actual data available, to UK Budget forecast data. For council tax, this is London Councils Council Tax Monitor (2015/16), for business rates, CIPFA Revenue Collection statistics (2014/15), for stamp duty land tax, HMRC UK Stamp Duty statistics (2014/15), for annual tax on enveloped dwellings, HMRC ATED statistics (2014/15). For capital gains property disposal tax, as with the LFC's 2013 report London's share of SDLT of residential properties over £2 million is used as a proxy.

Table 3: Identifiable expenditure by function (2014/15) in London, the UK and the rest of the UK (£ per capita)

	Public order & safety	Enterprise & employment policies	Transport	Health	Education & training	Social protection	Total identifiable expenditure on services
Greater London	651	97	600	2,534	1,543	3,624	9,840
UK	441	120	314	2,069	1,307	3,927	8,913
Rest of the UK	434	142	273	2,020	1,297	4,079	9,033

Source: HM Treasury, Country and regional analysis, 2015, and GLA Economics calculations

Table 4: Public expenditure as a per cent of London and UK GVA, 2010/11 to 2014/15

	London	UK
2010/11	28	39
2011/12	26	38
2012/13	25	37
2013/14	24	37
2014/15	23	36

Source: PESA (2015), ONS Regional GVA (2015), GLA Economics calculations

Note: PESA identifiable expenditure for the financial year is used here together with GVA for the calendar year. (So for 2014/15 it is PESA data for 2014/15 together with GVA data for 2014).

Table 5: Expenditure on selected services in London, the Greater South East and the UK in 2014/15: total, current and capital levels (£ million) and as a per cent of regional or national GVA

		London		Greater South East		UK	
		Level	% of GVA	Level	% of GVA	Level	% of GVA
Public order & safety	Total	5,555	1.5%	10,599	1.4%	28,492	1.8%
	Current	5,452	1.5%	10,294	1.4%	27,366	1.7%
	Capital	104	0.0%	305	0.0%	1,127	0.1%
Enterprise & employment policies	Total	835	0.2%	1,780	0.2%	7,726	0.5%
	Current	846	0.2%	1,757	0.2%	6,848	0.4%
	Capital	-11	0.0%	23	0.0%	879	0.1%
Transport	Total	5,121	1.4%	8,642	1.2%	20,296	1.3%
	Current	1,252	0.3%	2,277	0.3%	6,630	0.4%
	Capital	3,869	1.1%	6,365	0.9%	13,666	0.8%
Health	Total	21,638	5.9%	49,034	6.6%	133,637	8.3%
	Current	20,854	5.7%	47,383	6.4%	129,070	8.0%
	Capital	784	0.2%	1,651	0.2%	4,567	0.3%
Education & training	Total	13,178	3.6%	30,623	4.1%	84,403	5.2%
	Current	11,833	3.2%	27,967	3.8%	78,162	4.8%
	Capital	1,345	0.4%	2,656	0.4%	6,242	0.4%
Social protection	Total	30,948	8.5%	84,034	11.3%	253,640	15.7%
	Current	30,925	8.5%	83,945	11.3%	253,247	15.6%
	Capital	22	0.0%	88	0.0%	393	0.0%

Source: PESA 2015, ONS and GLA Economics calculations

Table 6: Sources and uses of funding in London local government (2014/15)⁶⁹

	Central Government	GLA	London Boroughs	Total London sub-national Government	Total Public Expenditure
Defence	8	0	0	0	8
Economic affairs	358	5,450	914	6,364	6,722
Education	5,439	22	7,717	7,739	13,178
Environment protection	196	29	984	1,013	1,209
General public services	34	39	859	898	932
Health	21,070	2	565	568	21,638
Housing and community amenities	-232	712	1,973	2,686	2,454
Public order and safety	2,017	3,445	93	3,538	5,555
Recreation, culture and religion	695	81	604	686	1,381
Social protection	20,908	0	10,039	10,039	30,948
Total	50,493	9,781	23,750	33,531	84,024
Council Tax	0	787	2,631	3,418	3,418
Grants (inc government and other contributions)	0	5,987	19,209	25,197	25,197
Capital Receipts	0	168	538	706	706
Revenue Contributions	0	1,629	865	2,494	2,494
Borrowing: Supported	0	0	0	0	0
Borrowing: Unsupported	0	1,210	506	1,716	1,716
General Taxation	50,493	0	0	0	50,493
Total	50,493	9,781	23,750	33,531	84,024

*Sources:**PESA 2014/15 for total public expenditure within the London region.**DCLG: Revenue Outturn Summary (RS) 2014/15 (Net Current Expenditure).**DCLG: Capital Outturn Return (COR) 2014/15 (Total expenditure)*

69 This table is based on the Government's Public Expenditure Statistical Analyses 2016, which provides data for 2014/15 and can be found here: <https://www.gov.uk/government/statistics/public-expenditure-statistical-analyses-2016> The analysis is limited expenditure that can be identified by region, which accounted for 85 per cent of total national expenditure on services in 2014-15. The expenditure has been classified in ten broad categories, as defined by HM Treasury. Using the HM Treasury figures as a baseline for London, the data was cross referenced against information from DCLG's Revenue Outturn (RO) and Capital Outturn Report (COR) data for 2014/15, which can be found here: <https://www.gov.uk/government/statistical-data-sets/local-authority-revenue-expenditure-and-financing-england-2014-to-2015-individual-local-authority-data-outturn>

This provided further information on the level of expenditure incurred by the GLA and the London boroughs and the City of London. Where the amount of total expenditure was higher than that recorded by London local government it was assumed that the remaining spend should be attributed to central government. A full reconciliation between these individual returns and HM Treasury statistics has not been possible. However, it is felt that these figures do serve to illustrate, in broad terms, the level of expenditure across the various tiers of government in London and where it is spent.

Table 7: Comparing public expenditure with devolved tax options (2014/15) – millions

		Central government	London's government	Total
Expenditure		£50,493	£33,531	£84,024
Defence		£8	£0	£8
Economic affairs		£358	£6,364	£6,722
Education		£5,439	£7,739	£13,178
Environmental protection		£196	£1,013	£1,209
General public services		£34	£898	£932
Health		£21,070	£568	£21,638
Housing and community amenities		-£232	£2,686	£2,454
Public order and safety		£2,017	£3,538	£5,555
Recreation, culture and religion		£695	£686	£1,381
Social protection		£20,908	£10,039	£30,948
Income		£50,493	£33,531	£84,024
Devolved taxes		–	£6,401	£6,401
Council tax		–	£3,418	£3,418
Retained business rates		–	£2,983	£2,983
Other income		–	£27,130	£27,130
Grants		–	£22,213	£22,213
Capital receipts		–	£706	£706
Revenue contributions		–	£2,494	£2,494
Borrowing (supported and unsupported)		–	£1,716	£1,716
Income from central government		£50,493	–	£50,493
General taxation		£50,493	–	£50,493
Potential income from other devolved taxes		–	£24,818	£24,818
Remainder of business rates		–	£2,983	£2,983
Stamp duty land tax	100% of London's tax take	–	£4,280	£4,280
Annual tax on enveloped dwellings	100% of London's tax take	–	£103	£103
Capital gains tax on property	100% of London's tax take	–	£1,144	£1,144
Income tax	10p in the pound of London's taxable income*	–	£14,444	£14,444
VAT	10% of London's tax take**	–	£1,863	£1,863

Sources:

1. London Councils using HM Treasury PESA, DCLG Revenue Outturn Summary and DCLG Capital Outturn Return
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3. HMRC Annual UK ATED statistics <https://www.gov.uk/government/statistics/uk-ated-statistics>
4. GLA Economics calculations using HMRC Capital gains tax statistics, OBR Economic and fiscal outlook November 2016 and City of London's London Finances and Revenues
<http://webarchive.nationalarchives.gov.uk/>
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* Illustrative only **Illustrative only

ANNEX 4

Recommendations of the first London Finance Commission

1. The first LFC, which reported in 2013, recommended a suite of devolved powers for the capital and encouraged the UK government and London to explore radical approaches to devolving powers across policy areas.
2. The LFC's recommendations focused on a two-fold approach: relaxing restrictions on borrowing for capital investment and devolving revenue streams, including a full suite of property taxes.
3. The above recommendations sought to give London's government the freedom to make appropriate investments in its own infrastructure both to cater for the growth already forecast for its population and economy, and to promote additional economic growth. The proposals aimed to give London the autonomy to invest in the capital and increase accountability to residents and businesses, without affecting the financial settlements of other parts of the country.
4. Ultimately, the LFC believed that any future growth or contraction in the tax base in London would be a matter for the capital to deal with.

SPECIFIC RECOMMENDATIONS

Infrastructure

- Delegate powers to London boroughs to act as commissioners of local infrastructure projects and increase overall infrastructure capacity across London.

Investment

- Explore more radical approaches to creating incentives for London's government in the tax system.

Housing finance

- Consider the devolution of housing benefit to London.
- Relax/remove borrowing limits for housing purposes for boroughs.

Taxation

- Devolve property taxes (council tax, business rates, stamp duty, annual tax on enveloped dwellings and capital gains property development tax) to London's government.
- Devolve the powers to set rates, revalue bands and offer discounts.

Domestic property taxes

- Devolve power to hold periodic revaluations to London's government.

Non-domestic property taxes

- Devolve 100 per cent of business rates and the business rates multiplier to London's government.

Income tax

- Consider assigning income tax if greater powers are devolved to London's government.

Smaller taxes

- Allow London's government to be able to introduce smaller new taxes.

Fees and charges

- Remove central controls on planning application fees, building control fees, land searches and licensing fees.
- Minimise the number of national set charges, making locally determined charges the norm.

Community budgets and city deals

- Extend the remit/scale of Community Budget Pilots and develop 'single pots' devolved from existing UK government budgets.

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