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Is over centralisation hindering economic growth?

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Couple stagnant economic growth across the last decade with the task of recovering from the economic impact of the pandemic and exiting the EU and the argument for a new approach to economic policy to tackle the stuck economy sounds compelling.

Breach and Bridgett's new report 'Centralisation Nation: Britain's system of local government and its impact on the national economy', issued by the think tanks Centre for Cities and the Resolution Foundation, sets out why the imbalanced division of responsibility between local and central government is linked to poor local and national economic growth and makes the argument for institutional reforms that will help to 'un-stick' the British economy. In this article we analyse some of their findings.

Devolving fiscal responsibilities

Britain's system of subnational government stands out internationally for its exceptional fiscal centralisation. Despite recent waves of devolution across the country and an increased recognition being placed on the importance of big cities in driving economic growth, Britain has become even more fiscally centralised since 2015, which has served to further reduce the already-weak incentive for local authorities to focus on growing their local economies.

Greater devolution will not, in itself, lead to improved local and national economic performance but rather the shift in responsibility that occurs will enable local authorities to have the ability to manage the specific needs of their local economy. If a subnational government is to effectively take on the mandate for managing local economic change, then there will need to be an acceptance that this will require reformation of the system as a whole and consideration needs to be given to the interconnections between nominally separate policy areas. Evidence from the international community suggests that such change is achievable, and other countries with similar structures for subnational government such as France, Japan and Ukraine, have made progress on overcoming similar challenges.

Fragmentation of local government structures and boundaries

The UK does not have a uniform system for administration but is made up of a complex structure of subnational governance that damages the ability of local government to take responsibility for managing local economic change and solving problems. In their view, the fragmentation of local government structures in England has created a bottleneck effect on local (and likely also on national) economic performance, which makes it harder to deliver the necessary levels of comprehensive reform needed of both funding and responsibility.

This fragmentation weakens any incentive on local authorities to pursue economic growth as the locality may be disconnected from the tax revenues generated. It also creates a geographical fragmentation as local services within an economic geography may not be within the remit of local policy makers to implement ideas and affect change.

Research has been carried out that shows that in areas in the UK where local autonomy is low, but the quality of governance is good, increased devolved power will lead to considerably greater productivity output. For example, in their report 'A comprehensive approach to understanding urban productivity effects of local governments', Jong et al suggest that if using this modelling, Leicester's local productivity would be 21 per cent higher if the city had a similar level of autonomy to Helsinki.

Fragmentation of English local government comes both horizontally (where multiple councils with the same responsibilities cover a single local economy) and vertically (where multiple councils with different responsibilities cover the same geography). The many tiers and geographies and variations of approach mean that governance of the local economy becomes fragmented often with powers that are separated between different tiers of administration.

To improve the ability of subnational government to manage local economies, their view is that there will have to be a reorganisation of local government structures. The complexity of localities has been historically addressed by central government permitting variations in structures but this has actually made the existing system more complex. The variation found in boundaries and leadership arrangements in English local government is starkly different to the rigid approach taken by central government on local policy and taxation. Making local government structures simpler will, they suggest, pave the way for other more complex reforms such as fiscal devolution and planning reform. Responsibility for reorganisation and reform in a country that is heavily centralised must come from central government itself.

Adequate resourcing for local authorities

Despite the evident political and economic need to tackle Britain's geographical economic inequality, local prosperity is not at the top of the agenda for local government and which is reflected by the fact that Councils only spend 9% of their budgets on local economic development. One reason for this is that local government is more focused on its responsibility for social care due to economic restraints and the absolutism of statutory duties. If local authorities are to be given greater responsibility for economic development, then this will have to be coupled with greater resource for local government in order to deliver on both fronts.

Undoubtedly, all of local government's responsibilities have become increasingly difficult to meet due to both spending cuts and the implementation of austerity. The focused suppression of revenue spending coupled with capital spending remaining cheap has led to an approach of increased borrowing to invest and acquire assets, which in turn creates false economies for local government. As a result, rather than local authorities using their investment spending to invest in the local economy, they have instead been incentivised to use it to help further support their spending on essential local services. This low level of spending on economic development means local authorities do not adequately fund activities that would increase the net worth of the local and national economy. Britain's economy is underperforming, and this in part stems from underinvestment in the public sector which means the level of local public investment is not at the required level.

To adequately resource local authorities in the short term, there will need to be an injection of funding from central government to enable local authorities to meet their current service responsibilities. In the medium to long-term, if local authorities are to take responsibility for driving local economic growth, then they will have to be given access to enough funding that the local authorities can meet their statutory duties and then have enough remaining to focus on this new responsibility. To ensure that local authorities' economic growth budget is not overly sensitive to changes in grant funding from central government, a fiscal devolution approach could be taken whereby local authorities could instead be allowed to use new levers to raise their own revenue. An increased ability to raise money locally would lead to increased investment by local authorities as it would incentivise them to grow the local economy and increase tax revenues which could be used to pay for other responsibilities such as local services.

It is argued that effective fiscal devolution as a tool to fund local economic growth would be dependent on systemic reforms and improvements to highly fragmented local structures. They see such an approach as having the dual benefit of improving local services in the short-term and improving long-term economic growth forecasts without requiring local authorities to choose between the two or be overly reliant on central government to always consider funding local growth to be a priority.

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