

## Written evidence submitted by the Local Government Information Unit (LGIU)



### About the LGIU

The LGIU - Local Government Information Unit - is a not-for-profit, non-partisan membership organisation. We are for local government and anyone with an interest in local democracy and finding local solutions to the challenges that we all face. Our resources, innovative research and connections are relied on by colleagues across the globe.

LGIU has 37 members across Scotland, including 27 of Scotland's 32 local authorities, as well as over 220 members across the UK, Ireland and Australia.

The majority of information collected for this submission is from an LGIU survey of senior council figures conducted from the 2nd to the 23rd of November 2023.<sup>1</sup> Additionally, we have recently published a review of local authority finances as part of our international comparative examples of local authority financing led by Professor Muldoon Smith.<sup>2</sup> Together, these two sources provide both an 'on the ground' perspective of the experience of local authorities with navigating their financial challenges, and an overview using statistical evidence and international comparators. Equally, LGIU maintains constant contact with our members in Scotland who provide us with ongoing expertise and insights on the sector.

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<sup>1</sup> The survey reached out to every local authority chief executive, leader and section 95 officer in Scotland. We received 42 unique responses representing over 75% of councils. Our respondents were identified as 36% chief executives, 25% council leaders and 36% section 95 officers. The full results are available here <https://lgiu.org/publication/the-state-of-local-government-finance-in-scotland/>

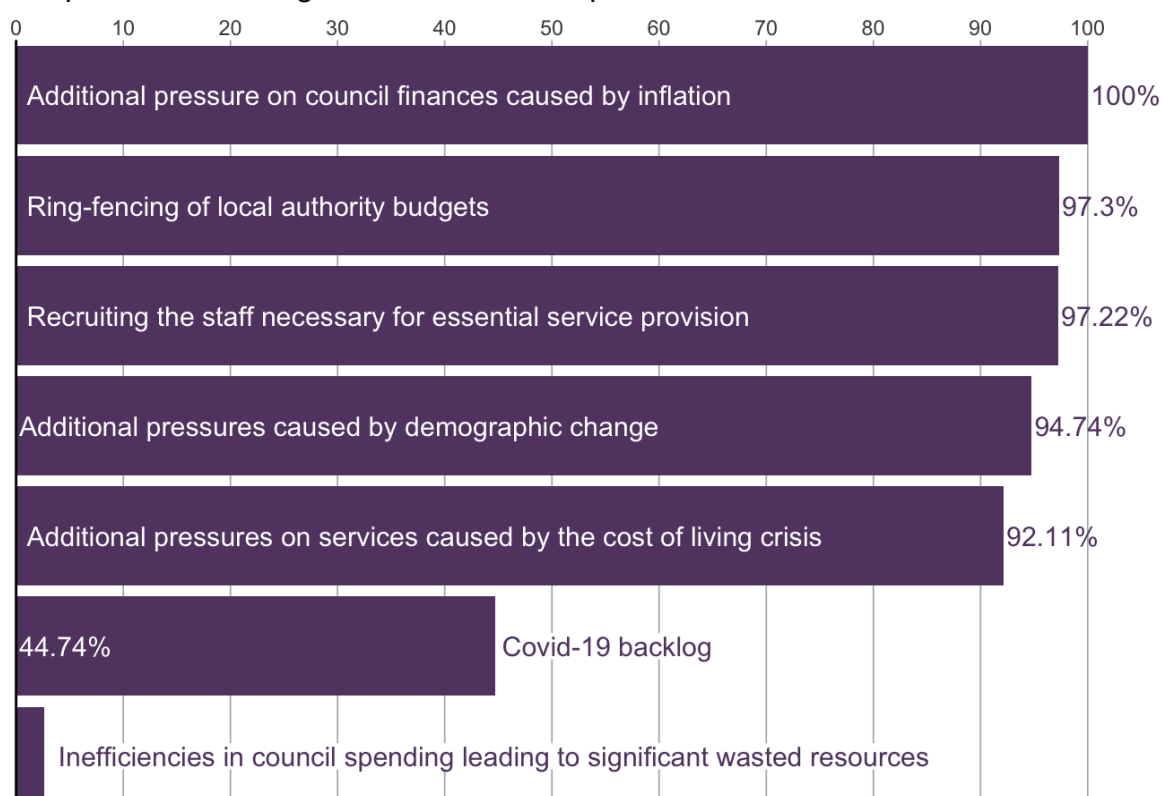
<sup>2</sup> Muldoon-Smith, Kevin, Jonathan Pearson and Mark Sandford. 2024. *Constrained autonomy and uncertain viability in Scotland: Local government finance challenges in a new political landscape* <https://lgiu.org/wp-content/uploads/2024/07/Constrained-autonomy-and-uncertain-viability-in-Scotland.pdf>

## Financial sustainability of Scotland's local authorities

### 1. What are the main challenges facing local government finance over the next five years?

Confidence in the sustainability of council finances in Scotland is critically low, with only one of forty-two senior council figures responding to our Autumn 2023 survey that they were 'quite confident'. At the time of the survey, there were several issues pointed to as drivers of the financial weaknesses of Scottish authorities.

#### Proportion describing each of these as a problem



Many written responses described how ring-fencing and directed spending were causing pressures on council finances. We heard about how pupil-teacher ratios and the requirements to maintain health and social care spending, both directed from Scottish Government, are limiting the resources available for discretionary spending.

In the next five years, many of the issues raised across Scottish local councils will likely remain or increase. In particular, increasing demand for services and workforce shortages, alongside limited flexibilities for raising income - particularly when council tax is frozen, lack of clarity around budgets, were all issues raised that are likely to continue or be exacerbated without intervention.

Councils in Scotland, when compared to their international peers, have a small number of options they can take when facing financial challenges, made even smaller when council tax

is frozen as it was in the last financial year. Every respondent to our survey said they would be cutting spending on services, 97% increasing fees and/or charges, 89% spending reserves, and 67% increasing commercial activity. Alongside this, 45% of respondents said they would be increasing borrowing.

Several of the options councils are taking, including the use of reserves, service spending cuts, and asset sales, cannot be used indefinitely, and will weaken council's overall financial resilience and capacity to deliver services in the long term. As a result of this situation, where cost and demand are increasing faster than spending power, several respondents raised their concerns about the viability of councils finances, as one respondent put it: "It is just a matter of time before the first Scottish council goes bankrupt."

### **3. Has the Verity House Agreement impacted on the financial sustainability of local government since it was signed last June and if so, how?**

At the time of our survey in Autumn 2023, only 10% of respondents agreed that the Verity House Agreement had resulted in improved communications between local government and Scottish Government, with the surprise council tax freeze cited as the most common reason.

One respondent specifically raised that little progress had been made towards the Verity House Agreement's stated intention to reduce ring-fencing and directed funding.

Before the launch of our survey and responding to the First Minister's surprise announcement of the council tax freeze, LGIU's Chief Executive, Jonathan Carr-West highlighted two reasons why the freeze was likely to have an immediate detrimental effect on the status of the Verity House Agreement. Firstly, the lack of consultation with local government demonstrated a failure of the principles of trust and respect that are encapsulated in the "no surprises" principle of the Verity House Agreement. Second, even when council tax freezes are funded by grants, the loss of growth in the council tax base undermines the council's finances for years to come and removes fiscal flexibility that councils should be guaranteed. Overall, this was viewed as an early backward step for both Verity House and financial sustainability.

### **4. What would you like to see in the forthcoming fiscal framework to help improve financial sustainability?**

From LGIU international comparative work, there are several key policies that have been proven to have a significant impact on the resilience of local authority finances from other jurisdictions. These are worth recognising as proven steps to improving local financial resilience in places such as Italy, Japan and Germany<sup>3</sup>.

First, in most other countries we have looked into, there is a constitutional definition of roles, giving local governments specific and enshrined rights and responsibilities. Often this

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<sup>3</sup> Muldoon-Smith, Kevin, Andrew Walker and Greg Stride. 2024. *Learning from local government finance across the world: Proposals for improving the financial resilience of local government in England* <https://lgiu.org/publication/learning-from-local-government-finance-across-the-world/>

includes the right to determine their own finances, and to enforce this right in the courts if they believe it is being contradicted, for example by central government decrees overspending or unfunded mandates. In Italy, for example, ring-fencing is considered unconstitutional.<sup>4</sup> The Fiscal Framework with consideration given to the European Charter of Local Self-Government<sup>5</sup>, and the Verity House Agreement itself, offer examples of how a similar non-binding agreement can be attempted in Scotland. But equally, the experience of Verity House could be seen as throwing into contrast the difference between the binding constitutional arrangements we have examined in Italy, Germany and Japan, and the types of non-binding frameworks being discussed.<sup>6</sup>

Second, there are several policies that would make managing the finances of local authorities easier: an end to ring-fencing, multi-year funding, and most apposite from our international work: an increased basket of different local revenue-raising options. These range from smaller local taxes (such as visitor levies, local fuel duties, etc) that raise limited income but provide additional flexibilities, up to the assignment of a proportion of national taxes including income tax, VAT or capital gains tax, all of which are more buoyant than council tax as a means of raising significant revenue in the long term.

Third, the Verity House Agreement included the maxim “local by default, national by agreement.” This is in-keeping with many of the jurisdictions we have analysed with more resilient local government finances, which tend to operate on the principle of subsidiarity: the bottom-up approach to distributing governmental responsibilities. In general, this means that tasks are administered at the lowest possible level of government.<sup>7</sup> One of the major reasons this is worth considering is because it also implies that adequate financing is provided for these tasks, and that there is consideration given as to what constitutes the lowest “possible” level of government. Our recent research on the role of local government in the proposed national care service in Scotland concluded that this type of consideration, how the rebalancing of responsibilities (in this case away from local government towards central government) would lead to improved adult social care, had not yet been convincingly demonstrated.<sup>8</sup> The planned fiscal framework should take into account the resources necessary for undertaking tasks at the lowest possible level and how this financial certainty would be guaranteed.

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<sup>4</sup> Kevin Muldoon-Smith, Cameron Forbes, Jonathan Pearson and Mark Sandford. 2023. *A system-wide analysis of local government finance in Italy*  
<https://lgiu.org/wp-content/uploads/2023/10/A-system-wide-analysis-of-local-government-finance-in-Italy.pdf>

<sup>5</sup> COSLA, Scottish Government. 2023. *Progress Publication, December 2023: Fiscal Framework between Scottish Government and Local Government*  
<https://www.gov.scot/publications/fiscal-framework-between-scottish-government-local-government-progress-publication-december-2023/documents/>

<sup>6</sup> COSLA, Scottish Government. 2023. *Progress Publication*. “The Fiscal Framework will have the status of a ‘Memorandum of Understanding’, it is a statement of political intent and should not be regarded as a binding agreement, and does not create legal obligations.” (P.4).

<sup>7</sup> Muldoon-Smith, Kevin, Cameron Forbes, Jonathan Pearson and Mark Sandford. 2023. “A system wide perspective of local government finance in Germany.”  
<https://lgiu.org/wp-content/uploads/2021/07/A-system-wide-perspective-of-local-government-finance-in-Germany.pdf>

<sup>8</sup> Burn, Emily, Catherine Needham, Martin Powell. 2023. *What role for local government in Scotland’s National Care Service?*  
<https://lgiu.org/publication/what-role-for-local-government-in-scotland-s-national-care-service/>

Fourth, the countries we looked at had mature systems of territorial equalisation. The Japanese system of local government, for example, has a process called the Local Allocation Tax:

*“The system guarantees that a portion of national tax revenue is a common financial resource for all local governments. The LAT is collected and administered by central government on behalf of local government. It is redistributed to compensate for financial imbalances and to maintain service provision – LAT based revenue is not ring-fenced or earmarked.”<sup>9</sup>*

This type of systematic territorial equalisation would complement the existing redistribution of Non-Domestic Rates, but could be extended to include an element of equalisation, to replace schemes such as the competitive bid-funding of the Levelling Up scheme. Equally, the exact specification of the territorial equalisation funds - which should be spent at the discretion of the local authority - could include a rationalisation of funding streams, moving away from the short-term pots of funding for specific policy priorities which tie local governments into complex reporting, inefficient spending, and uncertainty in medium to long term financial planning where funds are distributed outside of the funding formula.

Finally, other local government finance systems we have looked at included ongoing and protected representation of local governments in enshrined institutions together with central governments - to ensure that local government views on policy matters relevant to them are considered. These institutions can take on many different forms - in Germany it is generally municipal associations within federal states that represent local governments, in Italy there is a standing conference with local and central government figures. However, what they all have in common is that they guarantee that local governments are represented whenever policies that might affect them are considered. In the case of Scotland, this would go beyond the narrow question of budget consultation, important and necessary, but not sufficient and include full involvement from an early stage and consultation on all issues relevant to local authorities for example social care provision or education policy.

**5. Is there a risk that Scottish local authorities might face similar financial difficulties to those faced by some English councils such as Nottingham, Croydon, Thurrock and Slough? If so, how can this risk best be mitigated?**

The cases of Nottingham, Croydon, Thurrock and Slough, each of which has issued at least one section 114 notice, are due to specific commercial and governance issues at each of these councils. Scottish local authorities are perhaps less exposed to commercial risk as it stands because they lack the general power of competence. However, risks remain that are associated with authorities that have issued 114 notices (such as equal pay claims) to which local councils in Scotland may be exposed. However, Councils and Directors of Finance are

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<sup>9</sup> Muldoon-Smith, Kevin , Cameron Forbes, Jonathan Pearson and Mark Sandford. 2024. *A Systematic Analysis of Local Government Finance in Japan*  
<https://lgiu.org/publication/a-systematic-analysis-of-local-government-finance-in-japan/> (P.21)

aware of the risks and have been planning to manage that risk in the short to medium term. LGIU has been working with CIPFA on this throughout the summer and will present our findings at the CIPFA Scotland conference in September. The longer-term financial outlook remains uncertain.

There is a greater risk that councils in Scotland might face a similar situation to many in England where without exceptional financial support, the combination of increasing service costs and limited flexibility to raise income will make it difficult or impossible for councils to pass balanced budgets or meet their statutory obligations.<sup>10</sup> In our survey of English local authorities in Spring 2024, we found that over half of respondents answered that they were likely to issue a section 114 notice in the next five years, and 9% said they were likely to in the next financial year, unless financial circumstances change.<sup>11</sup>

This risk, the more widespread possibility of resources not keeping up with costs, is the more salient risk across local authorities than the governance or commercial failings associated with the pattern of 114 notices listed. LGIU are repeating our survey of council leaders, chief executives and section 95 officers in Scotland in Autumn 2024, with results being reported in November. This will offer additional insights into the short and long-term financial resilience of local councils.

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<sup>10</sup> Department for Levelling Up, Housing and Communities. *Exceptional financial support for local authorities for 2024-25*

<https://www.gov.uk/guidance/exceptional-financial-support-for-local-authorities-for-2024-25>

<sup>11</sup> Stride, Greg and Mike Woods. *The State of Local Government Finance in England 2024*

<https://lgiu.org/wp-content/uploads/2024/02/State-of-Local-Government-Finance-in-England-2024.pdf>