One Year After: Birmingham's Path to Financial Recovery and Ongoing Challenges

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1. Introduction

In English law, the financial distress of local authorities is managed through unique measures that differ significantly from corporate insolvency procedures. Local councils are required by law to maintain balanced budgets, theoretically making them immune to insolvency. This requirement is governed by the **Local Government Finance Act 1992**, specifically under section 31A, which mandates that local authorities must calculate a council tax requirement each year to ensure that they have sufficient funds to cover their expenditures. Additionally, councils must adhere to certain principles of financial prudence as outlined in the **Local Government Act 2003**.

The **Local Government Act 2003** reinforces this requirement, particularly in Part 2, sections 25 to 27, which require:

- Councils to set a budget that is balanced and sustainable.
- The chief finance officer to report on the robustness of the budget estimates and the adequacy of reserves.

These provisions, taken together, establish a legal framework compelling councils to avoid budget deficits, effectively mandating a balanced budget through responsible financial planning and oversight.

However, as seen in the recent financial difficulties of Birmingham City Council, local authorities can still encounter severe financial strain that necessitates intervention.

2. Existing Legal Framework

Increasing financial pressures, rising populations, higher demand on social care and lower council incomes are putting local authorities under pressure.[2] Under English law, there is no formal insolvency framework for councils akin to corporate insolvency procedures. The primary mechanism available for managing a council's financial crisis is the issuance of a

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[2] For a more detailed analysis of the causes of financial distress in English local authorities, see: M Sanford, 'Why Are Local Authorities Going 'Bankrupt'?' (House of Commons Library, 16 July 2024).

"section 114 notice" under the **Local Government Finance Act 1988** (LGFA 1988).[3] This notice can be issued by a council's Chief Financial Officer (CFO) when the authority's spending is projected to exceed its resources, effectively freezing new expenditure except for essential services.

A section 114 notice serves as a moratorium but lacks the restructuring or creditor negotiation elements found in corporate insolvency. Its primary purpose is to halt financial haemorrhaging, maintain statutory services, and create a financial plan that can hopefully stabilize the council's finances.

3. Role and Powers of the Chief Financial Officer (CFO)

The CFO plays a crucial role in monitoring and maintaining the fiscal health of a council. Under the LGFA 1988, CFOs are empowered to issue two types of notices:

1. A **section 114(2) notice**, or advisory notice, when the council is about to engage in unlawful financial activity, effectively preventing the action.
2. A **section 114(3) notice**, which suspends all new spending when a council's expenditure is forecasted to exceed available resources.

The issuance of a section 114 notice typically signals that other remedial efforts have failed. When issued, it mandates that the council convenes a meeting within 21 days to discuss the implications, creating a "prohibition period" where spending is tightly controlled. During this period, only essential expenditures—such as payroll, statutory services, and legal obligations—are permitted. All other discretionary spending is halted unless directly authorized by the CFO.

4. Intervention by Independent Commissioners

in some circumstances the Secretary of State for Levelling Up, Housing and Communities may use powers under the **Local Government Act 1999**, specifically under section 15, to intervene in the operations of a local authority, for example by appointing commissioners to exercise specific functions of a local authority in place of that authority's elected representatives.[4] These commissioners take over the council's financial management to ensure stability and adherence to statutory obligations. The commissioners are tasked with creating a sustainable financial strategy, often through austerity measures, budget realignment, and, in some cases, workforce reduction.

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[3] For a more detailed explanation of the procedure, see: M Sanford, 'What Happens if a Council Goes Bankrupt?' (House of Commons Library, 13 September 2023).

[4] This has happened in the following local authorities which have issued section 114 notices since 2018: Northamptonshire County Council, Slough Borough Council, Thurrock Council, Woking Borough Council, Birmingham City Council and Nottingham City Council.

Unlike corporate insolvency administrators, commissioners for councils do not liquidate assets to repay creditors, as public service continuity remains the priority. This type of intervention is rare and typically reserved for cases where the financial or governance failure is severe.

5. The Case of Birmingham City Council

Birmingham's financial crisis has become emblematic of the critical consequences of inadequate governance and oversight, as seen previously with Croydon. Like Croydon, Birmingham's situation illustrates how governance failures and lack of external auditing can devastate local communities, with the "restructuring" processes triggered by a section 114 notice often disregarding essential social and environmental considerations.

On 5 September 2023, Birmingham City Council issued its first section 114 notice, later followed by a second on 21 September 2023, meant to push the council to address the deep-seated causes of its financial distress. The Labour-led council attributed much of the financial burden to a decade of austerity, citing a £1 billion funding cut under the Conservative government. However, the previous central government—led by the Conservative party—countered that it had increased Birmingham's funding in recent years, challenging the council's narrative.

While funding cuts played a role, Birmingham's financial issues largely stemmed from three main challenges: an over-budget IT system costing £100 million, the remaining debt from hosting the 2022 Commonwealth Games (amounting to £184 million), and ongoing liabilities from equal pay claims. These equal pay claims have a history rooted in gender discrimination within the council, with thousands of female employees initially compensated in 2012. Since then, the council has spent £1.1 billion addressing these claims and still faces liabilities between £650 million and £750 million, which increase monthly by £5 to £14 million.[5] This represents a striking case where social and equality issues lie at the core of financial instability. In light of similar situations surfacing across other councils, Birmingham's case highlights the broader risks threatening the stability of local authorities in England.

Yet, Birmingham's restructuring approach does not fully address these underlying issues. Instead, the council approved severe cuts of £300 million, including reduced funding for highways and youth services, alongside up to 600 redundancies and a 21% increase in council tax over two years. While such measures may temporarily alleviate budgetary pressures, they fail to consider the core factors driving Birmingham's financial distress, replicating the standard approach of cuts and taxation increases without meaningful, systemic reforms.

Central government has stepped in, committing an additional £685 million in financial support for the upcoming financial year and appointing a commissioner to oversee the

[5] Grant Thornton, 'External Audit 2020-21 to 2023-24' (29 September 2023).

council's activities. The council has also initiated negotiations for a new, non-discriminatory job evaluation scheme, a crucial step given the estimated monthly increase in equal pay liabilities. However, progress has been slow, and the delayed payment of equal pay claims has sparked union unrest and threats of industrial action. Such delays underscore a broader disconnect between Birmingham's current financial restructuring and the social issues at its core.

While Birmingham's governance issues may appear less severe than Croydon's, an independent review has highlighted strained relations between council officers and councillors, creating a blame culture that prioritizes individual accountability over systemic improvements.[6] Despite the commissioners' recommendation to address governance issues, this aspect remains minimally integrated into the financial restructuring process.

A year after Birmingham's effective "bankruptcy," commissioners report that the council has yet to establish solid plans to balance its 2025-26 budget. Conservative opposition leader Councillor Robert Alden has criticized the Labour administration for insufficient planning, pointing to unresolved issues with the costly Oracle IT system and delayed implementation of the job evaluation scheme. Commissioners acknowledge that, while progress has been made, more decisive action is needed to steer Birmingham's financial future.

A Labour spokesperson asserted that the administration has intensified financial controls and initiated service transformations to set the council on a sustainable path. They further expressed that a new Labour government would prioritize sustainable, long-term funding for councils nationwide. Birmingham's financial troubles remain a testament to the challenges that local authorities across the UK face, underscoring the need for comprehensive solutions that address not only financial distress but also the underlying social and governance issues.

6. Limitations and Challenges in Addressing Local Authority Insolvency

One of the critical distinctions between corporate and local authority insolvency is the absence of creditor compromise and asset liquidation mechanisms. Under the current framework, councils are not allowed to restructure debts in a way that would reduce or delay payments to creditors. Creditors of local authorities can rely on government-backed repayment, which limits the risk of default but also means councils have limited tools to manage unsustainable debt levels.

Another significant limitation is that councils lack access to interim financing in distress situations. In corporate insolvency, new funding can sometimes be arranged to allow the business to continue operating while a restructuring plan is negotiated. By contrast, distressed councils rely solely on existing resources, with government support as the last resort.

[6] Centre for Governance and Scrutiny, 'Birmingham City Council. Report to Cabinet' (12 December 2023).

7. Government Intervention and Legislative Reforms

Historically, direct interventions by the government, such as appointing commissioners, are rare and limited to cases of severe failure. Since the Local Government Act 1999 gave the Secretary of State authority to intervene, only few councils have seen such measures, typically involving commissioners stepping in to ensure that public services are safeguarded.

Birmingham's case has reignited discussions about potential reforms, including whether a more structured resolution framework, akin to special administration regimes in sectors like water and rail, could help local authorities manage distress more effectively. Such a framework might allow councils to:

- Negotiate Limited Restructuring Plans. Allowing councils to engage with creditors and negotiate debt adjustments could prevent situations where councils face unsustainable long-term liabilities.
- Access Temporary Government-Backed Financing. A model similar to interim financing in corporate insolvency could enable councils to bridge budget gaps while implementing structural reforms.
- Enhance Financial Autonomy. With clearer financial mechanisms, councils might rely less on government bailouts and maintain greater control over local service delivery.

8. Conclusion

The legal treatment of councils in financial distress under English law is primarily preventative, aimed at avoiding insolvency by mandating balanced budgets and restricting spending through measures like the section 114 notice. However, cases like Birmingham City Council's illustrate the need for a more comprehensive approach that balances fiscal discipline with the flexibility to address unsustainable liabilities. Reforms that allow for limited creditor negotiation and access to temporary financing may better equip councils to navigate financial challenges while continuing to serve their communities effectively.