



Adrian Waite (Independent Consultancy Services) Limited

Briefing Paper

Balance of Funding Review

February 2004

Introduction

Local authorities, the government and public opinion appear to be united in their dissatisfaction with the current system for financing local government. However, there is no consensus on what the solution to the problems should be.

In April 2003 the government announced a review of the balance of funding of local authorities. The review is intended to examine all aspects of the way that local government is funded in the light of public dis-satisfaction with the council tax. Nick Raynsford MP, Minister of State, chairs it, and suggested to the Labour conference in September 2003 that it was likely to conclude with recommendations for incremental change. This is despite the fact that most local authorities that have made representations have pointed to deep-seated problems and advocated radical solutions. These include the introduction of a local income tax and the return of business rates to local control.

It is expected that the review will report in April 2004. However, one of the review team members, Professor Gerry Stoker, said:

"It has been difficult to come up with a politically acceptable solution.

"I've never heard so many serious civil servants and political players saying something has to be done about the balance of funding, and this is the best chance we're going to get for a long time.

"There is no settled policy. This is a genuine, open attempt to come up with a solution."

David Smith, Director of Finance at Warrington Borough Council, is also a member of the review team and said:

"Some people will be impatient to see conclusions emerge, but it is more important that those conclusions are the right ones.

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"We must see it as an opportunity and get it right, because it's not an opportunity that comes up often."

Another review team member is Sir Brian Briscoe, Chief Executive of the Local Government Association, who said:

"The fact that the issue (council tax) has moved up the agenda ought to encourage the government and other parties to think seriously about the balance of funding rather than (having) knee-jerk reactions."

Nick Raynsford received a compliment from political opponent and fellow review team member, Chris Clarke, leader of the Liberal-Democrat group at the Local Government Association, who said:

"Nick Raynsford is conducting the review in a very open and inclusive way. He's a man who's prepared to listen and take notice."

Representations to the Review Panel

Local authorities and others had until September 2003 to make their representations and some examples of representations that were made follow:

"The key principles which should govern a local government finance system are accountability, transparency, fairness, sufficiency, buoyancy, efficiency and support for partnership working."

"For a system based on these principles to be fully effective, local government needs to have access to more local income."

"We would like to see the review examine returning business rates to local government, introducing a local income tax to fund local services, and making council tax fairer and less regressive."

"No change is not an option."

Local Government Association

"Clarity matters – people are unclear (as to) why taxes have shot up and don't know which tier is responsible – but things are a complete mess at the moment."

"We explain it in our leaflets, but people don't read them or don't believe them because of conflicting messages coming from central government."

"Until there's clarity it will turn people off."

"I think clear accountability could boost turnout at local elections in the future."

Steve Hoyes, Strategic Finance Manager, Harrogate Borough Council

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“The current balance is wrong, if we are to have local democracy. Councils have to raise more of their net expenditure. To transfer education as the highest cost service away from local government is not the answer as it weakens local democracy.”

David Andrews, Borough Treasurer & Deputy Chief Executive, Southend Borough Council

“We have been consistently pushing for localisation of business rates. As a regressive tax, council tax is not the best placed to raise more income.

“Manchester is a big business centre with a relatively low population for a major city – which means we’re poor in terms of council tax, but rich in terms of business rates. We’re pressing for revaluation.”

Richard Paver, City Treasurer, Manchester City Council

“If people want to have locally determined funding, it’s going to be unfair.

“We’ve got to be brave enough to allow things to be unequal, and that’s the real challenge.”

Robin Goater, Assistant Chief Financial Officer, Calderdale Borough Council

Kerry Lonimer, a reporter with the local Government Chronicle, said;

“Not since the Layfield enquiry of the 1970’s have senior politicians and civil servants been forced to think so long and hard about local taxation and what it means for local accountability. The furore over council tax increases has leant Mr Raynsford’s review an even greater political significance”.

The local Government Association in its submission to the review said;

“The local government finance system is an anomaly, a hangover from a different epoch dominated by a very different view of local government, of its role, its trustworthiness and its relationship with central government... (and) local government is too reliant on income from one local source.”

The Chartered Institute of Public Finance and Accountancy, in its submission said:

“Recent levels of council tax have reached - and in some cases arguably exceeded - the levels of acceptability of such a tax”.

“That is not however, an argument for the abolition of the council tax. As a property tax, the council tax is efficient and effective. However, it is an argument for reducing the absolute proportion of the total tax named through the council tax”.

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The Local Government Association also suggests that the review should consider:

- * return of business rates
- * local income tax
- * changes to council tax benefit system to make the tax fairer and less regressive.

The County Council Network said,

"We believe that by restoring (business rates) to local control or by the introduction of other sources of local revenue, which would have a similar import, the balance of funding issue can be addressed with minimal disruption and change to the existing system".

The Society of District Council Treasurers said:

"Consideration should be given to the opportunities for more programme taxation linked to ability to pay (which) provides sufficient resources for local government".

However, there remains scepticism about the outcome of the review in some quarters of local government.

Simon Heywood, Director of Finance at Wandsworth Borough Council, said:

"We don't set much store by the review given the time its taken to get it up and running and the issues it's been chewing over for the first few meetings.

"The tenor is negative on business rates and the government is not approaching it in an open way."

David Berry, Director of Finance at Bexley Borough Council, said:

"The government is obviously concerned about council tax increases, but I don't think much has changed. I haven't been aware of any change of sentiment suggesting, for example, business rates coming back."

In November 2003, Nick Raynsford, Minister of State for Local Government, ruled out a local income tax and said:

"It would be bizarre to have no tax on property, as well as causing a huge upheaval and very considerable turbulence.

"No one sees (local income tax) as the way forward."

And in December 2003 he added:

"I want to make it very clear that the fact the group is looking at how each of these (options) might work does not mean the government endorses them or is planning to adopt them.

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"The group needs the chance to find out how different taxes would really work in practice and what their advantages and disadvantages might be."

However, in December 2003, Sarah Wood, the Director of Economic and Environmental Policy at the Local Government Association, said:

"My view is that no change is not an option. The review must produce options which lead to substantive, sustainable, long-term change in the funding of local government. We must be careful not to tinker at the margins."

"We must make sure we don't miss the chance... The balance of funding review is an important opportunity for local government to put forward its case for strengthening local democracy."

Audit Commission Report

In December 2003 the audit commission reported on the reasons for high increases in council tax in 2003/2004. It identified 'fundamental flaws' and a lack of accountability in the local government finance system. In particular the commission criticised a 'lack of transparency' in the calculation of revenue support grant; the absence of a relationship between decisions to spend and increases in council tax; and the complexity of the system that deters public participation.

The audit commission found 'a clear association' between council tax levels and levels of revenue support grant, but none relating council tax increases to political control or grades under the comprehensive performance assessment. Variations in council tax are caused by 'a range of contradictory factors, some of which are the responsibility of central government and some of which are the responsibility of local government.'

The audit commission reported on the 2003/2004 council tax increases. It found that there was a significant difference between the 3.7% average increase in council tax forecast by the government and the 12.9% increase that actually occurred. They attributed this to:

- Increased national insurance
- Increased superannuation contributions
- Passporting of funds to schools
- Increased requirements for social services
- Movement of resources from the south to the north following the introduction of Formula Funding Shares
- The 'gearing effect'

The audit commission concluded that as local authorities are obliged to spend to meet national policy priorities such as increased education funding, the 9% increase in local spending seen in 2003/2004 was 'justifiable but not in all cases unavoidable.' However, there is 'insufficient countervailing pressure' to minimise increases in council tax following the ending of 'capping'.

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James Strachan of the audit commission said:

“Some of the simplistic explanations for this increase are simply not true... It is quite clearly a fault with the system – grants need to be more transparent.”

Sir Jeremy Beecham, Chair of the Local Government Association, said:

“The evidence speaks for itself. This report nails on the head any belief that councils have been frivolous, careless or politically motivated when taking hard decisions on council tax and spending on vital services.

“The commission agrees with our belief that the system is ripe for reform.”

Tony Travers, Director of the Greater London Group at the London School of Economics, said:

“Orally, the Chairman (of the audit commission) has been careful not to be drawn, but the only interpretation that can be given to the report is one that is fiercely critical of the government.

“This is a brave intervention by the audit commission which is indicative that the commission is changing its role somewhat.

“It is clearly going to look at the way in which government policy hits local government more than in the past, including the obvious inconsistency between the demand from different departments for spending and the demand for low council tax rises.”

Dennis Reed, Chief Executive of the Local Government Information Unit, said:

“All the experts can't be wrong... It will no longer be tenable to portray local authorities as responsible for excessive council tax increases. It is now vital to move the debate beyond the blame mentality.”

Maureen Wellen, Assistant Director for Local Government Finance and Policy at the Chartered Institute of Public Finance and Accountancy, said:

“The present imbalance in local government funding distorts the scale and impact of council tax rises as a result of the ‘gearing effect’... It also affects the ability of local authorities to be transparently accountable to their electorates for the resourcing and delivery of local services.”

Kit Malthouse, Conservative Deputy Leader of Westminster City Council, said:

“Ultimately ministers cannot promise extra money for public services on the one hand and take away our ability to deliver that investment with the other.

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“Local Government is elected to address local needs as well as national priorities. If ministers are to avoid council tax increases they must either give us, or allow us to raise locally, the money to fund both their and our requirements.”

Sir Robin Wales Labour Chair Association of London Government said:

If anyone needed it then the Audit Commission report into this year’s council tax increases is the clearest evidence yet that the way councils are funded is not working.

For councils to keep up with the demands and expectations of the government and residents while keeping council tax increases to a minimum they must receive a fair share of the funding.

London boroughs have continually strived to ensure they are able to provide the best possible services while limiting the impact on the capitals residents – including many on low incomes – through the council tax demands.

The report highlights “fundamental flaws” in the way councils receive money – through which “London and the south east were disadvantaged”.

It was this tough settlement coupled with the fact London suffers from some of the country’s worst deprivation that fuelled the problem in London. Despite some people’s perceptions, the capital’s streets are not paved with gold.

We need to start again and use the balance of funding review to come up with a system that enables everyone to pay a fair share for the services they receive rather those who can least afford it to dig deeper into their pockets than others.

David Curry MP, shadow secretary for local and devolved government said:

“Midsomer Murders rather puts me in mind of the debate on council taxes. We have graphic scenes of mass violence, the result of that relentless scourge, the gearing effect. There are outraged members of the public. There are ministers – nothing to do with me gov – promising summary justice to offenders. And now we have the police inspector in the form of the Audit Commission saying well, err, actually there does appear to have been a dangerous tax-raiser on the loose and he is representing the government.

“Of course, I paraphrase slightly. But not very much. The report contains two crucial pieces of evidence. Neither of them comes as a bolt from the blue. The first is that where the increase in government grant was relatively generous council taxes rose more modestly. Conversely, a meagre increase in government grant stimulated a large council tax increase.

“The second is that the effect was not differentiated in party political terms. In other words, the main driver of council tax increases is the extent to which the government was demanding spending increases not covered by additional grant.

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“One other point caught my eye – the commissions exhibit four. This shows that “regions in the south with lower grant increases had higher average council tax increases and those in the Midlands and North with higher grant increases had lower council tax increases”. In other words, there has been a drag of funding towards the mets. Guilty, your honour, as charged.

“But who is this dangerous man on the loose? Certainly not local government minister Nick Raynsford. I have got a soft spot for Mr Raynsford – debating with him on the council tax is like looking through a mirror back to the time of the last Tory government. He knows the lines, I know the lines, and now the roles have switched. Mr Raynsford might well be charged as an accessory but he should get away with community service.

“Nor even is Deputy Prime Minister John Prescott the main culprit – he, to uses that technical term particular to local government finance has been “stuffed”.

“No, the real culprit is the stuffer-in-chief, the belligerent education secretary Charles Clarke. His passporting of education shafted the system – he has come as close as you can get to removing education from council control as you can within the present framework. It will be interesting to see whether the balance of funding review ends up by accepting a virtual fait accompli.”

National Non-Domestic Rates

The last year during which business rates were set locally was 1990/1991 at which time business rates met 24% of local government expenditure. From 1991/1992 national non-domestic rates were introduced that are set nationally, collected locally and the proceeds pooled. Since then, however, the proportion of local government expenditure that has been met by national non-domestic rates has declined from 24% in 1991/1992 to 23% in 1993/1994 when Council Tax was introduced, to 18% in 2003/2004.

The proportion of local government expenditure met by Council Tax in 1993/1994 was 15% and this increased to 20% in 2003/2004. This means that over the ten-year period there has been a 33% increase in council tax that has been required to meet the real-terms reduction in national non-domestic rates receipts. This represents a significant shift in the balance of taxation from businesses to individuals at a local level.

Conclusions

So – does all this suggest that the balance of funding review will result in radical changes to local government finance?

On the one hand, the answer should be ‘Yes’. There appears to be unanimous agreement that the current arrangements are unsatisfactory with central government, local government, the audit commission, all political parties, public opinion polls and pensioners demonstrating in the streets all expressing dissatisfaction and frustration with the current arrangements.

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The central problem appears to be the Council Tax. It raises only a quarter of the money required for local authority spending, yet in the process achieves a very high profile in the minds of council tax payers, many of whom regard it as unfair. Yet to solve one problem would be to exacerbate the other. Quadruple Council Tax so that it could fund all local government spending and remove the 'gearing effect' whereby a 10% increase in council tax is needed to increase a local authority's expenditure by 2.5%; and create a public outcry at the size of the bills that would result! Alternatively, abolish the council tax to leave local government totally funded by the centre!

The fact that council tax raises a significant amount of revenue at minimal cost means that any government would be reluctant to abandon it, yet its high profile means that large increases cannot be countenanced politically. As a result it is likely that council tax will be retained albeit in a modified form to make it more acceptable to its critics. More bands at the higher end could achieve this. The government will also have to address the implications of revaluation of properties that will see a significant redistribution of the council tax burden.

Business Rates are the next issue. Since these were nationalised the share of local government expenditure that they meet has declined from 24% to 18%. A return of business rates to local government combined with a significant increase in rates would increase local autonomy and make local authorities less dependent on central government funding. However, businesses would oppose this while the government appears to be of the view that allowing different authorities to set rates at different levels would not be appropriate.

Then there are the more radical alternatives – local income tax, local sales tax and so on. These could make local government self-financing but would the Treasury find it acceptable to relinquish their monopoly of control over these sources of revenue? Alternatively, the Treasury could assume responsibility for funding some services directly – Education, for example, leaving local government with a restricted range of services to fund from existing resources.

So – there may be nothing more than minor changes to the way in which local government is funded.

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