



Government Response
to the ODPM
Select Committee Report:
Local Government Revenue



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Presented to Parliament by the
Deputy Prime Minister and the First Secretary of State
by Command of Her Majesty
October 2004

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Introduction

The Government welcomes the Committee's report. It is a helpful contribution to the important debate about local government finance. There is significant common ground between this report and that of the Balance of Funding Review which was published on 20 July¹.

As the Minister for Local and Regional Government announced to Parliament on 20 July, the Government has appointed Sir Michael Lyons to carry out an independent inquiry into the detailed case for changes to the present system of local government funding. The inquiry will take evidence from stakeholders and make recommendations by the end of 2005 on any changes that are necessary and how to implement them. The terms of reference are set out in the Annex. The Committee's report will be a valuable input to the inquiry.

The Government's response to the Committee's conclusions and recommendations is set out below. However, the Committee will appreciate that, in view of the Lyons inquiry, it would not be appropriate for the Government to take a final view on many of the Committee's conclusions and recommendations at this stage. Indeed many of the issues raised by the Committee fall within the remit of the inquiry and the Government expects the inquiry to consider the Committee's views very carefully in these cases.

¹*Balance of Funding Review Report* ISBN 1 85112 721 6; £14.00.
Tel: 0870 1226 236; email odpm@twoten.press.net.
Also available at: www.local.odpm.gov.uk/finance/balance/report.pdf

Response to Committee's conclusions and recommendations

Introduction: Balance of Funding

1. We commend the ODPM for its commitment to transparency on the progress of the review and for making a range of working papers publicly available, including the steering group minutes. (Paragraph 9)
2. Enhancing the accountability of local authorities to the people they serve is at the heart of the balance of funding debate. (Paragraph 14)

The Government is grateful for the Committee's appreciation of the openness of the process of the Balance of Funding Review.

The Government agrees that accountability is at the heart of the balance of funding debate.

Gearing

3. The Committee is convinced that gearing has a negative impact on local authorities by distorting accountability, magnifying any weaknesses in the formula grant system and making the entire system less clear. It was the major factor in the 12.9% average increase in council tax bills in 2003/04. The ODPM has confirmed that there is no evidence that gearing has any positive effects on efficiency. (Paragraph 40)

The Government accepts that gearing can cloud the accountability and transparency of local spending decisions.

4. It is clear that Government grant can be significantly reduced from its present level and still fully meet its functions of equalisation and meeting national objectives through ring-fencing. Revenue Support Grant of £27 billion in 2004/05 is well above the level needed for equalisation. Plans to cut ring-fencing will mean a greater proportion of grant is paid through Revenue Support Grant. We conclude that the only purpose of keeping grant so much higher than necessary is to have a greater control of local authority expenditure, as a tool of macroeconomic policy. While economic stability is a legitimate goal, the relatively marginal effect of small changes in local authority expenditure within the context of the whole economy and negative impact of gearing on local authorities leads us to recommend that central Government should have control only over the grant it needs to meet the goals outlined above. Local authorities should have control over a much greater proportion of their income, at least 50%. Our proposals for the taxes which should fall under local government control are outlined later in this report. We accept the Minister for Local and Regional Government's argument that equalisation means that some gearing effect will always be part of the system, but the changes we propose aim to reduce this and its distorting effects. A shift in the balance of funding of the order of our recommendation would make the system significantly more acceptable and transparent. (Paragraph 50)

Consideration of the level of the Government's contribution cannot be disentangled from the broader questions of the balance of funding and the scope of local revenue-raising powers, as adjusting the amount of headroom whilst retaining the same level of overall spending would require a greater yield from local taxation. It also needs to take account of the future arrangements for schools funding which will require changes to the grant system (see response to Recommendation 5 below). The Government has asked the Lyons inquiry to consider these matters further.

5. The Government needs urgently to clarify its plans for funding for schools. (Paragraph 51)

The Department for Education and Skills' (DfES) five year strategy published on 8 July clearly sets out the Government's plans for funding schools. From April 2006, DfES will take responsibility for determining the size of each local authority's 'Dedicated Schools Budget' – the amount spent locally on schools and other services for pupils (e.g. pupils with Special Educational Needs). DfES will fund this with a 100% direct grant (made possible through a transfer out of Revenue Support Grant). The local authority will not be able to divert this funding to any other purpose, so the total spending on schools and other services for pupils will be guaranteed in each local area. But the local authority will be able to top it up, if it wishes. This Government has always given special priority to funding for schools; the decision to introduce a Dedicated Schools Budget crystallises that priority, ends long-standing confusion between central and local government about responsibility for setting the level of schools funding and will allow local authorities to concentrate fully on their strategic and quality-assurance roles in education.

Other grant issues

6. We recommend that the ODPM publishes details of the estimated cost pressures for each local authority service. We accept that much of the detail is likely to be technical, but summary information could spell out at a national level what funding had increased by, what service-specific inflation was predicted to be, what assumptions about efficiency improvements have been made and hence what remains for actual service improvements. (Paragraph 58)

The Government is keen to ensure that local authorities have as much information as possible to enable them to make sensible budget decisions. The Government agrees that clarity in areas such as overall increases in funding and efficiency assumptions is vital. The recent Spending Review announcement set out the overall increase in general grant to local authorities up to 2007/08 and the Government's assumptions about the efficiency savings which should be available to improve front line services by the end of the Spending Review period. This was based on work with the Local Government Association in the context of the Local Services Review. The Government believes, however, that providing they budget prudently and avoid excessive budget increases local authorities are best placed to take decisions on spending priorities based on their local knowledge of the circumstances which exist in their areas and in the light of their statutory responsibilities and the wishes of their electorate.

In addition to the plans for general grant so far announced, Departments are currently considering the Spending Review outcome for their spending plans and will be looking to announce details of their specific grants for authorities as soon as possible.

7. There would be obvious advantage in a three year rolling programme of grants for local authorities. It would enable authorities to publish at least indicative budgets for the same period, and associated local tax rates. The Spending Review system in central Government already provides this element of certainty and predictability. A similar scheme already operates in Scotland. We would in principle like to see the practice of three year assured funding proposed for school budgets extended to all local service funding. If this is not done it is important that the ODPM and DfES explain the relationship between education and other local authority spending and whether all education funding is effectively going to be ringfenced. We recommend that ODPM inquire into the lessons to be learned from Scotland, and investigate appropriate safeguards for its introduction in England. (Paragraph 62)

The Government is committed to the introduction of three year local government grant settlements for individual authorities and will be consulting on proposals by the end of the year with the view of starting to implement them from 2006/07. That will greatly assist councils' medium-term spending plans.

Capping

8. The Committee acknowledges that the Government wants to ensure that its national policy agenda is followed at local government level, and in particular its macro-economic policies, although we have expressed our conviction that variations in local government expenditure have little macro-economic effect. We believe that this would be more constructively achieved through discussions within the Central-Local Partnership than by capping. It is much more appropriate for local authorities to be held to account for local decisions, including the level of local taxation, through the ballot box. If the Government insist on retaining capping, capping should be selective, rather than general and selected local authorities should be given a year in which to meet the requirements. (Paragraph 70)

The action taken this year in relation to a number of authorities was taken in order to protect council taxpayers from excessive increases in bills, not to reduce local authority expenditure for the purposes of economic management.

The Government introduced new reserve capping powers in the Local Government Act 1999. In 2004/05, it has made use of the more flexible capping powers now available. This included "nominating" eight authorities and setting them notional budgets for 2004/05 against which subsequent increases in budget requirements will be measured for capping purposes. Such authorities are not required to make cuts in their budget requirement or council tax this year. Six authorities were subject to in-year capping.

Passporting and Ring-fencing

9. Despite the 8 July announcement by the Secretary of State for Education and Skills, we recommend that the Government ensure that its target of reducing a ring-fenced grant to 10% of overall grant in 2005/6 is met. The Government should provide an annual statement of its performance and intentions with regard to ring-fencing and passporting in future years. (Paragraph 81)

10. We recommend that the Government reconsider the use of ring-fencing and passporting, and acknowledge the potential role of the local electorate in terms of setting the local agenda. Mechanisms such as the central-local partnership can be used to ensure minimum standards. However, local authorities should be given the freedom to implement local priorities, and be judged for these decisions by the local electorate. (Paragraph 82)

The Government will continue to look closely at all existing ring-fencing grants and restrict the use of ring-fencing to those areas which are a national priority. In 2004/05 it removed ring-fencing from £750m of grants. It has been the Government's practice in recent years to announce the percentage of grant which is ring-fenced at the time of the local government finance settlement.

The framework for the delivery of local services must secure improvements against national priorities and also allow local authorities to meet local priorities and respond to

local circumstances. The Government recently published a discussion paper which addresses this issue in the context of a longer term vision and strategy for local government, titled 'The future of local government: Developing a 10 year vision'. Earlier this year the joint Treasury/Cabinet Office Devolving Decision Making Review recommended a reduction in input, output and process controls in order to give local authorities and other bodies more freedom to tailor their services to the needs of communities and to reflect local priorities.

As part of the work to develop a ten year strategy for local government, the Government has announced proposals to pilot Local Area Agreements (LAAs) in nine local authorities. Building on Local Public Service Agreements, LAAs are a way of giving greater freedom to councils and their partners to explore local solutions to local problems. They are intended to simplify funding streams, join up public services and give councils and other local delivery partners more flexibility.

These initiatives build on the package of measures provided to all local authorities to increase flexibility and local decision-making, including more proportionate inspection, the new prudential borrowing regime, charging powers for discretionary services and fewer plan requirements.

11. The Government should allow local authorities to make spending decisions, and take the consequences for these decisions at the ballot box. If Central Government wishes directly to control education funding it should consider funding education directly. If it believes that education is an important and integral part of local government services and funding it should set minimum standards and then allow local discretion. The present situation lacks clarity and transparency as to where responsibility lies. (Paragraph 83)

The position on schools funding is explained above in the response to Recommendation 5.

Best Value and the CPA

12. The Committee recommends that the Government dramatically reduce their inspection regimes on local authorities. In particular the Government should consider the concerns of smaller local authorities and ensure their inspection regimes are proportionate to their size and responsibility. The Government should continue to free “good” and “excellent” authorities from some inspection and plan-making regimes and should ensure the inspection framework is appropriate to the improvement needed in “poor” and “weak” councils. (Paragraph 92)

The Government gave a commitment in the Local Government White Paper, published in December 2001, to introduce a proportionate and co-ordinated inspection regime for local authorities. The main inspectorates of local government represented on the Local Services Inspectorate Forum have been asked to reconsider forward inspection programmes to reduce the burden on authorities, and to adopt a more risk-based approach developed in consultation with authorities themselves wherever possible.

By using Comprehensive Performance Assessment (CPA) judgements as the focus for a collective discussion with each council, programmes can be better targeted to the needs of individual councils, and more proportionate to their strengths and weaknesses. The timing of an inspection can also be better matched to the improvement activities planned by the council. Inspectorates can develop joint or co-ordinated inspections where these will add value.

The amount of inspection has already reduced. In 2003/04 there was a reduction of approximately one-third in total inspector days compared to 2002/03. Councils that scored best under CPA will see the biggest reductions in inspection.

The Government is continuing to implement the changes necessary to reduce very substantially the requirements for plans from the best performers. An Order removing a series of requirements for plans from authorities categorised as excellent was recently laid before the House.

Council Tax

13. We recommend that council tax should be retained, provided it and council tax benefit are reformed in line with our other recommendations in this report in order to address the shortcomings of the current arrangements. In addition, local authorities need greater freedom in the use of their other sources of revenue to ensure that council tax payers are not exposed as at present to large increases in annual bills. (Paragraph 100)

14. We recommend that, in principle, banding should be expanded at either end of the scale with divisions in what are now bands A, G and H. We also recommend that multipliers should be changed to ensure that the new bands are broadly in line with household income, resulting in a wider range of liabilities from the present ratio of top to bottom bands of 3:1. All these reforms should be implemented at the same time as revaluation, in 2007, to avoid unnecessary disruption. (Paragraph 115)

15. We recommend that consideration be given to regional and sub-regional banding being introduced to address any inequalities caused by revaluations and changes to the banding arrangements but not addressed by equalisation. (Paragraph 119)

16. If council tax is retained, then the ODPM should, at the earliest possible date, draw up and implement a strategy with local authorities to improve public confidence in council tax and their knowledge of the impact of revaluation. This should not wait for detailed information on property values, which can be communicated later, but concentrate on the general effects of revaluation and how council tax has been reformed to address its failings. We also recommend that, as suggested by the Audit Commission, council tax bills in 2007 should separately identify changes in individuals' bills that are the result of i) local spending decisions, ii) revaluation and iii) reforms to council tax. (Paragraph 123)

17. We welcome the Minister's commitment to a 10 year domestic revaluation cycle. (Paragraph 124)

As announced on 20 July, the Government has already accepted the conclusion of the Balance of Funding Review that council tax should be retained but reformed. It now looks to the Lyons inquiry to recommend what reforms are needed, taking account of all relevant evidence including the Committee's report. The Government fully recognises the need to involve local government. The Office of the Deputy Prime Minister has started discussions with the Local Government Association about revaluation and this provides a forum for discussing the detailed proposals by the Select Committee. The Government is glad that the Select Committee welcomes the commitment to a ten year revaluation cycle. This is now enshrined in primary legislation by amendments made to the Local Government Finance Act 1992 by the Local Government Act 2003.

18. Whatever other changes are made to council tax benefit, the Government needs to give a higher priority to increasing its take-up by a number of readily identifiable target groups, in particular pensioners, and low-income households. It is unfortunate that the central Government is saving over £1.2 billion of unpaid council tax benefit every year, and that 2 million households are paying more than they should to local government. (Paragraph 130)

The Department for Work and Pensions (DWP) has already taken steps to support local authorities in their take-up activities for Council Tax Benefit, and will continue to give priority to this issue. Earlier this year, DWP launched a national awareness campaign and issued local authorities with a Best Practice Guide to help maximise take-up. The Pension Service also considers eligibility to Council Tax Benefit as part of its holistic approach to take-up of entitlements by pensioners. DWP is looking at further ways to streamline the claims procedure. For example, where a person claims Council Tax Benefit alongside a number of other benefits, the common information on personal and financial circumstances required should only be given once. The Government is keen to ensure that everybody who is entitled to help with their council tax bills claims Council Tax Benefit.

19. We recommend that in response to this report the Government set out the nature of the inquiries it has set in motion into conversion of council tax benefit to a tax credit, any obstacles identified so far, and a timetable for possible implementation. We are strongly of the view that this is the way forward in making a property tax a more acceptable means of raising local revenue. We do not, however, underestimate the time and effort required to implement such a change, not least at local level. As an interim measure, and a further means of improving take-up, we therefore recommend that council tax benefit be re-branded as council tax discount or rebate, more accurately reflecting its true nature. (Paragraph 132)

DWP will continue to consider ways in which help with individuals' council tax liability might be better delivered, through both improvements to the current rules and options for more radical reform, including the possibility of a tax credit approach. The Committee is quite right to acknowledge the time and effort required to implement fundamental change. DWP does not intend to set out a timetable for any such fundamental reform until the Government has firm proposals for the way forward.

Meanwhile, the Government is not persuaded that simply re-branding Council Tax Benefit would be sufficient to effect a significant shift in the public perception of the help that is currently available. However, DWP will continue to consider this along with other ways in which help with individuals' council tax liability might be better delivered.

20. The Government should do further work to ensure equity release schemes, or other means of deferring payment, are available. (Paragraph 133)

It is currently possible for local authorities to recover outstanding council tax by means of a charging order on the property, but that can only happen if arrears exceed £1,000 and the authority has started enforcement action. The Government looks to the Lyons inquiry to advise on any proposals to make council tax payments easier.

Review of Local Income Tax as an alternative

21. The introduction of a local income tax in 1976 would have been a leap in the dark, which ahead of new technology would have created acute administrative problems for local government. Since then new technology, and a scaling down of the

plan for local income tax to that suggested by CIPFA, has created a system that might work. Nevertheless, the evidence is not remotely persuasive. Administration would be costly. There is still far too little known about the practical implications including the cost, redistribution effect, impact on tax payers, including first time buyers, and where people choose to live. It would be unwise to pursue implementation of a local income tax before detailed research on these areas had been undertaken. (Paragraph 143)

The Government shares the Committee's view on the need for caution about local income tax. This view is also consistent with the report of the Balance of Funding Review. The terms of reference of the Lyons inquiry ask it to conduct a thorough analysis of options other than council tax for local authorities to raise supplementary revenue, including local income tax.

Business Rates

22. In the Committee's view it would be both practical and sensible to halt the decline in the proportion of local revenue which comes through business rates. (Paragraph 155)

23. The Committee therefore recommend that the cap which prevents business rates increasing by more than the rate of inflation is removed. Irrespective of whether business rates remain at a uniform national rate set by central government or are relocalised and set by local authorities, the Committee believe that the proportion of local government revenue which is raised nationally through the business rate would be fairer at a level of 25%. (Paragraph 156)

24. The Committee therefore recommends that the Government returns business rates to local authority control as soon as possible, but no later than 1 April 2006. In addition, the proportion of local government revenue derived from business rates should account for at least 20% of total local government revenue. (Paragraph 160)

25. When business rates are restored to local control, the Committee recommends that the Government put in place a mechanism to prevent excessive increases by, for example, limiting the annual increase in business rates in an area to no more than the annual percentage increase in the council tax in the area. (Paragraph 166)

26. For as long as the Government continues to set a national rate in the pound but with annual increases greater than inflation, the Government should consider:

- enshrining in primary legislation the maximum rate of increase above inflation that can be imposed; and
- announcing any increases above inflation as part of a three year rolling programme. (Paragraph 167)

The Government notes the Committee's clear views on this matter. The Government looks to the Lyons inquiry to conduct a thorough analysis of reform of business rates alongside other options for raising more funding locally to supplement council tax, as required by the inquiry's terms of reference.

Different tiers of Local Government

27. The Committee believes that the complicated nature of sub-national service provision and service cost needs further clarification, and that the Government should review the information that accompanies council tax bills. Whatever judgement is made on implementing a revised council tax, the Committee believes that the Government should survey authorities to gauge current best practice and feed

these findings back into the central-local partnership for discussion, before the next council tax bills are issued. (Paragraph 171)

For 2004/05, the Government simplified the requirements for information accompanying council tax following a consultation exercise. The Council Tax and Non Domestic Rating (Demand Notices)(England) Regulations 2003 (SI2003/2613) allow local authorities to decide what information to provide within a framework set by Government. The Government believes this is a more appropriate way forward than prescribing in detail exactly what information should go out with council tax bills. It does agree that local authorities should follow good practice in the content and design and will consider how this might best be achieved. However, as local authorities start preparing their accompanying material well in advance, it is unlikely that this could be achieved in time to influence what goes out with the 2005/06 bills.

28. The laudable desire of Parish councils for expenditure directly attributable to their activities to be known to local electors, and to be raised from local taxation, is a further strong argument for a local tax base and local taxes. (Paragraph 173)

The Government's decision to retain council tax meets this point.

Alternative means of raising local revenue

29. We believe that any decisions about new taxes should be taken at the local level. As these taxes will be fairly revenue low, there should be safeguards put in place to protect local authorities from any cut in central grant, if they choose not to raise local revenue in this way. The important point is the existence of local flexibility and accountability of local authorities to their electorate for the decisions they take. (Paragraph 182)

30. We believe that local authorities should have the opportunity to increase their income by extending more fees and charges to a wider range of services. Local authorities should also be allowed to make profit from services. All local authorities should be required to have in place a socially inclusive fees and charges remission scheme. (Paragraph 185)

31. Despite being prima facie attractive, we have doubts about the legal and practical possibilities of a local sales tax. We recommend that the Government investigate the implications of introducing such a tax in order to inform local government decision making. (Paragraph 190)

32. We recommend that local authorities consider the experience of congestion charging in both London and Durham and in the light of this reflect on its potential usefulness in their area. However, the most important point is that local authorities should retain the option to implement congestion charges where appropriate to their area. (Paragraph 193)

33. Local authorities could choose to invest income from workplace parking charges in local transport infrastructure as they can from congestion charging: there is no good reason to limit their freedom to do so. (Paragraph 195)

34. The Committee believes that a tourist or bed tax could generate funds to reinvest in services for tourists, thus bringing fringe benefits for local people and businesses. (Paragraph 198)

35. Overall we believe that local authorities should have the opportunity to introduce a 'basket of local taxes'. However, it is important to acknowledge that they will not raise enough revenue to replace the existing council tax and that they should be seen as nothing more than a supplement. It should also be acknowledged that the primary role of such local taxation should be to generate behavioural change, i.e. a congestion charge should lead to reduction in car usage, rather than just seek to generate revenue. (Paragraph 199)

The Government notes the Committee's thoughts on alternative means of raising local revenue. It looks to the Lyons inquiry to take them into account and make recommendations as appropriate. At this stage, the Government would simply comment as follows.

Local authorities have powers to introduce, if they wish, road user charging or a workplace parking levy to help manage local congestion. They must apply the net revenues to local transport purposes for at least ten years from the start of a scheme.

Recent economic research shows that a local tourist tax or bed tax could make the UK tourism and hospitality industry less competitive in comparison to other countries at a time when the industry is only just recovering from events such as Foot and Mouth Disease, Severe Acute Respiratory Syndrome (SARS) and September 11.

On 29 July an Order came into force enabling best value authorities classified 'excellent', 'good' or 'fair' to trade at a profit in any of their ordinary functions. Guidance on these trading powers was issued on 28 July.

Annex

Independent Inquiry into Local Government Funding in England

Terms of Reference

The inquiry will be led by Sir Michael Lyons and will report by the end of 2005 to the Deputy Prime Minister and the Chancellor of the Exchequer.

The inquiry will:

- consider, in the light of the report by the Balance of Funding review, the detailed case for changes to the present system of local government funding;
- make recommendations on any changes that are necessary and how to implement them; and
- take evidence from stakeholders.

In particular, the inquiry will:

- make recommendations on how best to reform council tax, taking into account the forthcoming revaluation of domestic property;
- assess the case both for providing local authorities with increased flexibility to raise additional revenue and for making a significant shift in the current balance of funding;
- conduct thorough analysis of options other than council tax for local authorities to raise supplementary revenue, including local income tax, reform of non-domestic rates and other possible local taxes and charges, as well as the possible combination of such options; and
- consider the implications for the financing of possible elected regional assemblies.

The inquiry will also consider, as appropriate, any implications that its recommendations have for other parts of the United Kingdom.



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