

**BALANCE OF FUNDING  
LGA CONSULTATION PAPER**

**(Report by the Corporate Director – Commerce and Technology)**

**1 PURPOSE**

- 1.1 The purpose of this report is to allow Cabinet to consider the LGA's Consultation paper and determine any response it wishes to make.

**2 THE CONSULTATION PAPER**

- 2.1 The LGA believes that the current system of local government funding – council tax – is unsustainable. The problem of 'gearing' and the need for many councils to set increasingly high levels is a clear indication that the current system cannot cope.

- 2.2 In 2000 the government announced a high level review of the balance of funding between central and local government. This is being led by the minister for local government, Nick Raynsford. The aim of the review is to explore alternative approaches to the balance of funding. The LGA is contributing to this review.

- 2.3 The LGA is promoting an approach to local government finance that combines a variety of different options to create a more sustainable, buoyant and accountable system of resourcing local government.

- 2.4 **What is wrong with the current system of local finance?**  
The LGA believes that an effective local finance system should give councils more access to a higher proportion of local income. Overall this does not mean people paying more taxes; it means that the types of taxation need to change. The LGA believes that the existing council tax system:

- **Distorts accountability** – council tax increases have been called upon to pay for national, not local, pressures – for example the shortfall in funding for schools this year. Local communities do not see a clear connection between local taxes and local decisions and services. Academic studies have shown that turnout in local elections is low partly because people do not think their vote makes a difference to the kind and level of services provided locally. Ring-fenced grants also distort accountability to local people. The proportion of these grants from central to local government has risen since 1997, meaning that central government, not local councils, are taking decisions on how local taxes should be spent.

- **Is not fair** – for local taxpayers, the current system is not fair. For those on fixed income, such as pensioners, the recent increases have affected them disproportionately. For local councils the grant system is having to bear too much weight – but this is not taken into account within grant formulae. This effects local council tax disproportionately, with councils facing the ‘gearing effect’. This means an increase in expenditure of, for example, 1 per cent, can leader to higher rises in council taxes, on average multiplying the impact on council tax payers by four.
- **Cannot meet demands** – councils’ own income, most of which comes from council tax, is not sufficient to cope with the range of demands made on it. It is not a buoyant tax, able to reflect increases in the tax base. The grant system means that a council must take an annual decision to change the level of council tax to secure more income. This contrasts strongly with central government which gains more income from buoyant taxes, like income tax, when the economy grows.

## 2.5 What is the LGA’s proposal?

The LGA believes that the way to tackle the council tax problem is to create a combination of local funding sources. This does not mean increasing the level of taxes paid overall. The sources could include:

- a reformed and more equitable property tax;
- progressive ‘relocalisation’ of business rates, rather than simply collecting business rates on behalf of government to be redistributed;
- shifting a proportion of national income tax to fund local government directly, and reducing the level of grant to local government in line with this. This approach could develop into a local income tax; and
- a basket of smaller taxes and charges.

## 2.6 Reforming the property tax

A property tax has some merits – it offers certain yield, is difficult to evade and collection costs are low. However we need to address the issues of fairness and how the tax interacts with the benefit system. Possible options include: increasing the number of bands; reviewing the discount system particularly for specific groups; ensuring that council tax benefit provides an adequate safety net for those who truly cannot pay; revaluating the tax more frequently; and calculating the tax as a percentage of capital value rather than bands.

## 2.7 Relocalising the business rate

Local government collects business rates. These are paid into a national pool and redistributed on a per head basis. This rate is tied to the Retail Price Index. By ‘relocalising’ the rate, this would restore councils’ link with the business community and give them access to a share of the growth in the business tax base, making this income more buoyant.

## 2.8 Moves towards local income tax

Currently the grant paid to councils equates to 26 per cent of income from national income tax. By transferring a proportion of this directly to councils would mean central government grant could be reduced and replaced by a share of income tax. This would not mean additional taxes would be levied. Income tax is buoyant, so income from the tax would grow with the economy.

Once this system of 'assigning' income was in place, councils could then move towards varying the rate, which would make it a local income tax. Alternatively councils could move towards local income tax immediately.

Grants to councils would then become a much smaller proportion of the councils' total income, but would be retained to equalise needs and resources, on the same basis as the current system of formula spending shares.

## 2.9 The basket of taxes and charges

There is also a range other new taxes and charges that could be explored. Individually none of these would raise large amounts of income. They include localised vehicle excise, local sales taxes, localised stamp duty, land value taxes, tourist taxes, more charging for services, charging for utilities' street works, local congestion charges and 'green' taxes.

The implications for the system overall are whether income from these would be taken into account when calculating grant. Currently income from parking charges and congestion charges is treated separately.

## 3. COMMENT

3.1 There is probably general acceptance that the current system has problems and the LGA's views on what is wrong are outlined in paragraph 2.4 above. There may however be significantly different views on which elements of the possible solution will be most attractive either practically or politically.

3.2 The Council determined at their December meeting that:

***This Council urges the Government to:***

- ***review the duties, functions and powers of local government with a view to giving real autonomy to local people by removing all centralised control; and***
- ***pursue urgently the reform of local government funding so that the level of tax continues to reflect the ability of people to pay and the funding itself is distributed to local authorities in a fair, open and understandable manner.***

3.3 Responses are requested by 13 February.

#### **4. RECOMMENDATION**

- 4.1 **The Cabinet is asked to determine what comments it wishes to make on the LGA's consultation paper.**

#### **ACCESS TO INFORMATION ACT 1985**

The balance of funding – a combination option, Local Government Association  
Filed in Financial Services

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Further information on the balance of funding review is available on the LGA website at [www.lga.gov.uk/OurWork.asp?lsection=59&ccat=753](http://www.lga.gov.uk/OurWork.asp?lsection=59&ccat=753) and the ODPM website at [www.local.odpm.gov.uk/finance/balance.htm](http://www.local.odpm.gov.uk/finance/balance.htm)