

INTRODUCTION

D.1 As part of my Inquiry, I commissioned five pieces of analytical work to explore my interest in other countries' approaches to local finance arrangements, public attitudes to local government finance and taxation, and local taxation options:

- a team at the University of Cardiff, led by Professor John Loughlin, built on their work for the Balance of Funding Review to explore international models of local government finance and their advantages and disadvantages in terms of greater fiscal decentralisation;
- Professor Tony Travers from the London School of Economics used the Cardiff work, and other pieces of international research, to produce a think piece on the key challenges of applying international models to the English system;
- NERA Economic Consulting were commissioned to do a comprehensive literature review of actual and suggested local tax options. This inevitably encompassed international examples of local taxes as well as more theoretical suggestions for change; and
- two pieces of public attitudes work were commissioned:
 - the first was two waves of focus group work commissioned from GfK NOP Social Research that gathered in-depth attitudes to the principles behind local taxation – including understanding of who was responsible for services – and potential changes to local taxation; and
 - the second was a national survey commissioned from BMG Research that aimed to quantify people's attitudes to local taxation, as well as explore views on who should control local services and taxes. This survey is in two waves, the second of which is not yet ready for reporting, meaning this summary focuses on findings from the first wave.

D.2 In addition, in June 2005, I brought academics and other experts together to critically assess the case for greater devolution of decision making to local government. I considered this an important input into my consideration of change to local-national fiscal arrangements. Professor Gerry Stoker from the University of Manchester chaired this seminar and produced a paper on its key conclusions.^{1 2}

D.3 This summary brings the key findings from this analytical work together. The full research reports and related work are also being published by the Inquiry.

¹ Stoker G, *Greater Local Devolution: Evidence in Support: report of a seminar held for the Lyons Inquiry, 22 June 2005*, 2005

² Turok, I, *Local and National competitiveness: the economic case for devolution*, 2005

Smith, M, *Policy making and joined up government*, 2005

Martin, S, *Impacts of local devolution for efficiency and effectiveness in service delivery*, 2005

Perri 6, *Devolution for local government, individual choice about services and personal responsibility*, 2005

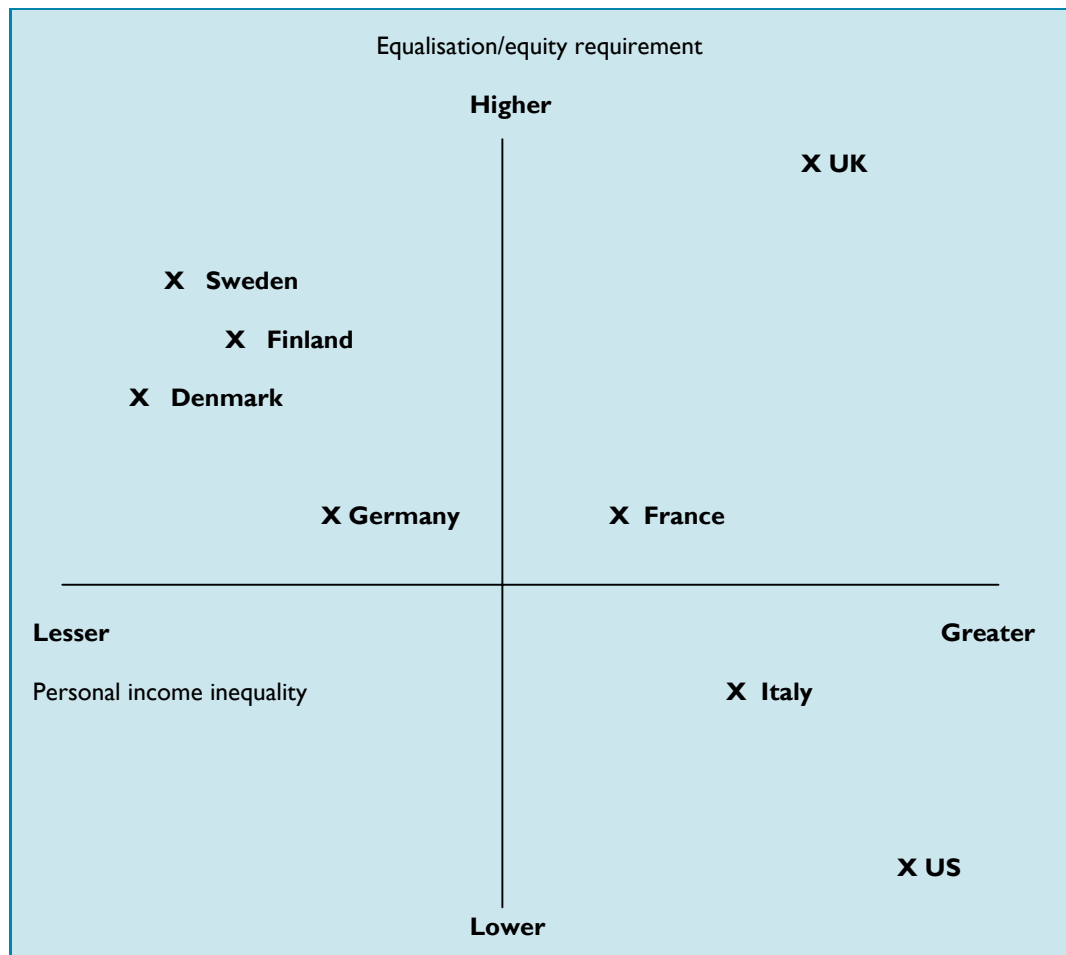
Lowndes, V, *The case for local devolution: community cohesion and self-determination*, 2005

Key findings from the international comparisons work

D.4 In any comparative work it is important to remember that the possibility of taking models of government or taxation from one country to another is limited by the challenge of fitting the concept or institution into another context. However, exploring other countries' approaches does allow assumptions about the status quo to be explored.

D.5 The international work demonstrated that the UK is distinctive in terms of the very low proportion of resources raised from local taxes (comparative data from 1999 showed the UK raised 13%, compared to 50% in Denmark, 57% in France and 59% in Sweden), its reliance on a single local tax, its breadth of ambition for national standards, and its aim for a high level of equalisation between areas of different tax raising power. Even compared to Scandinavian countries the level of English ambition for resource equalisation is high. These features are illustrated in the chart below (from Professor Travers' report) and the table.

Chart D.1: Equalisation by income inequality



NB: Personal income inequality measured using Gini coefficients

Table D.2: Different countries use of major forms of local taxation

	Local income tax	Local business tax	Local property tax
UK			X
Belgium	X	X	X
Denmark	X		X
Finland	X		X
Spain	X	X	X
Sweden	X		
Italy	X	X	X
Germany		X	X
France		X	X
Portugal		X	X

D.6 The work by Cardiff University shows there are a number of potential advantages associated with a greater level of fiscal decentralisation than currently exists in England. These include:

- improved local efficiency;
- greater local policy discretion;
- enabling local innovation;
- more targeted use of local resources with gains in both efficiency and effectiveness; and
- enhancing local democracy and accountability.

D.7 However, it also suggests that these potential gains need to be weighed against potential disadvantages of fiscal decentralisation that include:

- where there are a number of different sources of funding at the local level, increased complexity and loss of transparency;
- equity costs;
- difficulties in achieving central government policy goals; and
- the potential for economic distortions caused by variations in taxes and rates across jurisdictions.

D.8 Different countries have different ways of managing some of these potential disadvantages including:

D.9 *Complexity and transparency*: limiting the range of taxes available to different tiers of local government and ensuring that as far as possible any fiscal decentralisation confers the same powers to similar units of government, thus avoiding asymmetries between similar jurisdictions, as these introduce complexity and reduce understanding.

D.10 *Equity costs*: different countries have different aims for, and forms of, equalisation, with much depending on the desire for equality of service provision, as against the emphasis on accountability and economic efficiency. In England the system is one of vertical equalisation, meaning resources are transferred between central and local government. Such systems can lead to an over-reliance on central government. The alternative is a horizontal system, in which resources are transferred between local authorities at the same level of government. Horizontal systems reduce demands on central government for resources, but can mean conflict among regional and local authorities.

D.11 *Managing central policy goals*: depending on how it is arranged, high levels of fiscal decentralisation can mean that there are trade offs between local autonomy, central policy goals and the management of macro-economic policy. However, other countries' experience demonstrates that these trade offs can be managed either through negotiation, use of specific grants, central control over some key functions but not others, and national-local agreements.

D.12 *Potential for economic distortions*: there is a risk that greater fiscal decentralisation could lead to issues such as high levels of tax competition between areas. Experience in other countries shows how these can be minimised through co-operative mechanisms to reduce inter-jurisdictional variation in rates, tax sharing arrangements and, to some extent, equalisation mechanisms. Ensuring that the local tax base is residence-based and taxes relatively immobile units is another way of minimising excessive tax competition and tax shopping, where people or businesses move or change their behaviour in order to take advantage of different tax regimes.

D.13 Professor Travers' observations in comparing the British and international models of local government finance are:

- there are more likely to be uncontrollable and rapid rises in local taxation in situations where local taxation only represents a small proportion of local government income, but where local government provides a major share of public service delivery;
- the inclusion of welfare services in local government service responsibilities means that there is a greater likelihood of central government involvement; and
- in situations where local government has more than one tax, and where such taxes are not perceived to be regressive or highly visible, there is less likelihood of difficulty with local taxation than where there is a single, visible, regressive tax..

D.14 His conclusions are:

- there is some evidence from overseas experience that political systems with greater degrees of trust (or a greater propensity for collaborative working)

between tiers allow for a more relaxed public finance regime to operate. If Whitehall and local authorities could evolve a stronger and less adversarial relationship concerning expenditure and local taxation, financial reform would undoubtedly be easier to implement;

- British or English local government is unusual in the degree of equalisation, and the consequent lack of inter-authority tax competition that is a by-product of the full (or near-full) equalisation arrangements in use. Arguably, the present system of local government finance provides authorities with a number of perverse economic incentives. In designing reformed local tax and grant mechanisms in England, there would be powerful arguments for ensuring that authorities faced rational incentives. For example, councils should have at least some financial encouragement to build up their local tax base and/or to attract new businesses to the area. At present, such incentives are wholly absent from the local government finance system; and
- because of the visibility of local government taxation and its recent political importance in Britain, there is likely to be popular pressure to avoid or minimise reform. But healthy local government finance is a key element in the democratic and constitutional arrangements of virtually all developed democracies. Some commentators would like a one-off revolution. Others would prefer an incremental approach to change. Whatever the case, the importance of a firm and effective system of funding for local government is not in doubt.

Key findings from literature review of local tax options

D.15 The literature review conducted by NERA explored the advantages and disadvantages of a wide range of potential local taxes. The table below summarises some of the issues identified by NERA’s work.

Table D.3: Advantages and disadvantages of different forms of local taxation

Tax Type	Advantages	Disadvantages
Local income taxes	Used in a number of other countries, broad based, raise substantial revenue, buoyant, progressive and can include measures to protect low income groups, visible so good local accountability, having a national income tax system should help with administrative feasibility	Volatile – less tax at times of downturn, buoyancy can lead to over-provision of services, locational inefficiencies (i.e. people moving to lower tax areas), income disparity in England could impact on equalisation, care needed in terms of impact on work impacts and savings decisions
Property taxes	Very widely used in other countries, difficult to evade, revenue raising potential can be high, visible	Low growth, fixed nature of tax, can discourage development on land, some locational impacts, valuations can be high cost, can be regressive to income (although this depends on measure of wealth that is used)

Land value tax	Advocates consider it to be neutral and non-distortionary, beneficial as tax increases in line with economic value, can be designed to give local authorities an additional tool for land development	Pure land value tax rarely used – usually split rate system that taxes improvements on the land as well as undeveloped land – which involves a trade off between maximising revenue and making tax base non-distortionary, land value tax is complex to explain which impacts on accountability, potentially high admin costs
Local sales tax	Generally used in combination with other taxes, can be a large source of revenue especially if high proportion of business purchases are covered, relatively buoyant and can be made less cyclical if covers retail items such as food, can be used to tax non-residents	EU constraints are likely to mean that only final sales taxes would be an acceptable form of local tax, potential problems with internet sales, if tax too high will deflate local economy so can't sustain large increases, could cause locational distortions, difficult to target exemptions, concern over regressivity to income especially if it covers items such as food
Business taxes	Broad range used across the world – can be levied on property, sales, income, activity – means wide scope to raise significant amount of revenue, can be progressive, locally variable taxes could make more local authorities more accountable to business, buoyant	Can cause locational inefficiencies and other distortions, could impact on employment, difficult to tax more mobile businesses, volatile (especially business income taxes), increased tax burdens are passed onto consumers and labour in the end, if a property tax could affect land/property development, can be difficult to allocate income/profits/sales to local units
User Charges	Usually feasible on services that are publicly provided private goods, applied world wide, promote efficiency in resource allocation, administratively low cost	Need to ensure that people who need services can still access them, including those on low incomes

Key findings from public attitudes work

Tax Awareness D.16 The public attitudes work showed that there is a good awareness of the main tax streams by which central and local revenues are raised. Council tax was the tax with the highest level of awareness (99.8% of respondents) although income tax, VAT and road tax were all named by over 95% of respondents. In the focus group work the taxes most frequently recalled were council tax and income tax. There was also consistent recall of VAT and a widespread awareness of its rate.

Payment of services from council tax

D.17 A key finding from the focus group research was the confusion over what council tax paid for. The general view was that it funded a very large range of services, which is an interesting issue when set against the survey finding that only a third (31%) of respondents considered that it represented good value for money. The table below sets out how respondents thought that different services were paid for.

Table D.4: View on whether services funded through local or national taxation

Exclusively funded by national taxation	Predominantly funded by national taxation with local contribution	Exclusively funded by local taxation
Motorways Roads	Emergency services (police, ambulance, fire) Health Education	Social services Parks Local roads/pathways Refuse collection/tips and street cleaning Leisure facilities Libraries Tourism Housing Planning Environment health Community relations and local events

Public understanding of council tax and balance of funding

D.18 A further example of lack of understanding or knowledge is that many people do not know which council tax band their house is in, regardless of whether they pay council tax or claim council tax benefit.

D.19 In the focus groups, knowledge of the balance of funding between local and central funding was rather limited. When asked to hazard a guess, most felt that the majority of funding for local services came from local government. Most frequently participants guessed that 20-30% came from central government and 70-80% from local government. The survey work presented a different picture with a wider range of values given, but these were not often the actual balance of funding for their local authority area. These findings support those of a number of previous studies, including those by the Balance of Funding Review, on public perceptions of local government funding.

D.20 The focus group work showed only limited awareness that local authorities received grants from central government to finance public services. Those who were aware of this tended to be the more affluent people who had a greater degree of awareness about the tax system.

Attitudes to what balance of funding should be and who should control council tax levels

D.21 When directly asked what the split should be, just over half (52%) of survey respondents considered that central government and local councils should provide similar amounts of funding. Twenty-five per cent said that local services should be mainly funded by local councils from council tax, and 13% said that central government should be the main provider from national taxation.³

D.22 Two-fifths (41%) said local councils should have the main say in levels of council tax (compared to 35% saying this should be local residents and 23% saying should be central government). Interestingly, there appear to be some regional differences in attitudes to local control, with respondents in central areas and the north more likely to believe that local councils should have the most say in setting levels of council tax.

Understanding of who does vs. who should control different services

D.23 The public's understanding of actual responsibility for different services was explored in the survey work and compared to which level of government respondents thought should control service standards. This is set out in Table D.5 below. This shows a good deal of overlap in the results for who does, as opposed to who should, control services, although there is support for further standardisation of emergency service standards, refuse collection, leisure services and social housing, and support for more local control over public transport.⁴

D.24 Interestingly, however, three times as many respondents indicated that they would be willing to see different standards in different areas as long as local people are consulted and are happy with the service they receive – 63% of respondents compared with a base position of 21%.⁵ Any further survey research that is commissioned for the Inquiry will seek to further explore this finding in relation to individual services.

Table D.5: Understanding of which level of government provides services and attitudes on which level of government should control service standards

	Who provides service (% respondents)			Who should control service standards (% respondents)	
	CG	LG	Both	CG	LG
NHS	84	8	6	80	17
Education	63	23	12	64	31
Police	56	29	6	66	29
Roads	34	44	18	46	49

³ The focus group work that supported the Balance of Funding Review found a feeling of mistrust – typically neither local nor central government could be trusted – when asked about who should control resources for local services. The majority of respondents felt uncomfortable allowing local authorities full control of funds, despite a belief that they are best suited to identify where funds are needed. On the other hand central government was considered too far removed from local users to be involved in local spending decision, however they did have a role in ensuring that there was accountability over how the money was spent locally.

⁴ The focus group work for the Balance of Funding Review showed a particular lack of clarity about local councils role in relation to police, fire, health/NHS and transport.

⁵ Provisional results from the wave 2 survey, which asked a similar question but in a different context, shows a lower proportion of respondents responding positively than in wave 1. This issue will be reported in 2006 when full results have been analysed.

Fire and rescue services	46	43	7	60	36
Refuse collection	8	88	2	19	78
Leisure services	11	82	4	19	77
Social housing	15	76	4	27	68
Social services	29	61	6	38	58
Planning and development control	15	72	6	26	70
Public transport	31	54	6	35	61

Principles that should underpin taxation systems

D.25 Fairness was considered by focus groups to be the most important principle underlying a tax system, and most equated fairness with ability to pay. To most people this meant income and, to a lesser extent, savings. Property, especially a home, was not considered to form a component of ability to pay, as it was not seen as a source of wealth that was immediately accessible. This attitude to property as a base for local taxation was confirmed in the survey work.

D.26 There was generally a strong desire that there should be an equal quality of service, irrespective of how well off people were or where they lived, though as noted above people were willing to consider local variation if they were consulted and happy with services. There was a general view that the rich should support the poor. Less affluent groups were most likely to consider personal circumstances, for example age, health and caring responsibilities, as having an impact on ability to pay.

D.27 Simplicity, transparency and accountability were also considered to be important parts of a fair system.

D.28 There was a strong and consistent view that council tax was too high and unfair, especially for elderly people, irrespective of their financial circumstances. However there was also a concern that changes to tax system, for example a partial local income tax, should not put too big a burden on less affluent working families. A local income tax as a replacement for council tax was not tested given the Inquiry’s terms of reference, but there was a general resistance to the idea of a partial local income tax combined with council tax. There were concerns about the additional complexity of such a proposal and that it would dilute the perceived ‘fairness’ benefits of a tax based on income alone.

D.29 Total household income was the factor most mentioned (42%) as something that should be taken into account when calculating council tax. Respondents were more willing to pay some extra council tax to subsidise some groups, especially pensioners (55%), people with illness/disability (41%), and to a lesser extent students (21%).

Case for devolution seminar: key conclusions

D.30 At the seminar the role of greater devolution was explored in relation to:

- local and national competitiveness;
- policy making and joined up government;
- efficiency and effectiveness in service delivery;
- choice and personal responsibility; and
- community cohesion and self-determination.

D.31 The seminar did not hear arguments for abandoning national level decision-making, and the discussion focussed on where a shift of responsibility to the local level would be productive. It brought into play a wide range of evidence that lent support to the view that greater local devolution could support enhanced service performance and provide an arena for building community coherence and engagement. It also noted detailed theoretical evidence that it could drive forward local economic competitiveness.

D.32 The presenters also concluded that the scale and nature of local government made it capable of sustaining considerable policy-making responsibilities – although the exact shape and structure of local authorities is a matter of debate – and that the argument for greater local collective choice should not be seen as antithetical to the argument for greater personalisation and choice in public services.

D.33 Some of the more detailed issues that were raised by the presenters and in discussion were:

- the importance of the relationship between national, regional, local and other agents in ensuring both local and national competitiveness;
- how far other local priorities, such as education, health and social services, had pushed issues such as place making and economic development off the local agenda;
- the relationship between central and local government in ensuring effective and efficient service delivery;
- the appropriate roles for managerial autonomy and local political choice in determining service improvement success;
- the extent to which top-down strategies are creating a self-defeating dynamic in public judgement about public services, as they obscure choice about the inevitable rationing of resources;
- how far much of the local government contribution to community building goes unrecognised;
- how to ensure that local authorities' accountability to local communities is effective, recognising that some local authorities are better at this than others; and
- local government's role in relation to institutions that, also, could be seen as targets for devolution, for example regions, city-regions, neighbourhoods or client-focussed organisations.

D.34 The overall conclusions were:

- the case for greater local devolution ultimately rests on the ability to show that there is a strong role for local governance in delivering against a range of social and economic objectives; and
- much of the analysis that emerged at the seminar was supportive of the case for greater devolution in a number of contexts, but it was recognised that there is a need for further research and analysis to support the body of published evidence.