

Derby City Council

EVIDENCE TO THE LYONS INQUIRY INTO LOCAL GOVERNMENT FUNDING

1. The terms of the Lyons Inquiry assume the retention of a reformed council tax following its revaluation, possibly supplemented by other forms of revenue, including a local income tax and reformed non-domestic rates. These terms mean that the Inquiry is operating in a context that is not fully consistent with the overall position of the political parties forming the controlling political group of Derby City Council.
2. The Council nonetheless considers it necessary to make some points within the terms of reference of the Lyons Inquiry. This is in relation to the specific options for reform of council tax now under further consideration following the conclusion of the Balance of Funding Review in July 2004. The comments below are made strictly in this context and without prejudice to the wider position of the controlling political parties on local taxation reform.
3. The considerations of the Balance of Funding Review were extensive. The Council is therefore focussing its evidence to concentrate on a few technical points on council tax reform, which it is considered were not adequately dealt with by the Review and need to be better taken into account by the Lyons Inquiry.
4. These issues are as follows:
 - Trends since the 1991 council tax valuation
 - Band weights and implications for regional banding
 - Basis of determining regional shares of local taxation
 - Options for updating council taxes in between full revaluations
 - Interim measures pending revaluation
 - Local taxation as an instrument of wider Government policy
5. Trends Since the 1991 Valuation

There is abundant evidence that regional differences within England have grown in the 14 years since the 1991 council tax valuation, London and the South East prospering at the expense of other regions. Similarly, with the exception of London, most larger urban areas have declined relative to semi-urban and rural areas. This has been evidenced by migration patterns and accompanying shifts in both incomes and property prices. The local taxation

system, in the absence of a revaluation, has not kept pace with this trend. The relative taxbase in most urban authorities outside of the South East is therefore overstated for grant assessments, and they have lost grant as a consequence. This is in contrast to changes in the SSA/FSS needs elements, where population growth and rising costs in the South East are recognised for grant purposes, and cause increases in grant.

There is therefore a justifiable perception that the council tax system has become severely imbalanced to the disadvantage of most major urban areas outside of the South-East in the last 14 years, including Derby. There is a corresponding heightened expectation that the 2005 revaluation will at last rectify this situation.

The evidence presented to the Balance of Funding Review by the NPI, the lead researchers for ODPM, is therefore disappointing. It pointed to a very limited associated shift in grant funding at regional level and an uncertain shift within regions. The Council perceives that the goalposts have been shifted by the Review without good reason. The Inquiry needs therefore to look critically at the approach taken by NPI and to challenge it, asking why their models are not producing larger resource shifts particularly shifts between regions, and to reconsider and challenge the underlying assumptions made by NPI. Some specific points are set out in the sections below.

6. Band Weights and Implications for Regional Banding

The former domestic rating system levied a tax that was strictly proportionate to property value, with a fixed rate poundage per unit of rateable value, and also equalised rate support grant on that basis. The Council considers that a key aspect of making council tax fairer is to ensure that the reformed council tax levied is much more proportionate to property values than the current 3-1 spread of band ratios. This cannot be achieved to any great degree if the system is reformed solely by adding additional 'A minus' and 'H plus' bands to the current range. The weights applying within the existing Band A to H range also have to be much more proportionate to property values.

NPI's research for ODPM did demonstrate that such proportionate band weights would by themselves lead to inter-regional differences in council tax that would be too great to be equitable, with such a reformed council tax being significantly lower relative to income in the North than the South. NPI went on to demonstrate that a system of regional banding of council tax could avoid this outcome. In combination with proportionate band weights within regions, regional banding would reduce the regressive nature of council tax to a minimum – that is, it would be more closely proportionate to income than any other option.

In this context, the Council therefore sees some merit in a regional banding approach. However, it must be emphasised that the case for regional banding only has real merit if it accompanies a radical reform of council tax, such that the band weightings become much more closely proportionate to property values. Without this there is no case for regional banding, as high value

properties regions with high property values would then receive excessive protection.

7. Basis of assessing regional shares of local taxation

The research of NPI made an assumption that the equity of a revalued or reformed council tax could best be judged by assessing how closely regional tax shares corresponded to disposable net income. A key criticism of the Balance of Funding Review is that it did not test this key assumption. The issue deserves further review by the Lyons Inquiry.

The effect of the assumption has been to overlook a credible case that regions in the South should bear a higher share of council tax than that solely determined by disposable net income under a regional banding model.

Evidence to assess regional shares of council tax was set out in research undertaken in 2002 for SIGOMA by NPI prior to their work for ODPM, in which they were asked to assess regional council tax shares against regional wealth as well as income. The table below is an extract from that research.¹

Region	Share of properties	Share of Tax Burden			Share of tax burden if allocated in proportion to:				
		Revaluation	Revision	Reform	Average household income	Average male earnings	GDP per head	Wealth-income mix	Average household wealth
NE	5%	4%	4%	3%	4%	4%	5%	3%	2%
NW	14%	12%	11%	9%	13%	12%	13%	11%	10%
Yorks & H	10%	8%	8%	6%	9%	9%	9%	7%	6%
E. Mids	8%	7%	7%	6%	8%	8%	7%	7%	6%
W. Mids	11%	10%	10%	8%	10%	10%	10%	9%	9%
Eastern	11%	11%	11%	12%	11%	12%	11%	11%	11%
London	15%	18%	19%	24%	18%	19%	19%	19%	20%
SE	16%	19%	19%	22%	18%	18%	17%	21%	24%
SW	10%	10%	10%	10%	9%	9%	9%	10%	11%
England	100%	100%	100%	100%	100%	100%	100%	100%	100%

Although this work is now somewhat outdated, two points should be noted:

- Comparing the final 'average household wealth' column with the 'average household income' column, it is clear that the SE, London and SW regions have much higher England shares of personal wealth than they do total income. Other regions have lower shares of wealth than income – for example 6% wealth in the East Midlands compared to 8% income.

¹ "COUNCIL TAX REFORM: Analysis And Policy Implications. A Report for the Special Interest Group of Municipal Authorities within the LGA". October 2002. Table 5.1

- The income measure used by NPI for SIGOMA (as opposed to ODPM) was total income, not net disposable income. Total income is the normal measure of taxable income. It is believed that use of net disposable income for ODPM would have produced a still lower share for the Southern regions than that shown in the table.

The definition of the wealth measure derived by NPI is given in the Appendix. It takes account of property values net of outstanding loans, and other personal savings. The Lyons Inquiry needs to update this research, in the absence of available wealth statistics directly from Government sources.

The Council considers that, if council tax is to be retained in some form, then regional shares should be based partly on income, but should also take some account of regional shares of wealth. The NPI SIGOMA research is useful in drawing out the point that the capital windfalls from property, that have occurred more in the South than the North, are reflected in very sharp differences in personal wealth. For a property based council tax, it is reasonable for this to have some limited bearing on regional taxable capacity, particularly given the quite limited extent of other capital taxes at present.

8. Updating Council Tax Between Full Revaluations

The extent of controversy over the current revaluation stems from the lack of regular council tax revaluations since 1991. Similarly, the lack of domestic rates revaluation since 1973 made local taxation reform a major issue in the 1980s. If a property tax is to be retained, the Lyons Inquiry needs to consider options for overcoming this. The Government has already indicated that it is not prepared to consider regular full council tax revaluations, which limits the options.

Subsequent council tax revaluations would have less impact and be less controversial if a system was put in place from the outset to track movements since the 2005 revaluation, and make interim adjustments. By definition, this cannot be done down to individual property level without a full revaluation. However, at a more aggregated level, such adjustments are possible. The Government now has available a host of indices on movements in house prices by area through the Land Registry and building society indices, in some cases down to local authority level. Measures of income and wealth potentially available at regional level are also capable of being regularly updated.

This means that in a system using regional banding, it would be possible to adjust regional shares on a frequent basis, even annually, to reflect the movements in the base figures used to set those regional shares. This could be done whatever the measure used to set regional shares. Essentially this would require a variable multiplier to be applied in grant calculations to alter the standard Band D (or equivalent) value of a property assumed for each region in between revaluations. This would lead to a shift in revenue support grant between local authorities, similar to the shift that would have occurred had a full revaluation occurred. The eventual grant shift on full revaluation

would then be minimal, reducing the scale of controversy when a full revaluation were necessary.

It should be noted that this method, using a variable multiplier, could also be applied at sub-regional level and does not strictly require a system of regional banding to be in place for it to operate. In these circumstances, the standard Band D value would need to be adjusted by a factor varying for each local authority.

Given the persistent trend for economic growth in the South of England to outstrip that in the Midlands and the North, it is important that a such a method of updating the taxbase for grant distribution purposes is adopted at the outset. Note that at present, there is a bias in the revenue support grant system in favour of the South. This is because spending needs since 1991 have been updated annually through a revised area cost adjustment, which has over the last 14 years increased to reflect the increased relative prosperity of the South, which has been reflected in increased wage differentials. By contrast, the increased taxable capacity of the South has not been properly taken into account in grant distribution, in the absence of a revaluation.

9. Interim Measures Pending Revaluation

The 2006/7 local government finance system will come into effect before the revaluation in 2007/8. It is important that the current bias referred to in the previous section is not added to in the 2006/7 settlement. The Lyons Inquiry is therefore asked to recommend that the area cost adjustment factors should not be updated to reflect the most recent wage data in the 2006/7 local government finance grant settlement. The absence of change would have the added benefit of reducing the turbulence arising from revaluation in 2007/8, in that the net regional shift in funding away from the South East would reduce in scale in 2007/8

10. Council Tax as an Instrument of Wider Government Policy

There are some wider issues for the Inquiry to consider, that reinforce the need to reform council tax more fundamentally, by making the council tax if retained more closely proportionate to property prices. These are as follows:

- Property taxes including council tax act to damp down the overall property market. Reform would better focus council tax a tax on 'consumption' of property. That is, it would provide a financial incentive to live in smaller properties, by increasing the tax on more expensive properties in relative terms, and reducing the tax on less expensive properties. This is consistent with the aims of Government housing policy.
- The effect on property price inflation is also important in macro-economic terms – the Bank of England Monetary Policy Committee has in recent years clearly been influenced by the inflationary risks of

speculative house price inflation when taking decisions on interest rates.

- By reducing the cost of living in low value properties – mainly to be found in less prosperous urban areas outside of the South East - a reformed council tax can act to a small degree as an incentive for people not to migrate out of such areas, and will achieve a better community mix. Similarly, it would also act as a limited brake on regional migration patterns, if bills rise in the South East. It is therefore a fiscally neutral means of assisting regeneration of deprived areas and regions.

Such effects will clearly not be the primary driver of local taxation reform, but they do show that council tax reform would have some positive wider effects.

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APPENDIX

Definition of NPI Measure of Regional Wealth

The NPI wealth measure takes reported data on non-housing assets (savings and investments) and adds to this an estimate for the housing wealth. This estimate is constructed using the following data:

- Information on whether the household rents or owns their home, and whether they have a mortgage or not.
- The value of the home. This is estimated using the 1991 council tax band. Prices are updated from the valuation date using a regional property inflation indices.
- The value of any outstanding mortgage. This is calculated from data about the original mortgage value and the year it was taken out. Interest rates are assumed to have been 6% per annum in all cases.