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**Mike Stringer**  
**Head of Financial Services**

**Finance and Planning Directorate**  
London Borough of Havering  
Town Hall, Main Road  
Romford RM3 3BB

**Telephone: 01708 432101**  
Fax: 01708 432162  
email: mike.stringer@havering.gov.uk  
Switchboard: 01708 434343  
Minicom: 01708 433175

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Sir Michael Lyons  
Lyons Inquiry into Local Government Funding  
Room 3.12  
1 Horse Guards Road  
London  
SW1A 2HQ

**My Ref:** MJS

Dear Sir Michael Lyons,

Thank you for the opportunity of contributing to the independent inquiry on the case for changes to the present system of local government funding. Please find below a response to the questions underpinning the terms of reference of the inquiry.

### **1. Background**

London is recognised as having unique characteristics and experiences unique pressures and opportunities such as a wider range of earnings and higher costs. It is important that the inquiry considers these as well as how the unique characters of each authority can be considered. London faces higher property values than people elsewhere in the country, and this is also true for people in social housing. By way of illustration, Havering has one of the largest older person populations but the FSS for Social Services is one of the lowest per head of population.

Other developments in the local government area will also impact on the funding for local authorities and should be considered, including:

- Changes to the way the authorities can set their level of capital expenditure (prudential regime)
- The ongoing effects of the introduction of CPA and the resulting freedoms and flexibility's

- The revaluation of domestic properties for council tax purposes
- Introduction of the business growth incentives scheme.

It is vital that the consequences of any change is fully assessed and this must include an assessment at individual authority level.

## 2. Key issues

- The balance of funding, and the consequent gearing effect, is a problem. It can lead to an inexplicable burden on council tax at times when expectations of public services and new responsibilities are increasing faster than grant subsidy. It leads to confused and disputed accountability for spending and tax changes that damages both central and local government.
- Council tax is an efficient tax that needs improving and defending, not scrapping.
- Council tax reform must be sustainable beyond revaluation, but it must be looked at in combination with the effects of revaluation and other policy changes (e.g. schools funding), since the public will experience the cumulative effect. Responses to reform will be determined by the initial impact.
- Public acceptance of council tax is called into question when headline percentage increases are large. Whatever changes happen there will need to be a cap on tax increases for households. Grant protection for councils will also need to continue.
- Protection for the low paid should also be improved through streamlined and improved council tax benefit rules, permitting more generous limits and less form filling.
- Equity between regions is important. Londoners should not be asked to pay a significantly higher share of their income in council tax than other regions from the combined effect of revaluation and other changes. This is likely to mean either regional banding, or more constrained options for change.

## 3. Balance of funding

The balance of funding and consequent gearing, matters. It separates local decision making from locally paid taxation. It obscures accountability and means the connection between spending change and tax change is distorted. It is hard to explain to residents.

Havering is particularly concerned that given the impact of gearing, it receives a level of grant insufficient to cover its level of need. It is important to us that we have sufficient control over our revenue to allow us to adapt to changing circumstances, in particular, increases in cost. A significant proportion of an authority's expenditure is effectively outside of the control of the authority, at least in the short term.

The divergence in recent years between local government's assessment of the cost of meeting spending demands and the grant available is magnified by the gearing effect. This has strained the whole system to its limits. Too great a share of the increase in local government services has been borne on a single tax, narrowly based and with very limited buoyancy in its tax base.

Particularly for people on low or fixed incomes, such as pensioners, these issues can undermine the credibility of local government and contribute to cynicism about the governance and efficiency of Councils. The system does not help residents to understand the position on overall spending. Transparency about the balance and control of local spending is a real issue, not helped by the obscure and alienating language local and central government use to debate the issue.

It is unlikely that differences in gearing can be eliminated as it is a by-product of different levels of grant to compensate for needs and resources, but the gearing level

can be less exaggerated if other revenue sources are brought under local authority control.

#### **4. Council Tax Reform and Revaluation**

Council tax has real strengths: the system has been stable and therefore cheap to administer, it is difficult to evade and collection rates are generally high, the tax is clearly identified with the locality, there is wide public understanding of the principles of the tax, and it broadens the national tax base.

The one significant criticism of the council tax system is that many London residents in high value properties are on relatively low incomes. In most areas of the country the poorest residents are protected by council tax benefit. However, this benefit is restricted to the level of council tax that would apply to a band E property. Research commissioned by the ALG has highlighted that a significant number of Londoners are being unfairly treated by the restriction.

There is a need to protect the credibility and acceptance of council tax as a core local tax. Problems arise when the percentage increases appear disproportionately high, because council tax bears the strain of all local spending variations and because of the lack of tax base buoyancy. People are far more sensitive to a council tax rise of 15% than to a much bigger national insurance rise that takes 1% of their earnings.

Therefore council tax cannot be pushed too far. Council tax reform must not be looked at in isolation from the likely impact of other changes happening in tandem. (Even the Olympics could cost Londoners an extra £20 on band D). Revaluation is likely to be a big issue in London, where housing price rises are expected to be above average. Research undertaken indicates that after revaluation (if the current eight band model is simply rolled forward) average income in London for each of the bands A to G would be significantly lower than the national average for that band. This means that on average London residents will be forced to pay proportionately more of their income as council tax. As Havering has a large elderly population, the impact this would have is to create a vicious circle; their dependency on Social Services could increase and hence our need to spend increase.

Key issues for the experience of the council taxpayer therefore are:

- Recognition of the impact of the big disparity between disposable income and property values for middle and lower income families in London.
- Regional banding for implementation of council tax revaluation, to restore equity.
- Transitional arrangements which cap the increase in council tax bills to residents resulting from the combined effect of revaluation and other system changes.
- Reform of council tax benefit to widen access.

Council tax benefit needs to be easier to claim. This means higher capital thresholds and less penal assumptions about the income generated from savings. There should be better arrangements for passporting between one benefit and another.

Transitional arrangements are always an additional layer of complexity and hotly debated where winners have to pay for losers. The greater the turbulence in the system, the higher the temperature of the reaction. Damping the scale of potential turbulence arising from all changes in combination is a further argument for regional banding and /or the moderation of changes to bands and their weighting.

There will also need to be transitional arrangements for local authorities. Whilst extra yield from a changed tax base would be offset by reduced grant, this substitution is not necessarily cost neutral.

Increased housing costs overall clearly impact on residents. They can also affect recruitment and retention in the London public sector, as problems with key worker housing in the capital have shown.

The current RSG system builds into FSS high levels of growth for Government initiatives but assumes that council tax will fund a significant proportion of that growth. Increases of council tax of 5% plus are built into the local government finance system. This leaves no room for local priorities, pushes up council tax to what will turn out to be unsustainable high levels and makes life intolerable for authorities with lower than average increases in grant.

This leads on to the fact that Council Tax itself distorts accountability because people cannot see any clear connection between local taxes and local decisions to spend and there is no 'marginal accountability' for increases in local taxes. It is the Government, rather than local people, taking decisions on how local taxes should be spent, e.g. passporting and ring-fenced grants.

Local Government's income is not sufficient to cope with the various demands. Authorities are heavily dependent on the grant system, which does not cover every expenditure pressure or Government aspiration.

## **5. Options for Changing the Balance of Funding**

The Balance of Funding Review concluded that a share of business rates or a local income tax (LIT) were the realistic options to change the balance of funding. Local government advocates re-localisation of business rates and a removal of the RPI cap that has shifted the cost of expanding services towards households. The advantages of this are, that it would restore the situation to the position before 1990. It would not require any new arrangements to set up, and it would restore a link between local authorities and local businesses and thus support partnership working. Council tax is currently bearing all the burden of spending increases unmatched by grant and it is important to bring rates back into the equation, enabling business to share in the costs of local services.

Whilst nationwide businesses may find it more convenient to pay a national rate, the business rate of individual premises can nevertheless be closely identified to individual authorities. Many businesses also benefit directly from locally provided levels of infrastructure and business friendly services. Localised rates retention is administratively relatively cheap to accomplish. It is also easy for local taxpayers to understand, since many believe this is what happens anyway.

Consideration should be given to a local income tax to fund local services, possibly alongside the council tax or similar property tax, in place of a proportion of national income tax therefore grant. This would provide a new source of local income for local authorities, which is more buoyant than council tax (i.e. would automatically rise with income without requiring additional decisions). It would be fairer than council tax, enabling a direct relationship with ability to pay, as it is a progressive tax (i.e. rises in line with income). There should be full flexibility with respect to fees and charges, including a charge for utilities street works, which are a particular public irritant in urban areas.

In considering any of these, clarity in accountability to the public must be the aim.

## **6. Practicalities**

Changes to the current system of local government funding must fit operationally with other funding initiatives, e.g. ring-fencing funding for schools and the potential introduction of three-year settlements and any forward modelling of tax changes needs to take this into account.

Ring fencing schools will both reduce and substantially alter the allocation of Formula Grant between councils. This swings the balance towards stability and predictability, rather than towards equalisation as a dominant feature of the local government funding system.

The recent Consultation paper on three-year budgets is suggesting forward statements of council tax and published reconciliations of estimates and eventual decisions. This will be impractical and misleading until the impact of council tax changes is much clearer.

We would emphasise the importance of forward planning and timetabling for implementation of successful change. This includes adequate time to develop and test proprietary software solutions, but also taking into account integration with benefits packages and other systems, including general ledgers, customer relationship management systems and the document imaging and workflow systems on which much processing depends. It is therefore not simply a matter of engaging with four or five dominant revenues and benefits software suppliers in the market. It would however also be helpful for negotiations on the principal costs of change to be conducted at national level with those suppliers, to minimise the cost, both in payment terms and in the cost of staff time on negotiation.

Yours sincerely

Mike Stringer  
**HEAD OF FINANCIAL SERVICES**