

## **Lyons Inquiry into Local Government Funding Consultation Response.**

### **Justification for Change.**

There is general consensus that the present system of local government finance has inherent weaknesses. Some of the more striking inequities include the regressive nature of council tax, serious data lags and the impact of gearing. It is acknowledged that the present system upholds the principle of no taxation without representation, but in practice this is inconsistent with some of the existing funding mechanisms, ring-fenced being a case in point. Furthermore it could be argued that the imposition of capping further diminishes the importance and freedom of local financial decision making.

The present system also attracts other criticisms. Of particular concern to Medway is the issue of buoyancy. The system is not sufficiently responsive so that areas experiencing growth or regeneration have to be assisted through area cost or other resource equalisation adjustments; although these are often delayed and arguably never provide the full compensation or entitlement. Perhaps telling evidence against the adequacy of the existing system to meet local needs has been the practise (for a second consecutive year) to augment the local authority finance settlement with additional cash injections and the removal of the formula spending share ceilings as a method of equalising spending needs.

The Local Government Association argues a link between local democracy and accountability, and local funding – a proposition which Medway Council supports. Hence there are options for a greater proportion of locally raised or related income, in the form of a reformed property tax, and a re-localised business rate.

### **Council Tax Reform**

The balance of funding review concluded that the current system of council tax should be reformed. Clearly there are opportunities for a more fundamental change possibly replacing council tax with a local income tax. This would remove the negative aspects associated with the existing council tax system - it is regressive (bearing heavily on those with low and fixed incomes), and very importantly in our case, it is not sufficiently buoyant to reflect increased revenue as the local economy grows. Conversely the council tax system is easy to understand, it is easy to collect and the revenue yield is highly predictable. In addition, it is cost effective to administer with the cost of operation on average equating to as little as 2% of the yield.

There is a clear argument that local authorities are better positioned to administer property based taxation systems, but may lack resources and expertise if there was a switch to alternative methods of funding, particularly a local income tax. Furthermore Gershon related efficiencies are likely to encourage local authorities to work more collaboratively (possibly by pooling valuation, billing and debt management functions) that will drive down costs even further.

Irrespective of the desire to implement a more fundamental change to reinforce local accountability, there are changes that can be applied to the council tax system to eliminate some of the current problems. The Inquiry should consider increasing the number of valuation bands (especially at the ends of the spectrum); reviewing the system of discounts to make it more simple and available for eligible groups; revisiting council tax benefits; revalue properties more frequently; and possibly even consider replacing bandings with a tax based on a percentage of property value.

As the supporting information to Inquiry implies, it is presumed that some form of central grant allocation will be retained - if only to satisfy resource equalisation needs. As the proportion of this funding method increases, quite obviously the local element is diminished. This emphasises one of the recurring issues in that it is the proportion of funding that is generated locally that is a key consideration – hence the balance of funding debate.

### **Flexibility for economic growth**

Models of local taxation tend to be inherently unfair, in that prosperous or successfully developing areas generate a higher yield (comparatively speaking). National equalisation adjustments act as disincentives or worse, as perverse incentives to not address these issues. Nevertheless, from a purely parochial perspective, Medway Council (along with other growing councils) believes it must have the opportunity to enjoy extra revenue from greater economic activity. In our case it is imperative that the funding system recognises the population growth that is likely to occur over the next 10 to 20 years. Not only must it recognise this growth but data adjustments to funding formula must be made on a more frequent and contemporaneous basis so that significant time lags are avoided.

Greater powers and/or control over local revenue raising arrangements would overcome some of these difficulties. This should be responsibility for the level of locally raised revenue but also the timing of its benefit. One area that provides an obvious starting point would be to relocalise business rates, and with this to re-establish indexation. (In 1990/91, National Non-Domestic Rates accounted for 29% of council spend, but by 2003/2004 this had fallen to 22%, simply because the rate was pegged to RPI.

## **Supplemental revenue**

As indicated above, Medway would enthusiastically applaud either the introduction of new, or possibly the augmentation of existing arrangements, that would generate supplementary revenues. One of our major concerns is that although there are reforms and initiatives on the horizon that will allow Medway to develop and our economy to regenerate, we are experiencing constraints that curtail our ability to achieve this. Three areas are worthy of closer attention.

We would welcome a review of the planning obligation system, to streamline the process, provide greater certainty and predictability. In addition, it would be helpful to extend the system to catch developments that benefit from our infrastructure investment, after the investment has been made. This tariff approach is of course a close cousin to the business rate, but would have much to commend it, particularly where a local authority provided asset was valuable to a commercial entity.

Medway Council would support the idea of some form of planning gain supplement to encourage development and provide the funding to support on-going infrastructure costs. One option would be an annual land value tax, to encourage landowners to release unwanted or under utilised assets for development. Alternatively there could be a charge at some key juncture in the development process, say the award of planning permission, rather like a stamp duty. Obviously this would augment section 106 obligations and should not remove the existing arrangements for negotiating developer contributions.

The third option relates to the new ability for authorities to undertake prudential borrowing to support investment in infrastructure. Currently, this presents difficulties at the affordability hurdle. Some linkage between benefit to local businesses and meeting the cost of this borrowing would alleviate any problems associated with funding the debt charges on the revenue account – this could be in the form of a business rates supplement.

## **Regional Assemblies**

Tony Travers commented in a recent article for Public Finance: “both the Labour and Conservative parties appear more likely to transfer power to neighbourhood service providers or individuals than to conventional local, health or police authorities. Perhaps the writing is finally on the wall for old-style public service deliverers.” He suggests that the Government’s agenda is to bypass local government in favour of giving decision-making to very small local entities, as illustrated by the policy of giving schools virtually local autonomy. This approach appears inconsistent with the regional assembly debate.

From Medway’s perspective the question is not simply the financing of elected regional assemblies sometime in the future, but dealing with the reality of the

consequences of funding relating to local authority functions that are directed through existing regional bodies. For example, GOSE will allocate £200 million to the 19 transport local authorities in the SE in 2005/2006; SEEDA operates a number of funding streams at a regional level to improve the competitiveness of industries in the South East, and has invested over £500 million in the region since 1999; and the Regional Housing Board has siphoned off a significant proportion of the income stream previously directed to support local social housing projects. Medway has been comparatively successful in securing funds from these regional agencies, although under terms set by central government policy. The short answer to the Inquiry's question is that regional bodies redirect tax revenues to the delivery of centrally set goals possibly at the expense of local agendas.

Inherent in this debate are important issues associated with democratic deficit and loss of local accountability. The aim must be to streamline local government whilst at the same time improving local democracy and interest, ensuring that administration of local government is cost effective, and very importantly ensuring that we provide highly quality services that are valued by our communities.

### **Summary of main points**

The key points can be summarised as follows:

- the case against Council Tax is that it distorts accountability, is unfair to individuals on fixed incomes, and is not buoyant. However, it has distinct benefits in that it is simple and (comparatively speaking) cost effective to administer. Any change to this system should address the inherent defects but not sacrifice the important positive characteristics. Clearly a more minimalist approach could be adopted by overcoming the deficiencies in the council tax system itself (eg increasing the number of bands, ensuring property valuations are more current, and improving the discount and benefits arrangements to those that are needy but currently ineligible);
- the buoyancy weakness is an area of particular concern. Significant physical, economic and social regeneration is planned for Medway over the next ten to twenty years. Any financing system (whether entirely new or an improvement to existing arrangements) must reflect increased and above average growth. Special arrangements should be implemented for local authorities that experience rapid growth (perhaps independent and more frequent surveys) to reflect the increased numbers and permit the extra yield to be retained. Hence both the increased yield from additional business activity and the extra revenue from a growing population should be more readily available to councils;
- flowing from the point immediately above, local authorities should be permitted to raise more revenue locally. A reformed business rates system offers one opportunity, with local authorities determining the yield and fully retaining this form of revenue. The additional options discussed under the supplemental revenue heading (ante) could also be considered; and

- regarding regional assemblies, it is important that closer and more effective links are forged with our local communities so that local accountability and decision making are enhanced. Irrespective of financing, arrangements should not be implemented that undermine these central tenets.