

**HERTFORDSHIRE COUNTY COUNCIL
CABINET
MONDAY 8 SEPTEMBER 2003 AT 2.00 PM**

Agenda Item No.

9

LOCAL GOVERNMENT BALANCE OF FUNDING REVIEW

Report of the Finance Director

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Executive Member:- David Beatty

1. Purpose of the Report

- 1.1 To provide background information on the Government's review of the balance of local government funding and the proposed process for agreeing a paper for submission to the Review.

2. Summary

- 2.1 The report summarises the background to the balance of funding review, the aims and structure of the review, the issues and the questions on which the Steering Group is seeking views.

3. Conclusions

- 3.1 If the Cabinet wishes to submit a paper to the Government's Steering Group this will need to be agreed in time to meet the deadline of 30 September 2003.

1. Background

- 1.1 The “balance of funding” refers to the proportion of money for financing local government which is provided by central grant compared to the proportion raised locally. This has been a long standing issue for local government and has been frequently cited as the underlying cause of high council tax rises in recent years, problems with Education Funding and the low turnout in local elections.
- 1.2 Up until 1990, local government gained over 50% of its revenue from locally raised taxes (domestic and non-domestic rates). National taxes accounted for less than 50%. The transfer to central control of the business rate in 1990 shifted the balance of funding so that the amount raised locally fell to the present average of about 25% (mostly council tax). Currently national taxes (Government grant and business rates) accounts for about 75% of local government funding. However, the relative proportions do vary considerably between individual authorities. (Hertfordshire County Council’s net budget is 62% centrally funded and 38% locally raised.
- 1.3 The 2000 Local Government Green Paper stressed the need for local freedom and responsibility. Its priority was to redress the ‘balance of control’ by reducing ring fenced grants and abolishing capping. Some respondents to the Green Paper believed that the priority should be to change the balance of funding by reducing Government grant and increasing locally raised taxes. Over-reliance on central funding was felt to damage local autonomy and encourage voter apathy.
- 1.4 In the 2001 White Paper *Strong Local Leadership – Quality Public Services* the Government committed itself to establish a high level working group to look at all aspects of the balance of funding, reviewing the evidence and looking at reform options. The White Paper indicated that the Government did not think that there were any quick or simple ways of securing a major shift in the balance of funding. However, it recognised the need to be clear about what the longer term reform options were, and the need to consider whether there were more modest reform options that could be pursued more quickly.
- 1.6 The Local Government Bill has gone some way to increasing freedoms and flexibilities through a package of changes including freedom to reduce the council tax discount on second homes, local retention of income from civil penalties, new trading powers and the ability to introduce Business Improvement Districts. They are also currently consulting on a scheme to allow local authorities to keep the additional business rates generated by businesses in their area.

2. Aims of the Review

- 2.1 The overall aim of the review is to look at all aspects of the balance of funding, review the evidence and look at reform options. This breaks down into two basic objectives:
 - i) *Establishing the nature and priority of the issue.* The Review will explore and test the criticisms levelled at the present balance of funding, establish the key issues, and determine the extent of their impact on different authorities.

- ii) Identifying and analysing options for change. Once it has examined the issues, the Review will consider short and long term options for changing the current balance of funding, and the implications of each.

3. Structure of the Review

- 3.1 The steering group is chaired by the Rt Hon Nick Raynsford MP, Minister for Local and Regional Government at the Office of the Deputy Prime Minister (ODPM). It consists of 22 people, including representatives of the Local Government Association (LGA), local authorities, the accountancy profession, academia, the business community, the union movement, ODPM and HM Treasury.
- 3.2 The first meeting of the Steering Group was on 28 April 2003 and the group plans to meet at least six times at intervals of 2-3 months. A final report will be produced at the end of the process, which will discuss the options for change and the advantages and disadvantages of each. Although the report itself will not make recommendations, the findings are expected to inform Government policy over the next decade.
- 3.3 Minutes of steering group meetings and copies of papers produced for the review are available at www.local.odpm.gov.uk/finance/balance.htm

4. Summary

- 4.1 The current balance of funding has been criticised for:
- contributing to a funding system that is opaque and hard to understand
 - blurring accountability
 - creating instability
 - reducing local freedom, flexibility and responsibility
 - discouraging efficient, diverse and local service delivery
 - contributing to lower levels of democratic participation
- 4.2 A summary of some of the main issues relating to the balance of funding is provided below.

Gearing

- 4.3 The current balance of funding makes local authorities very dependent on government grant and results in them typically having to increase council tax by over 4% to fund a 1% increase in expenditure (known as the gearing effect). For Hertfordshire County Council a 1% increase in the budget in 2003/04 would have required a 2.8% rise in council tax.

- 4.4 As a result of this comparatively small changes in grant or spending pressures can lead to large changes in council tax. This has resulted in local authorities spending a great deal of time and resources lobbying for or against methodology changes.
- 4.5 However, it has also been argued that gearing has the positive effective of encouraging councils to work efficiently and reduce their costs as efficiency savings translate into larger percentage reductions in council tax.

Equalisation

- 4.6 Equalisation is a central feature of the current grant distribution system and refers to the way it takes account of differences in both needs and ability to raise resources locally (both through council tax and business rates) between different areas.
- 4.7 The current system equalises at the level of the Formula Spending Share (FSS), ie if every authority spent at the level of its FSS then the council tax for an equivalently banded property would be the same across the country.
- 4.8 If more funding is raised locally then the method of equalisation will need to be reviewed to ensure that the system is fair.

Accountability

- 4.9 The balance of funding does blur accountability. The majority of people are not aware of how local government is financed and taxpayers are generally unable to distinguish a clear link between local services and local taxation – in particular who is responsible for rises in council tax or who should take the credit for improvements in services.
- 4.10 The Layfield Committee, which looked at the issue of Local Government Finance in 1974 stated that “Whoever is responsible for spending money should also be responsible for raising it so that the amount of expenditure is subject to democratic control”.

Research Proposals

- 4.11 The Steering Group is proposing to commission research on the following issues:
- the connection between the balance of funding, voter turnout and local authority spending decisions
 - a survey on public attitudes to the financing of local government and its impact on perceptions of service quality, accountability and participation.

Research on international comparisons has been suggested for later in the review.

Options for Change

4.12 There are a range of options which could be considered to address the current balance of funding position to various degrees. These include:

- Increasing the proportion of spending funded through council tax
- Returning business rates to local control
- A local income tax
- A local sales tax
- Remove responsibility and funding for some services from local government control (eg schools funding)
- Establishment of Business Improvement Districts
- Environmental taxes such as congestion charging and workplace parking charges
- Freedom to charge for a wider range of services
- A tourist tax

5. Timetable and Process for Inputting to the Review

5.1 The Steering Group have invited interested parties to provide their views on the balance of funding. This should take the form of a short paper which must be no longer than four sides of A4 in length. A list of questions has been provided which can be used to form the basis of the response. These are attached at Appendix 1.

5.2 A summary report of the responses received will be presented to the Steering Group.

6. Financial Implications

6.1 Any changes implemented as a result of this review will impact on the revenue funding available to the authority.

Background information referred to by the author:

Papers for Meeting 1:

Data for the Review. ODPM Paper (BoF(01)). April 2003.

Issues for the Review. ODPM Paper (BoF (02)). April 2003.

The Wider Policy Context. ODPM Paper (BoF (03)). April 2003.

The Balance of Funding – The Issues. LGA Paper (BoF (04)). April 2003.

Links between the Finance and Non Finance Elements of Local Government - Executive Summary. ODPM Research Report.

Papers for Meeting 2.

International Comparisons. Jeffrey Owens (BoF (5a and 5b)).

Local Finance: Guiding Principles in Context. Gerry Stoker and Elizabeth Meehan. (BoF (06)).

Equalisation and Gearing (BoF (07)).

Accountability in Local Government Finance (BoF (08)).

Research Proposals. (BoF (09a-d)).

QUESTIONS ASKED BY THE BALANCE OF FUNDING REVIEW

1. Do you think that a change in the balance of funding would improve local government's accountability, efficiency, flexibility or other factors?
2. Are there serious problems with the current local government taxation system, and if so, what are they? How can we best address them?
3. What do you consider the most important principles and objectives and why? What are the implications of your chosen priorities?
4. Does the present local government finance system distort accountability? If so, how? Is accountability the most important (or even the only) key principle for a workable system?
5. Are the balance of funding and local election turnout linked (directly or indirectly)? If so, how? Can the link be proved, and how? Does it have different effects in different areas or over time?
6. What else distorts the accountability of local authorities to their electorates? How and why? What can be done about it?
7. How important is equalisation? Would a change in the balance of funding provide an opportunity for less equalisation or more?
8. How easily would equalisation work if there were no central grant and local government were funded entirely from local sources?
9. Is the restriction of local government's ability to raise taxes at will via 'gearing' a useful discipline or an undemocratic burden? Does it promote efficiency? Is gearing itself the problem, or its uneven distribution?
10. How deeply should we be looking at other developed countries and why? What should we be looking for? Which countries should we look at and why? Do you know of any useful case studies?
11. Should the Review commission research on different issues? Are the research proposals on the table realistic and suitable?
12. Do you think that the problems we (and you) have identified can be solved by a package of reforms to the existing system (e.g. changing the banding on council tax, encouraging local referendums on financial issues)? If not, please explain why you think major (and probably disruptive) change is needed.
13. What specific options for major change would you propose or support? What changes might you oppose? Why? What are the pros and cons of each of these options?