Local Government Association

a new vision for local government finance

Lyons Inquiry – LGA further contribution

purpose

1 This paper is the Local Government Association's final contribution to the 'Lyons Inquiry into Local Government'. It contains some new proposals for:

a shaping and developing the public finance regime to support our shared vision for a strong, efficient and effective local government, fit for the 21st century; and

b developing the leadership and management roles for the local stewardship of public finances building on proposals in the recent local government White Paper.

2 The ideas put forward reflect and are in response to the analysis and evidence gathered in the Lyons Inquiry and his reports to date. These reports have been the culmination of a deal of debate in what has been a thorough, engaging and stimulating process.

3 The proposals are a logical extension of current thinking in various strands of local and national government work. That includes initiatives underway such as Public Service Boards and Local Area Agreements, and the direction indicated in the White Paper and the LGA's own *People and Places* vision for the future. They also include some radical new ideas directed at reforming the finance regime so that it should support not hinder the new direction. In our view the framework of these proposals can be implemented almost immediately, thereby creating the environment for some of the more complex and detailed changes to be developed in stages.

a new vision for local government finance

summary and key proposals

4 The association has welcomed the broad thrust of the local government White paper, but believes that for that broader agenda to succeed, a precondition is that it must be supported by a coherent and sustainable Finance System. That is a system founded on a strong partnership with central government, and which provides the incentives for:

- local ownership of and resolution of difficult problems and resource allocation decisions;
- continuous improvement and search for efficiencies;
- excellent local leadership and management; and
- fine tuning necessarily imperfect national resource allocations and policies so as to fit local circumstances.

5 Any new system must meet the criteria set out in the Lyons interim report, namely: accountability, fairness, sustainability, flexibility for local decisions, and delivery of national priorities. The present system is now some way from delivering well on most if not all of these criteria.

6 The LGA has submitted previous evidence to the Inquiry, principally its report on the 'combination option' which followed the balance of funding review. Our expectation is that the Lyons report will address the key issues around sources of local taxation. Although this paper does make some further suggestions in relation to specific taxes, its main purpose and thrust is to do with the overall framework of local public finance and its stewardship.

7 Much of the failing of the present system can be attributed to a combination of:

- the post-war growth in the major welfare and personal services programmes (specifically care and education) and their degree of dependence on local taxation. This has placed an over-burden on local taxation, from domestic/business rates to council tax which have been asked to bear too much;
- failure to maintain aspects of the system, eg valuations;
- political short-termism and the failure to recognise the effects of sudden changes in formulae or of system changes, with sometimes unforeseen and unacceptable short and longer term consequences; and
- consequential confusion about accountability.

These factors are expanded upon in subsequent paragraphs. The proposals seek to address those failures. Looking forward we need to have the capacity to cope with a fast changing world, to recognise that communities have different and enhanced expectations of public services, that models of delivery have moved on and that we need to make far better use of the resources available to us.

our proposals

8 To deliver our joint (national/local) ambitions for citizens and communities, we are putting forward three key proposals:

a) a redesigned central-local government relationship based on a 'single conversation' about all local public spending and how it is financed;

b) a new independent 'public finance commission' to oversee and maintain a sustainable local finance regime; and

c) enhanced models of local leadership and management of public finances based on the concept of a single local budget.

9 The rest of this paper explains in more detail the reasoning behind, and the nature of, those proposals.

the need for change

10 To a large extent the case for change has been well made starting with the joint central/local 'balance of funding' review, the subsequent setting up of the Lyons Inquiry, the extension to the Lyons terms of reference, and in much of the analysis already published by Lyons. Some of that case for change is rehearsed and supported in the following paragraphs in order to demonstrate the link to the specific proposals now being put forward.

partnership

11 When Lyons reported in May 2006, he referred to the rapidly changing environment within which government at all levels has to operate. Similar issues have been identified by the Treasury as background to the Comprehensive Spending Review for 2007. Tackling those major challenges requires partnership across all sectors and communities. This can only be achieved by central and local government working together to develop capacity, to innovate and to seek continuous improvement.

12 There are shared interests in developing a system of finance which facilitates responsive public services, and enables decision-makers, engaging with their communities, to strike the balance between 'wants' and peoples preparedness to pay for them.

13 In an earlier report (Dec 2005) Lyons referred to the fact that central government has a differential interest in local government services. There are particular and understandable national priorities around Education and Health, and this is partly reflected in funding mechanisms such as the new Dedicated Schools Grant and the direct funding of all 'health' services. Yet the case for partnership and the shared ownership of difficult locality choices remains as strong for those programmes as for others. Moreover many of the key social issues transcend most service or functional boundaries. The case for joined up solutions is acknowledged, whether for example to do with tackling the causes of school exclusions, or of too many elderly people in hospitals rather than local care.

14 It is notable that the growth in education and care spending since the early 1950s has far outpaced that for other programmes. That has been a key factor in the pressures placed on local taxation, from the rates through community charge to council tax.

15 Our proposals seek a new national settlement for the funding of the two major personal services programmes for 'Children & Young People' and 'Health and Adult Care'. We wish to see the emerging partnerships for those service areas at the local level strengthened through more formal arrangements building on the concepts of Partnership Boards, and 'single budgets'.

table 1: financing of revenue expenditure since 1985/86

	Revenue expenditure (b) (£ million)	Government grants (£ million)	% of total	Business rates (£ million)	% of total	Domestic rates/ Comm. charges/ Council taxes (£ million)	% of total
Rating system							
1985/86	24,284	11,715	48	6,740	28	6,388	26
1986/87	26,630	11,950	45	7,566	28	7,364	28
1987/88	28,980	12,723	44	8,088	28	8,090	28
1988/89	31,240	13,201	42	8,819	28	8,957	29
1989/90	33,282	13,481	41	9,595	29	9,713	29
Community charge system							
1990/91	35,851	12,927	36	10,429	29	12,251	34
1991/92	39,472	18,620	47	12,408	32	8,533	22
1992/93	42,020	20,968	50	12,306	29	9,521	23
Council tax system							
1993/94	41,506	21,685	52	11,584	28	8,912	21
1994/95	43,602	23,679	54	10,692	25	9,239	21
1995/96	44,827	23,335	52	11,361	25	9,777	22
1996/97	46,532	23,003	49	12,743	27	10,461	22
1997/98	47,256	23,840	50	12,034	25	11,241	24
1998/99	50,189	25,291	50	12,531	25	12,332	25
1999/00	53,651	26,421	49	13,619	25	13,278	25
2000/01	57,329	27,809	49	15,407	27	14,200	25
2001/02	61,952	31,469	50	15,144	24	15,246	25
2002/03	65,898	32,634	50	16,632	25	16,648	25
2003/04	78,931	41,404	55	15,611	21	18,946	25
2004/05	83,795	43,408	55	15,004	19	20,299	26
2005/06 (P)	88,929	45,798	54	18,004	21	21,315	25
2006/07 (a)	91,442	47,346	54	17,506	20	22,453	26

a Budget estimates
P Based on provisional outturn
b The sum of government grants, business rates and local taxes does not normally exactly equal revenue expenditure because of the use of reserves

Source: DCLG Local Government Finance Statistics 2006 table 1

notes to table 1

1 The introduction of the community charge / poll tax in 1990/91 saw the proportion of total revenue expenditure covered by domestic taxation jump from 29% to 34%. This was due to the fall in government grant from 1989/90 to 1990/91.

2 In 1991/92; the government cut the community charge / poll tax by £140; paying for this by putting up VAT from 15% to 17.5% and using the proceeds to increase revenue support grant; the result was that the proportion of expenditure funded by local taxes fell from 34% to 22%.

3 It fell still further to 21% with the introduction of the council tax in 1993/94.

4 From 1993/94 to 2006/07 the share has risen to 26%. This reflects local government spending above government grant assumptions being financed by the council tax.

The figures for revenue expenditure have not been adjusted for funding transfers and function changes. For example the fall in 1993/94 is mainly due to the removal of further education and colleges from local government and the sharp increase from 2002/03 to 2003/04 is partly due to changes in the way of financing teachers pensions and the transfer of London Underground to Transport for London.

mechanisms and finance regime

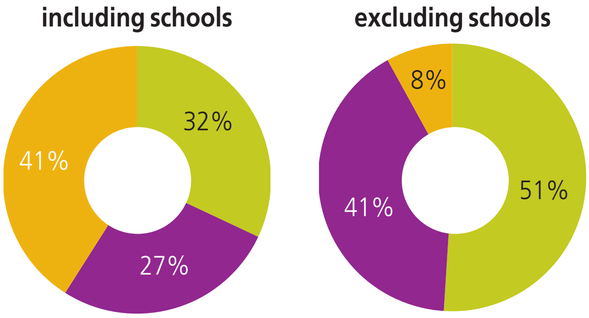
16 Table 1 shows the proportions of revenue spending met from government grant, business rates and the local domestic tax (from rates to council) since the mid 1980s, and charts the key events or interventions in that period. There is evidence of a 'glass ceiling' effect. This seems to occur whenever the domestic local tax is asked to provide over 25 per cent of the share of revenue spending in the sector. Community charge was problematic from the outset. It was the rise in domestic rates in the early 1970s, a period when the share taken by health and social care spending doubled in four years, which gave rise to the Layfield Inquiry.

17 Changes to the grant distribution mechanisms have, over time, meant that the present LG Finance system has become more difficult to operate and understand. There have been a range of compromises and the introduction of minimum grant increases (floors), and hence ceilings, whilst leading to more stability, has been controversial and left few authorities satisfied. The system has undermined trust and does not serve central or local government well.

18 The removal of Dedicated Schools Grant from general grant means that nationally general grant only funds 8 per cent of local spending (chart 1). The remaining 92 per cent comes from taxes raised locally, business rates and council tax, for local purposes. Yet with the adoption of a national non-domestic rate (NNDR) and the capping of council tax both of these are effectively nationally determined taxes.

chart 1: funding of local government net spending

Source: Lyons presentations in a different context



Revenue Support Grant (including school)
Council tax Business rates

19 Moreover the valuation base for council tax remains at 1991 property values. Lyons has already highlighted the credibility issues that this raises for what is a significant and high profile tax. Local government currently possesses and is identified with a high profile, unpopular tax, which is being asked to do too much, and which it barely controls.

20 By fixing the business rate poundage to RPI, the NNDR contribution to local services has reduced from 29 per cent in 1990/91 to 20 per cent in 2006/07 (chart 2). If it had been tied to council tax itself, then the latter would have been £258 lower for the average band D property. The growth in the take from business rates over the past five years has been lower at 22 per cent than for any other major tax sources as demonstrated in chart 3. In the same five year period Corporation tax take has increased by 30 per cent. The issue here is not about increasing the level of tax on business, but about the proportion attributable to local services and development, and about balance of funding.

21 A dynamic finance regime should enable authorities to supplement their tax income in imaginative ways. The new Local Authority Business Growth Incentives (LABGI) scheme is a step in the right direction. Fees and charges are subject to a large number of different regimes set by various statutes. Some of these define what cannot be charged for, such as library books, and some the rate at which charges are set. This is the case for local land charges. Sometimes these charges are reviewed on an ad hoc basis, and there is no systematic approach taken to them. Local government also has the right to charge for discretionary services under 2003 Local Government Act.

22 It is a serious shortcoming that, with the exception of the London congestion charge, local authorities have been held back from making intelligent use of locally

chart 2: local government funding

Source: IPF

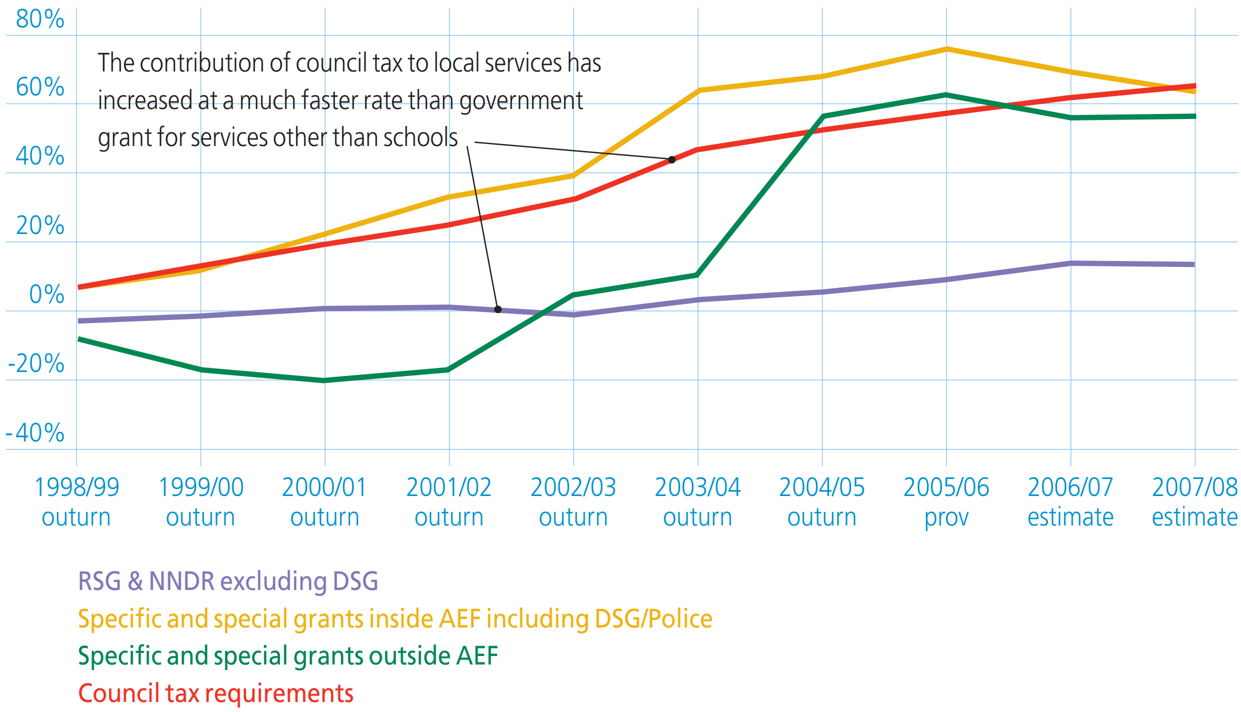
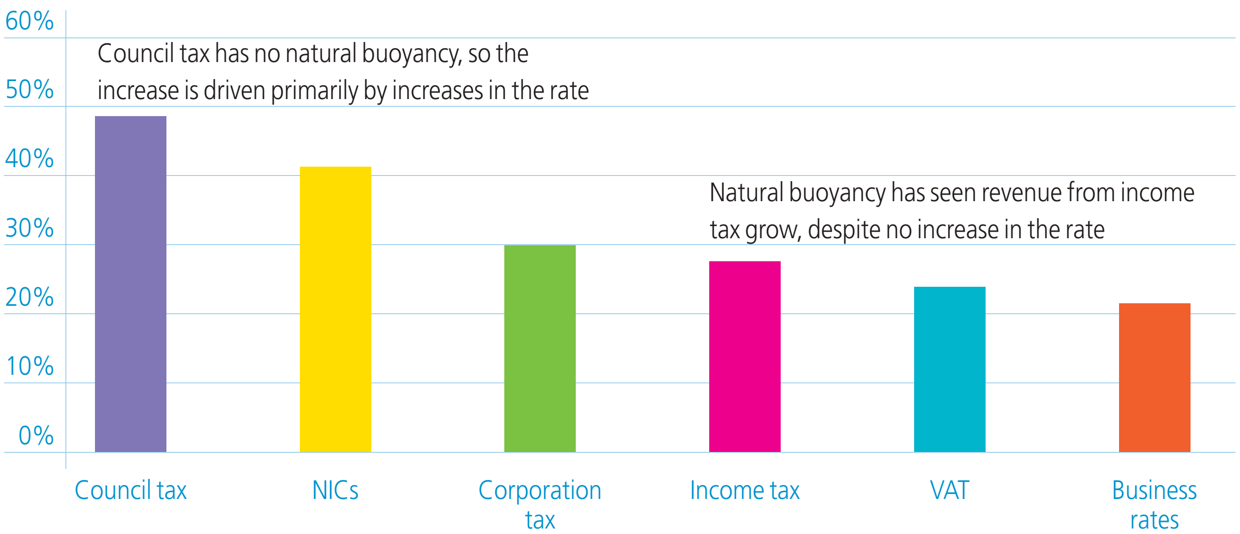


chart 3: % increase in tax revenue 2000/1 to 2005/6

Source: HM Treasury



NB. Barely 4% of the rise in Council tax yield is due to additional tax base.

determined taxes and charges to create incentives for economically rational behaviour in line with their local strategic objectives.

23 In addition to these failings in the mechanisms and income base, there have been a series of crises brought about by misunderstandings around the impact of national spending and resource allocation decisions on local budgets and council tax increases. Perhaps the two highest profile of these were to do with the passporting of school funding increases in 2003, and the average 12.9 per cent council tax rises in 2003/04, both of which have been commented on in Audit Commission reports. The Commission found no evidence of mismanagement by local government, rather they pointed to failings in the system and in the level of engagement and understanding at the national level as highlighted in these quotes from their reports:

"There is no evidence … that councils failed to allocate to schools funding made available by the government."

"We believe that better common understanding of the issues will ensure a more serious engagement between politicians at a national and local level …. "

"We found a clear association between the size of grant increase a council receives and their increase in council tax …. But no causal relationship between budget and council tax increase"

These are damning comments on the present system, which should be unacceptable to both central and local government.

24 Local Authorities do not wish to see inflation busting rises in Council Tax. We have the greatest possible concerns for the effect on individual taxpayers and particularly those on low and fixed incomes and pensioners. We therefore seek a finance regime that is open and evidence based, and which will support mature negotiations on an equal footing between the whole of central and local government.

looking forward

25 Those criticisms of and lessons from the present system provide an important historical context. However the opportunity exists now to be innovative and positive, and to create a system which supports the thrust and direction of current government policy-thinking, and to strengthen central-local partnership. We believe that the following proposals provide the framework for that to happen in a measured, developmental and sustainable way.

PROPOSAL ONE: a single conversation

26 Recognising that local government is a key partner and stakeholder in all the major domestic public services, affecting most departments of state, it is proposed that the national groundwork on finance and spending settlements should take place through a 'single conversation' involving all those departments, brought together and led by HM Treasury. This should include the entire spending plans for all locally delivered services through whatever local delivery agency, for example including highways agencies, police, health trusts and social security.

27 Discussions would cover the quantum of local public spending across all services (local government and partners); allocations across national priorities and any policy changes in distribution mechanisms. In other words it would deal with political choices and decisions. It would deal with annual or longer term settlements including the substance of comprehensive spending reviews and the assessment of new burdens.

28 For ease of illustration, Annex 1 shows this schematically over three spending blocks: the two personal services blocks of Children & Young People, Health & Social Care and a 'general' block. The reason for choosing these three is that we propose a fundamental realignment of the national/local funding partnership to recognise that:

1 because of the changing nature of the spending demands for children and care services, where central

government is acknowledged as the senior partner, these should be predominantly funded from national taxation whether that be via a specific grant distribution or some form of assigned revenue; and

2 the property based local taxes are better aligned to the non-personal services and 'place-shaping' and with the incentives inherent in the management of those taxes.

29 The proposition is that the 'single conversation' would cover quantums and priorities for each block. Local taxation would be the major funder of the general block and the minority funder for the two personal services blocks. This would bring a number of benefits. It would:

- help and inform an open national conversation and agreement around the costs of policies and trends;
- provide clarity about the local impact of nationally agreed spending plans;
- remove the potential for disproportionate impacts on local budgets and tax levels; and
- by maintaining a local financial stake in the two personal services blocks, retain:
  - incentives associated with local accountability;
  - flexibility for local finessing of necessarily crude national allocations to fit local needs;
  - ability for in year locally funded 'top ups' for local priorities.

Para 13 has explained the need for the local input to these service programmes.

30 Recognising the ultimate responsibility of Government and Parliament, the 'single conversation' would also:

- examine and make recommendations about the effects of individual departmental policies and changes in need;
- determine the 'new burdens' requirements within multi-year settlement periods;
- receive recommendations on and determine distribution guidance across all programmes in an holistic manner to deliver national priorities having regard to local impacts; and
- review outcomes, value for money and the delivery of a limited range of national targets.

31 We also believe that this approach would facilitate the more 'joined up' approach to service outcomes which the government is seeking. To be effective it must be Treasury led and chaired, but could be supported and facilitated by the existing DCLG team. We would also like to see it supported, and indeed the whole process enhanced by the establishment of an independent (public finance) commission.

PROPOSAL TWO: an Independent Public Finance Commission

32 The purpose of an independent commission is to depoliticise that which can be de-politicised. There are a number of precedents for this in banking and finance, not least the present Chancellor's decision to grant independence to the Bank of England (& management of interest rates) and to establish a light-touch regulator in the form of the Financial Services Authority. The commission would not be involved in making political choices, but could provide independent evidence, evaluation and advice to both central and local government around key issues. There are also several examples and lessons from abroad which will be summarised in a separate paper.

33 Such a commission would provide the opportunity to devolve from Government a number of tasks which are probably better regulated outside the 'government'. The key functions envisaged for the commission are:

- stewardship of overall funding regime(s), including determination of the distribution and equalisation mechanisms, and maintaining an overview of accountability arrangements;

- keeping data and tax base valuations up-to-date, in the latter case by commissioning contract work from valuation offices;
- regulation of a devolved regime of fees and charges, and to investigate and advise on new or alternative charging regimes;
- provide the regulatory framework for the relocalisation of business rates;
- research and advice, to support the integrity of the system.

stewardship

34 The independent commission should take over the work on distribution formulae currently carried out by DCLG; this would include regular reviewing of grant distribution between authorities, ensuring that data within formulae was as up to date as possible and co-ordinating formula reviews at regular intervals. The commission itself would not decide; but it would recommend to the central local partnership. This role is not unlike that of the Higher Education Funding Council which distributes £7bn to Universities on behalf of the DfES.

35 A new equalisation scheme will be required to reflect the proposals in this paper. The independent commission would then keep under review the operation of that equalisation system.

data and tax base valuation

36 he commission would have the task of gathering research and evidence on local government income and expenditure. For example, it could commission and maintain an index of local government pay and prices, separate from the GDP deflator, which commanded respect from both central and local government

37 It is proposed that the commission be given the power to ensure that the local tax bases should be kept up to date. Currently the business rates taxbase is revalued once every five years. The council tax taxbase has not been revalued since 1993, although the mechanics were put into place to implement a revaluation in England from 2007, following the implementation of a review in Wales in 2005.

38 The mechanics of revaluation are carried out by the Valuation Office Agency, and we do not propose changing this. The association considers that the property tax bases should be kept up to date on a continuous basis (perhaps akin to the Boundary Commission area by area reviews), that the wider use of regional indexing be explored and that 'big bang' reviews, which are politically difficult and costly in any one year, can be avoided.

overview of fees and charges

39 It is proposed that a new set of principles and guidelines should govern the setting of fees and charges. The presumption should be a 'bottom up' approach, with individual authorities responsible for reviewing and setting charges, but with exceptions. A hierarchy should be developed by agreement, led by the independent commission, within which there might be three categories:

- those charges (the majority) where local authorities should have freedom and flexibility;
- those where by agreement local government would wish to standardize to avoid regional or national cross boundary or equity issues, ie. Charge setting would be referred up; and
- those where it is agreed that they should be set nationally as a matter of policy. In these cases the commission would oversee the annual or periodic review, evidence based and tested against set criteria, and make recommendations to the central-local partnership, ie. reserved charges.

40 Both central and local government could refer to the commission new ideas for charging, research and advice. Recommendations from such a commission on environmental (particularly waste) charging would be particularly welcome at the present time. Tourist taxes, road tolls and planning gain supplement are examples of new topics that would have fallen into that category. The current proposed work of the Audit Commission to undertake a review of fees and charges in local government is opportune in this context. It could be asked to consider this hierarchical approach as part of its review.

A Framework for a re-localised business rate

41 Reference has already been made earlier to the diminution in the relative share of local spending met from business rates, and indeed its contribution to the national exchequer. It must be questioned whether a continuation of that trend is in the interests of a balanced tax regime. Moreover the present situation denies the opportunity of incentivising local authorities' interest in business as a customer, a driver of the local economy, and a recipient of basic services. The association's view is that a relocalised business rate provides the key to all those objectives, and that it should be relocalised within the following framework.

42 We propose that more work, either in advance of the proposed new commission, or as part of its early remit, should be done on a structure whereby:

a A new pooling and 'equalisation' model be adopted along the lines set out in a companion paper prepared by Tony Travers of the LSE. This would restore business rates as clearly a local tax raised and spent locally.

b The approach should incorporate an enhanced regime for allowing the local authority to retain in specified time periods the revenue from growth in its tax base.

c The determination of the business rate poundage should be evidence based having regard to set criteria which might for example include GDP growth, council tax growth, public spending inflation, and efficiency savings targets, and form part of a national conversation conducted by the commission. This would culminate in a recommendation to parliament.

d Individual authorities could have the freedom to set business rates either side of the core national rate within say a three per cent envelope in any one year. Where setting a higher rate this should perhaps be subjected to a formal agreement with business and specifically earmarked for jointly agreed schemes. It should be remembered that prior to NNDR, 50 per cent of authorities chose to set business rates below the average and some well below. The costs and benefits of lower or higher than core national poundages should fall locally, and authorities would be expected to pay into the pooling arrangements at the national poundage rate.

e In order to further embed the relationship between business and local authorities, business should have one or more guaranteed places on the strengthened partnership boards referred to under proposal three.

43 The table overleaf shows the present distribution of those functions proposed for the commission. Its role would be an important one, but would not require a huge bureaucracy to run it and it could be serviced by transfers or secondments from existing resources.

44 Appointments to the commission should be by an appropriate national open process, with a clear emphasis on skills and competencies, and should be of a non-political nature.

PROPOSAL THREE: enhanced local area management of public finance

45 Proposal One has already described our vision for a new national settlement around the key service blocks for Children & Young People and Health & Adult Care. We envisage that the funds distributed to LAs and partners in the same area would be 'pooled' for these two blocks, and that Partnership Boards would have the overview

Function	Where currently done
Stewardship of overall funding regime (inc. constitutional settlement)	Currently spread across DCLG, HMT and various government departments inc. ad hoc reviews and inquiries
Distribution mechanism (formulae)	DCLG; in consultation with LGA, through SWG
Equalisation mechanics	DCLG
Regulatory / advisory role on business rate poundage increases	Currently linked to RPI DCLG
Fees /charges regimes (tiered)	Various government departments; Audit Commission currently considering
Maintenance of tax bases	DCLG and VOA
Research and evidence	DCLG /LGA /LGE /Independent consultants

and the flexibility to distribute funds within an agreed framework. This is building on the concept of the present Children & Young Peoples Partnerships (Childrens Trusts) and Health – Social Services Partnership Boards.

46 In the manner envisaged in the local government White Paper we strongly support an overarching Partnership Board (or PSB) for the local authority area. This strategic partnership should take an overview of all public spending within its area. All public agencies should be mandated to participate and, under local authority leadership, to agree the key priorities for their area, to develop and negotiate Local Area and Public Service Agreements (LAAs & PSAs), and ensure that the plans of all partners fit together.

47 They would be expected to exploit and to deliver on the opportunities which exist for:

- efficiencies, including the merger of back offices and procurement;
- synergy including the pooling of budgets and sharing innovation;
- joined up front offices and access for customers; and
- addressing the key priorities for the area for the greatest benefit.

48 Annex Two illustrates this approach for the three blocks. The 'third' or general block would not have a single partnership board, rather it would comprise the whole range of existing partnership arrangements that exist for crime and disorder, economic development, drugs action and so on. It should be for each local authority with its partners to work out precisely what partnership arrangements and pooled budgets they wish to establish beyond the statutory ones to deliver their shared objectives within the architecture described here.

49 We expect that partners locally should have the freedoms, within the overarching PSB, to vire funds between main blocks and subsidiary programmes in an outcomes driven regime. Their task is to take collective ownership of key local issues, to deliver agreed national outcomes for their area and the best match to local needs, and to maximise value for money.

local taxation

50 Finally it is worth re-iterating the LGA's views on local taxation. These were set out in an earlier submission referred to as the combination option.

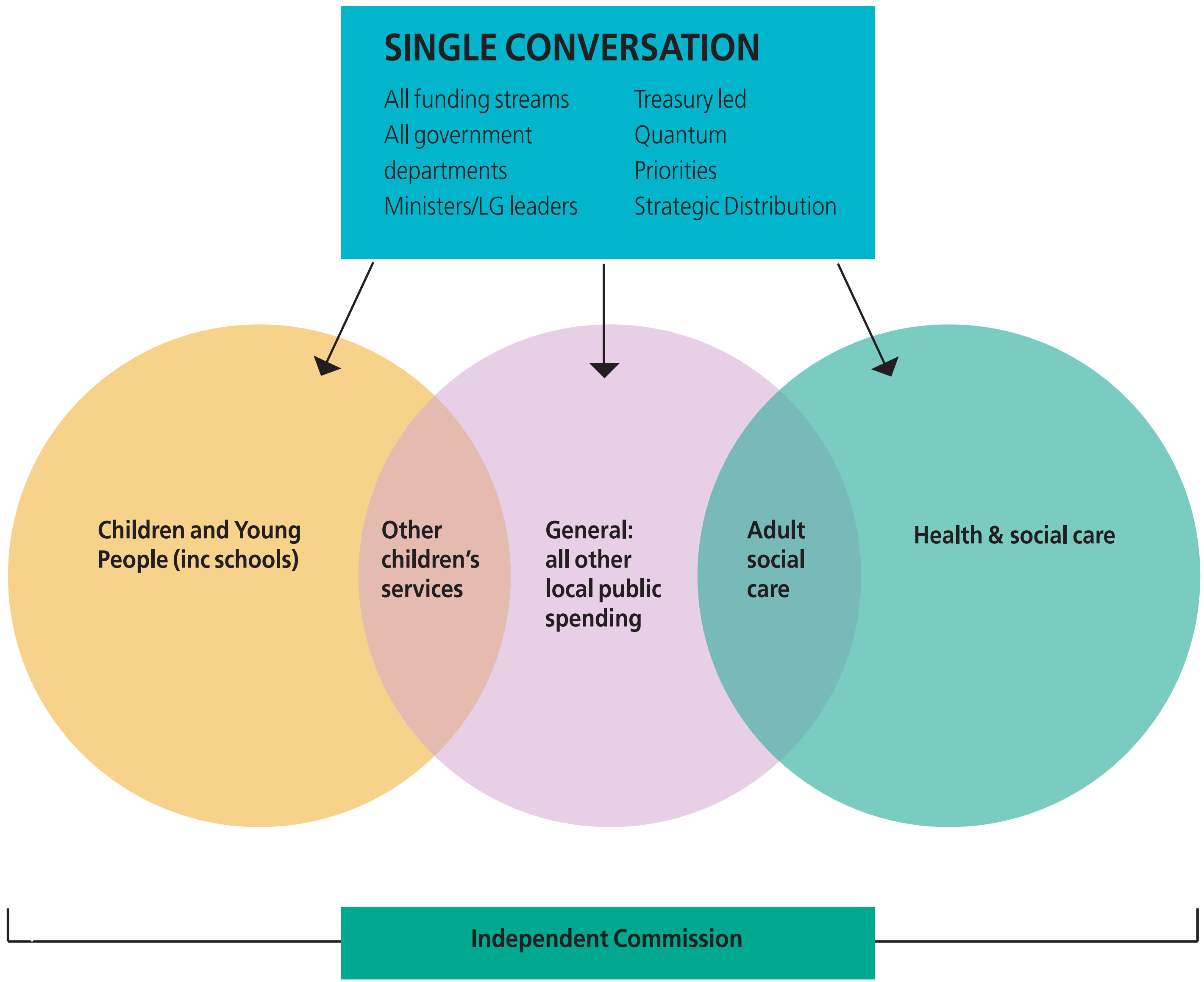
51 We firmly believe that it is important for locally accountable government to retain its own local tax source. The current property based council tax if retained requires some improvements and as stated earlier the valuation base needs updating. We further believe that if the package of recommendations in this report are implemented then the government should move with confidence to remove capping of council tax. Local authorities should have to account to local taxpayers for

their tax decisions. They should be challenged through the ballot box.

52 We have put forward ideas for relocalising the business rates within a framework that should give confidence to business, help to develop trust and bring incentives for public-private sector co-operation for the wider benefit of communities in general. Moreover we have argued in this paper that the new regime needs to see local taxes and charges not just as a means of cost recovery for particular services but as a mechanism for incentivising behavioural change in pursuit of both national and local objectives.

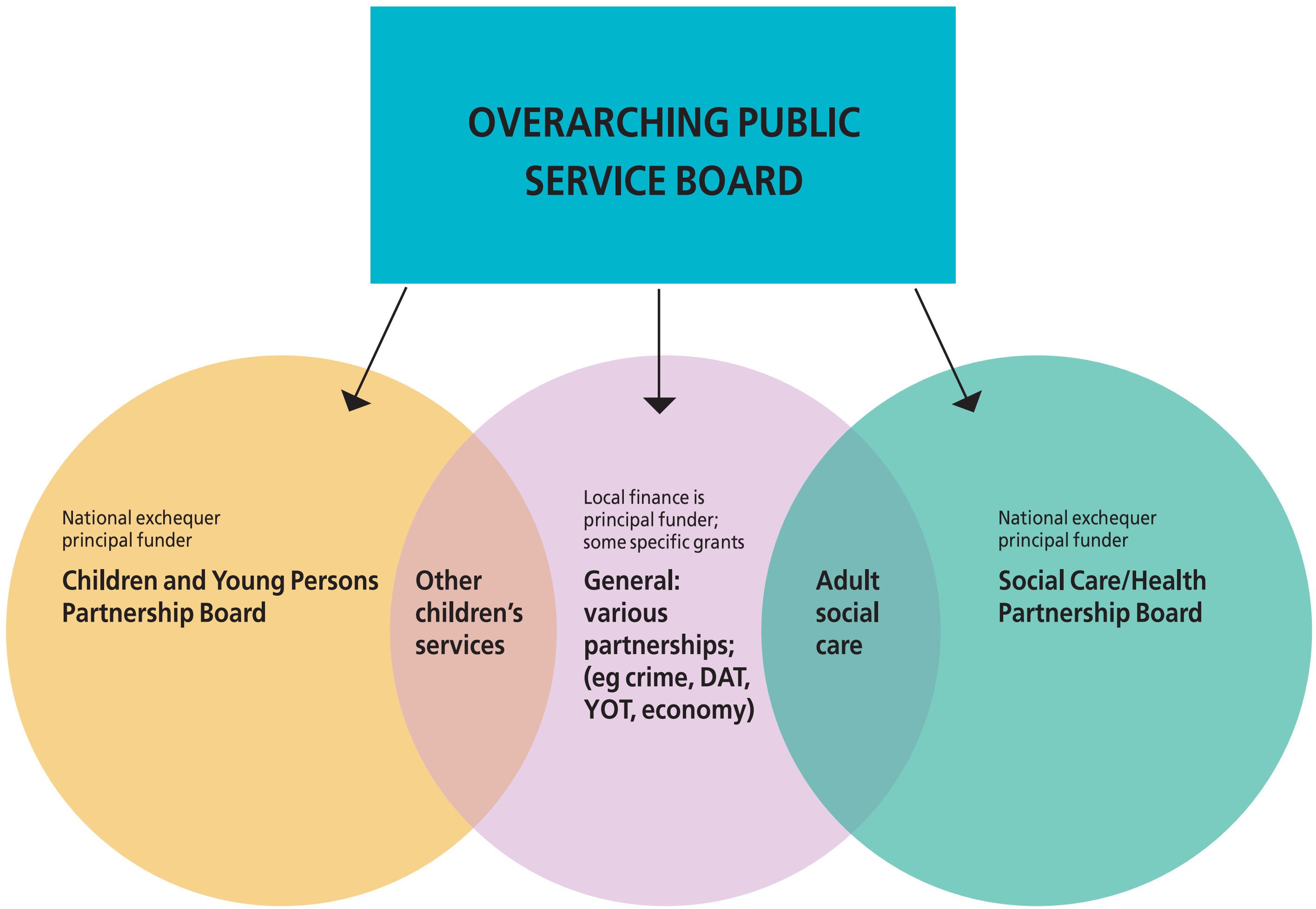
annex 1

National level: SINGLE CONVERSATION



annex 2

Local level: OVERVIEW OF ALL PUBLIC FINANCE



Local Government Association

The LGA welcomes comments on
the ideas in this document

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