

## **Local Government and Public Services Committee**

**LGPS(2)-01-06(p.5)**

**Date: Thursday 12 January 2006**

**Venue: Committee Room, National Assembly for Wales**

**Title: Lyons Inquiry into Local Government in England - Interim report**

### **Purpose**

This paper summarises the main points from the interim report of the Lyons Inquiry into Local Government in England and outlines the further consultation questions posed by the inquiry

### **Background**

2. The Lyons Inquiry was established by the UK government following the Balance of Funding Review in July 2004.

Its original terms of reference were:

The Inquiry will be led by Sir Michael Lyons and will report by the end of 2005 to the Deputy Prime Minister and the Chancellor of the Exchequer.

The inquiry will:

- consider, in the light of the report by the Balance of Funding review, the detailed case for changes to the present system of local government funding;
- make recommendations on any changes that are necessary and how to implement them; and
- take evidence from stakeholders.

In particular, the Inquiry will:

- make recommendations on how best to reform council tax, taking into account the forthcoming revaluation of domestic property;
- assess the case both for providing local authorities with increased flexibility to raise additional revenue and for making a significant shift in the current balance of funding;
- conduct thorough analysis of options other than council tax for local authorities to raise supplementary revenue, including local income tax, reform of non-domestic rates and other possible local taxes and charges, as well as the possible combination of such options; and
- consider the implications for the financing of possible elected regional assemblies.

The Inquiry will also consider, as appropriate, any implications that its recommendations have for other parts of the United Kingdom.

3. In May 2005, Sir Michael Lyons attended the Local Government and Public Services Committee to discuss his remit.<sup>1</sup>

4. In September 2005, the remit of the inquiry was extended and the new terms of reference are now:

The Deputy Prime Minister and the Chancellor of the Exchequer have agreed with Sir Michael Lyons that he will extend his work so that he can consider issues relating to the functions of local government and its future role, as well as, and prior to, making recommendations on local government funding. His work will inform the Comprehensive Spending Review 2007.

In addition to its existing remit which is focused on local government funding, Sir Michael's independent inquiry will:

- consider the current and emerging strategic role of local government in the context of national and local priorities for local services; and the implications of this for accountability;
- review how the Government's agenda for devolution and decentralisation, together with changes in decision making and funding, could improve local services, their responsiveness to users, and efficiency;
- in the light of the above, consider in particular: how improved accountability, clearer central-local relationships, or other interventions could help to manage pressures on local services; and changes to the funding system which will support improved local services;
- publish a report or reports, as appropriate, in time for the Comprehensive Spending Review 2007.

Sir Michael will work closely with local government as well as with central government in delivering his remit.

5. On 15 December, the Lyons Inquiry published a combined interim report and consultation document outlining the progress of the inquiry to date and its future direction following its change in remit<sup>2</sup>.

## **Consideration**

6. A summary of the interim report is at Annex A. It contains a description of the revised remit of the Inquiry along with discussions on the scope for further decentralisation of powers and responsibilities of local government and taxation and funding issues.

7. The summary also contains a list of 7 questions on which the Inquiry is seeking views:

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<sup>1</sup> A transcript of the session can be found at:

<http://www.wales.gov.uk/keypubrecordproceedings/content/lgps-050511.htm#g>

<sup>2</sup> The full document can be found at:

<http://www.lyonsinquiry.org.uk/Lyons%20Inquiry%20web.pdf>

## **The strategic role of local government**

1. What is the strategic role of local government? Is my description sufficient, or are there more elements you would add?

- Which elements of this role should extend to services other than those for which local government is directly responsible, and how?
- How does the strategic role vary between different types of councils?

2. What tools do councils need to perform the strategic role more effectively?

- What are the existing barriers to councils performing this role effectively?
- In what circumstances does it work well and less well?
- Are further improvements in performance, efficiency and accountability needed before local government can most effectively play this strategic role and be trusted to do so?
- What are the key signs of success and failure?

3. How important is the fact that local government is elected in relation to its ability and legitimacy to perform this role?

## **Devolution and decentralisation**

4. Which services (or parts of services) should meet national standards in all areas of the country? Which should meet minimum standards? Which should be entirely down to local choice?

- Are there aspects (such as standard setting, funding or choice of delivery mechanisms) of individual services which should be nationally controlled or locally controlled?
- Are there services where greater local variation in standards would be acceptable if there was clearer accountability and consultation with local people?

5. How has the Government's approach to devolution and decentralisation affected your area and your local services?

- Which aspects of the current system are helpful and unhelpful, and why?
- Have changes based on central government priorities differed from those that might have been driven by local pressure and opinion?

## **Managing pressures on local services**

6. How can pressures on local services be managed more effectively?

- What are the main types of pressures faced by local services and how are they currently managed?
- Which are the most difficult to manage and why?
- Would greater devolution of responsibility enable pressures to be managed more effectively?
- Do confusion about responsibility and duplication of effort contribute to pressures?
- Would greater public understanding of the actual cost of public services help to manage expectations and pressures?
- How can we ensure that the system provides the proper incentives and rewards for using resources efficiently?

**Scope for a new agreement**

7. How could responsibility for local services be made clearer between local government, central government and other agencies?

- What might this mean for the current performance management framework?
- Would a more contractual approach for a small number of key central priorities help to achieve this?

8. Comments on the analysis annexes of the report should be received by 31 January 2006. Responses to the questions posed in the main report should be received by 13 March 2006.

**Members may like to consider if they have any comments on the interim report (e.g. the report talks about learning lessons from elsewhere yet does not refer to the Council Tax revaluation in Wales under the relevant section of the report).**

**Members may like to consider if they would like to produce a formal Committee response to some or all of the questions raised by the Inquiry.**

**Members may like to consider if they would like to hear any additional evidence before any Committee response is produced**

**Action: That the Committee identifies ways in which it would like to respond to the Lyons Inquiry.**

## SUMMARY

### THE PURPOSE OF THIS REPORT

**S.1** This report contains two parts:

- Part 1 is a consultation document which sets out how I intend to approach my extended remit to consider the role and functions of local government, and seeks views on key issues. It marks the beginning of what I hope will be a wide and coherent public debate on the role and functions of local government in order to inform my work on the local government funding system.
- Part 2 presents some of the key issues to emerge from my work to date in relation to my original remit on local government funding and seeks further views on these issues in advance of my final report to ministers in late 2006.

### Technical Annexes

**S.2** The narrative of the front two parts is supported by four detailed annexes which set out the analysis and research I have conducted and commissioned in support of my work.

- **Annex A: Emerging findings from statistical modelling** sets out the results from the modelling analysis I have commissioned to support my research.
- **Annex B: Description of the modelling process** contains a technical description of the modelling process.
- **Annex C: Stakeholder engagement** sets out how I have engaged with key stakeholders over the past year and details some of the key themes that have emerged from the views and evidence submitted to my Inquiry.
- **Annex D: Research** includes a summary of the five pieces of research I have commissioned to explore my interest in other countries' approaches to local finance arrangements, public attitudes to local government finance and taxation, and local taxation options.

## PART 1: LOCAL GOVERNMENT ROLE AND FUNCTIONS

### The recent history of local government funding

**S.3** It has always been difficult to consider the reform of the local government funding system without considering what local government should be doing and how much power it should have. Other studies in this field have also reached this conclusion. Indeed, much of the report of the Layfield Committee, published in 1976, remains relevant today.

**S.4** The Committee struggled to avoid going beyond its terms of reference in the search for a sustainable solution to the problems of local government finance, and

concluded that “a durable financial system can be established only if it is founded on a political choice about the direction in which the relationship between central and local government should move”. The report suggested two possible directions for policy to address this:

- An approach based on ‘**central**’ accountability, whereby central government takes a more interventionist approach to local government, specifying spending levels for local services; or
- An approach based on ‘**local**’ accountability, whereby authorities are given a far greater degree of discretion over local services, funded by a new form of local taxation, with little interference from the centre.

**S.5** In the event, the government of the day did not follow either of these proposals explicitly.

## Change in the 1980s and 1990s

**S.6** The Conservative government which took office in 1979 sought to bear down on local government spending, which it saw as excessive, reducing grant for some authorities and introducing legal powers to control local budgets and to set rates of tax.

**S.7** After a long search to find an acceptable tax to replace the system of domestic and business rates, the government introduced the community charge (commonly known as the ‘Poll Tax’) in 1990. At the same time, control of business rates was moved from local authorities to central government and constraints on the yield were imposed. However, the community charge proved to be deeply unpopular and was replaced by the council tax in 1993. Business rates remained in central government control as they do today.

**S.8** Since 1997, the current Government has introduced a programme of reforms to local government with the aim of building stronger local accountability and engagement. Today, local government increasingly works with and through a host of other organisations and partnerships in order to deliver services and improve the prosperity of local communities.

**S.9** The basic features of the local government funding system have not changed substantially since the early 1990s. There have, however, been a number of important developments, including the introduction of prudential borrowing powers for local authorities, the growth in the size of specific and ring-fenced grants outside the main Revenue Support Grant, and the planned introduction of a ring-fenced Dedicated Schools Grant in 2006.

**S.10** The current Government has conducted a number of reviews of aspects of the funding system, most recently through the Balance of Funding Review in 2004 which was set up to consider the various means by which the balance of funding between local and central sources could be changed. It was following that review that I was asked to lead this Inquiry.

## Why my remit was extended

**S.11** One of the strongest conclusions emerging from my work to date is that wellfounded recommendations on possible reforms to the funding of local

government need to be based on a clear understanding of the expectations and responsibilities of local government, which continue to change. Furthermore, to be successful, the public must be able to understand any package of funding reforms in the context of what local government does. This conclusion echoes previous studies in this field (most notably Layfield) and is reconfirmed by the research and analysis I have conducted.

**S.12** Following discussions with ministers, during which I outlined this and other issues emerging from my work to date, I was invited to extend the remit of my Inquiry to consider the role and functions of local government before making recommendations on changes to the funding system.

**S.13** My research has revealed a weak public understanding of how local government is funded, and confusion over how the responsibility for the delivery of local services is shared between central and local government, and has indicated a poor public understanding of the cost of public services. This is problematic because if people do not understand how much services cost to deliver, they may have unrealistic expectations about what council tax pays for and how much local government can do with the level of resources currently available. My research also suggests that there is a high degree of public confusion about who is responsible for setting the level of council tax and the reasons behind the annual increases in the tax.

**S.14** Such confusion might be caused by the very real complexity of the local government funding system, the way local government is structured, and/or the confusion surrounding where the key division of responsibility lies between central and local government when it comes to making decisions about public services. All of this adds to the complexities of how each household's council tax bill is made up and what it funds.

**S.15** There is no 'golden key' which will solve all the problems of the funding system. Hard choices need to be faced and there will be 'winners and losers' with almost any package of reform. Therefore the reasons for reform need to be well understood if they are to gain public support.

**S.16** However, international comparisons suggest that there are other ways of doing things and I am interested in how approaches to local government funding in other countries might be applicable to the UK. This research has shown the UK system of local government funding to be distinctive in terms of the very low proportion of taxes raised locally, its reliance on a single local tax, its breadth of ambition for national standards in service provision and its aim for a high level of equalisation between areas of different tax raising power.

## **APPROACH TO MY NEW REMIT**

### **The need for a public debate**

**S.17** A wide and coherent debate on the role and functions of local government is needed to provide the basis for well-formed recommendations on funding which reflect what the public want from local government. This part of the report seeks to contribute to that debate, building on some of the issues which emerge from my extended remit in the following areas.

## The strategic role of local government

**S.18** Most people would consider a strong and successful community to be an attractive place to live and work, with effective public services and a good quality of life. Such communities will also be economically successful, providing opportunities for individuals and businesses to thrive, and socially cohesive, with an appreciation of the rights and responsibilities of residents from all backgrounds. Local government is uniquely placed to address these aspirations. It is accountable, through the election of representatives, to the residents of an area, and it is responsible for promoting the wellbeing of that area.

**S.19** The strategic role of local government, one we might term “place-shaping”, encompasses:

- Building and shaping local identity;
- Representing the community, including in discussions and debates with organisations and parts of government at local, regional and national level;
- Regulating harmful and disruptive behaviours;
- Maintaining the cohesiveness of the community and supporting debate within the community, ensuring smaller voices are heard;
- Helping to resolve disagreements, such as over how to prioritise resources between services and areas, or where new housing and development should be located;
- Working to make the local economy more successful, to support the creation of new businesses and jobs in the area, including through making the area attractive to new investment and skilled workers, and helping to manage economic change;
- Understanding local needs and preferences and making sure that the right services are provided to local people through a variety of arrangements including collective purchasing, commissioning from suppliers in the public, private and voluntary sectors, contracts or partnerships, and direct delivery; and
- Working with other bodies to respond to complex challenges such as dealing with natural disasters and other emergencies.

**S.20** This role needs to be considered alongside an understanding of the national context, as central government is responsible for providing a framework and direction for the country as a whole. There can be tensions between national objectives and frameworks and devolution to a more local level. Local actions can affect people who live elsewhere in the country and such impacts need to be taken into account. It will also be important to reflect on the capability of local authorities to deliver successfully in this role, and the confidence that local people have in them.

**S.21** We face important strategic challenges in the 21st century, which will create new demands on local government. Globalisation and increasingly mobile capital will require a flexible response to the needs of businesses and workers and the ability to seize new opportunities. Greater movement of people will create more complex and



diverse communities with a variety of new needs and local priorities. Environmental challenges will influence how the economy develops and how public services should be delivered to contribute to long-term sustainability. All of these things will test local government's ability to engage with communities and build prosperous and successful localities. They will also test the degree to which nationally set policies are capable of responding effectively to unique and diverse local situations.

### **The scope for further devolution and decentralisation of powers and responsibilities**

**S.22** The Government has devolved significant powers and resources to the administrations in Scotland, Wales, Northern Ireland and London, which has led to different choices and policies in these places in response to different needs and circumstances. The Government has also engaged in a debate about neighbourhood level governance and developed forms of decentralisation to service delivery level organisations such as hospitals.

**S.23** There are powerful arguments for devolving power from central government to local communities, relating both to how services are delivered and how priorities are set between services and other activities.

**S.24** Devolution is not just about giving local government greater freedom in delivering priorities defined by central government. It is also about giving local communities more choice to set their own priorities for service improvement. Giving local government more power and choice over local services could lead to more responsive services which are better matched to the preferences of local people. It might also help to make authorities more directly accountable to local people for the decisions they make and the money they spend. This is not just about the transfer of power from central to local government, but devolution to different levels of local government for different services, and decentralisation to give managers and front line staff more control over how those services are delivered. Some services will be best managed on a regional basis, or across a conurbation, whilst others are very local, with decisions most appropriately taken at the neighbourhood or parish level. Such an approach may lead to differences in the availability and quality of services across the country but this is a necessary - and valuable - consequence of having services which are tailored to the specific needs of different communities.

**S.25** However, the public have expectations about what people are entitled to as citizens and residents of the UK, and aspirations for improvements from which all can benefit. Greater devolution will lead to different choices being made in different areas. For some services, where people may not accept variations in quality or accessibility, it may not be appropriate for local government to play the major role in deciding on the level of performance expected – such services (for example, health and education) may benefit from being subject to 'national standards' decided by central government. Some would argue that a strong centre is essential in order to pursue such goals of equality, and to tackle under-provision of services, particularly in deprived areas. My research shows that public views about who should set public service standards vary between different services.

**S.26** I am interested in views on how we can strike the right balance between ensuring adequate national standards in service provision for all citizens, and allowing sufficient local variation to meet the diverse needs of local communities and to allow them to exercise choice over their own priorities. The debate needs to take account of the diversity between different services, areas, and ways of delivering. It

also needs to recognise the need to balance what we choose at local or national level and what we are willing to pay for.

**S.27** A number of stakeholders I consulted argued that the current approach to setting targets and allocating resources can undermine the scope for local authorities to set their own priorities. For instance, although changes to the performance management and inspection framework over recent years have clearly contributed to improvements in services, the large number of targets and inspection requirements authorities have to meet reduces their ability to prioritise one service over another where resources are limited.

**S.28** Local government should be better placed than central government to understand and meet local preferences due to its local knowledge and its ability to engage with the local community over what local people want. However, if it is unable to direct resources towards the services which are most important within its locality (and away from those which are not), it is difficult for it to respond to local priorities. Such a situation also gives rise to an 'accountability gap' between central and local government, with local government held accountable by local people for choices on spending over which it has little control. There is also a risk that a lack of flexibility and uncertainty about future priorities and funding can contribute to the level of pressure on local services overall.

### **Pressures on local services and the possible ways in which they could be managed more effectively**

**S.29** There is an ongoing debate between central and local government about the level of funding available for delivering local services and the degree to which central grants take account of new responsibilities which central government asks local government to take on.

**S.30** Those I have consulted, including the Local Government Association, have highlighted a variety of sources of pressure on local government and local services, including:

- demographic changes which affect the level of demand for services;
- new legal and policy responsibilities introduced by the Government;
- pressure from central government departments through targets to improve the quality of services;
- pressure from local people for better local services;
- the need for investment in the infrastructure which supports local economic development and social conditions;
- the need to deal with issues highlighted by central inspections;
- the costs created by the complexity of the system; and
- cost increases, including the local government pay bill.

**S.31** As part of my wider remit, I will be exploring how these pressures might be

managed more effectively. I will also consider how current and proposed changes to the system of local government funding, activities and structures, as well as those of other parts of the public sector such as the police and health, may all affect council tax bills. Such changes create the need for a disciplined discussion of potential reforms as part of a more effective approach to managing pressures. I am particularly interested in exploring the extent to which greater devolution of responsibility from central to local government could help to manage local pressures more effectively by enabling hard choices about local services to be made in a way which explicitly reflects local priorities.

## **Scope for a new agreement between central and local Government**

**S.32** I want to explore whether a framework giving greater clarity about which aspects of services are centrally determined priorities and which are areas for local discretion could help to deliver more responsive, effective and efficient local services and help to manage pressures.

**S.33** A wide variety of mechanisms might be used to provide greater clarity. For example, one framework might involve central government defining a smaller number of key priorities, linked to its central Public Service Agreement targets, which could be negotiated and managed through contractual agreements between central and local government. Local authorities might then be given greater freedom to decide on and respond to other priorities with less monitoring and intervention, and more room for manoeuvre in making the trade off between local services and tax levels in consultation with local people. I am interested in exploring this and other possibilities more fully.

**S.34** My work under the new remit will be organised under core themes, and I am seeking views on the following questions:

### **The strategic role of local government**

1. What is the strategic role of local government? Is my description sufficient, or are there more elements you would add?

- Which elements of this role should extend to services other than those for which local government is directly responsible, and how?
- How does the strategic role vary between different types of councils?

2. What tools do councils need to perform the strategic role more effectively?

- What are the existing barriers to councils performing this role effectively?
- In what circumstances does it work well and less well?
- Are further improvements in performance, efficiency and accountability needed before local government can most effectively play this strategic role and be trusted to do so?
- What are the key signs of success and failure?

3. How important is the fact that local government is elected in relation to its ability and legitimacy to perform this role?

### **Devolution and decentralisation**

4. Which services (or parts of services) should meet national standards in all areas of the country? Which should meet minimum standards? Which should be entirely down to local choice?

- Are there aspects (such as standard setting, funding or choice of delivery mechanisms) of individual services which should be nationally controlled or locally controlled?
- Are there services where greater local variation in standards would be acceptable if there was clearer accountability and consultation with local people?

5. How has the Government's approach to devolution and decentralisation affected your area and your local services?

- Which aspects of the current system are helpful and unhelpful, and why?
- Have changes based on central government priorities differed from those that might have been driven by local pressure and opinion?

### **Managing pressures on local services**

6. How can pressures on local services be managed more effectively?

- What are the main types of pressures faced by local services and how are they currently managed?
- Which are the most difficult to manage and why?
- Would greater devolution of responsibility enable pressures to be managed more effectively?
- Do confusion about responsibility and duplication of effort contribute to pressures?
- Would greater public understanding of the actual cost of public services help to manage expectations and pressures?
- How can we ensure that the system provides the proper incentives and rewards for using resources efficiently?

### **Scope for a new agreement**

7. How could responsibility for local services be made clearer between local government, central government and other agencies?

- What might this mean for the current performance management framework?

- Would a more contractual approach for a small number of key central priorities help to achieve this?

### **The work the Inquiry will undertake**

**S.35** In my work under the second phase of my Inquiry, I will be seeking to take views, evidence and analysis from a wide range of stakeholders, including through the analysis of responses to this document. I will also take into account, where possible, work being undertaken by others on the emerging and future role of local government, including the ODPM's local:vision work, work being undertaken by government departments which has implications for local government, and the activities of think tanks and other organisations in this field.

**S.36** Much of the work with local authorities and the public engagement work will be undertaken in the earlier part of 2006, with interim work published before Summer 2006. Work may include:

- Public engagement – particularly through local authorities
- Qualitative research
- Literature Reviews
- Detailed case studies – of particular services and / or particular areas
- Promoting debate and research across a wide range of organisations
- Scenario-building and futures work
- Publication of a small number of thematic papers on relevant issues

### **The question of local government finance**

**S.37** The work on these core themes and questions will also be underpinned by the underlying consideration of local government finance, and how the emerging and future role of local government impacts upon our aim to find a sustainable, fair and effective funding system for the future.

### **Conclusion**

**S.38** I hope that all those who are interested in the role and functions of local government and who have evidence or experience which would be valuable to my work will contribute their views as part of this consultation exercise. In particular, detailed examples and case studies of how the complex process of delivering public services plays out at a local level will be welcome.

## **PART 2: LOCAL GOVERNMENT FUNDING**

### **My original remit on local government funding**

**S.39** I was originally commissioned by the Deputy Prime Minister and the Chancellor of the Exchequer to consider the case for changes to the present system of local government funding in England and to make recommendations, including on the reform of council tax.

**S.40** The key issues to emerge from my work to date in relation to my original remit on local government funding are set out below. I would welcome further views on these issues, and also on the approach taken in the technical annexes to this report, and whether the illustrative models I have used to look at the implications of revaluation are illuminating.

## **COUNCIL TAX**

### **Positive attributes of council tax**

**S.41** Council tax remains important and continues to have real benefits as a local tax – it is relatively easy and inexpensive to collect and administer and collection rates are high. Basing a local tax on property ensures that the revenue to local authorities is relatively stable and predictable. It also helps to ensure that people who own their own houses contribute in relation to the size of their stake in the success of their local community, as reflected in the value of the property. Making the occupier rather than the owner liable for the tax ensures that the payment is linked to residency in a local area, which provides a direct link between the resident, the locality and the elected body. It also makes administration of the tax for both residents and billing authorities straightforward. I would welcome views on whether this fully captures the positive attributes of council tax.

### **Council tax as a property tax**

**S.42** Council tax is at heart a property tax because it is based on the capital value of domestic property. In economic terms it can be seen as a tax on the consumption of the benefit people receive from living in their property and their local area. However, it was never intended to be a ‘perfect’ property tax – the link between property value and tax liability was deliberately weakened by the banding and multiplier systems. I am interested in exploring further the role of council tax as a property tax.

### **Council tax as a local service charge**

**S.43** Council tax also has some of the characteristics of a household charge for local services. In the vast majority of cases the liability for the tax falls on the occupier of a property who benefits from local services, rather than the owner. Council tax also has a variety of discounts and exemptions designed to relate tax liability partly to the makeup of the household, rather than solely the value of the property.

### **Council tax as a hybrid**

**S.44** The hybrid nature of council tax reflects a desire to balance a number of potentially competing objectives. My work to date suggests the public do not strongly understand these objectives or the tensions between them.

**S.45** I am interested in the balance between council tax as a “fair” source of taxation and a property tax, and the issues raised by the need to balance these objectives in one tax.

## Understanding the problems of council tax

**S.46** The main problems with council tax are set out below and I would welcome views on these issues.

**S.47** Annual increases - Since the introduction of council tax in 1993-4, council tax bills have increased annually above the rate of inflation, with the steepest rises in 2003- 4, when the average bill rose by 12.9 per cent. Although property values have increased more steeply than council tax bills over the same period, increases in council tax have triggered concerns about the sustainability of the council tax system and has also seen some aspects of the tax come under increased scrutiny.

**S.48** High visibility makes increases more apparent. According to my research, council tax is the most visible form of taxation in England. The public are more aware of council tax than any other form of taxation, including income tax and VAT.

**S.49** Council tax only provides a fraction of total local spending, which means the level of tax can need to rise substantially in order to provide relatively low levels of additional resources. On average across all local authorities in England, council tax provides 25 per cent of revenue expenditure. This means that a 1 per cent increase in total spending that is not funded through other means requires, on average, a 4 per cent increase in council tax. This is known as the ‘gearing effect’.

**S.50** Council tax and the system as a whole are complex - There is a high degree of public confusion around local government funding and what council tax pays for. This may contribute to the difficulties in explaining the reasons that lie behind council tax rises. The complexity of the system may partly explain that confusion. A highly complex set of formulae is used to allocate grant between authorities, and changes in these can have an impact on the council tax an authority sets (even though changes to grant are usually damped). Even the council tax bill itself is not easy for everyone to understand. A number of different authorities are responsible for setting elements of each bill, for example district and county councils, fire and police authorities, parishes and waste authorities. There are arguments that many of the highest rises in council tax were caused by changes in elements raised through precepts.

**S.51** Fairness – One of the most common criticisms of council tax is that it is unfair. However, fairness is a complex concept and difficult to define - people can mean a number of different things when they refer to taxes being ‘fair’ or ‘unfair’. For example, they may be concerned with the link between what people pay and what they receive in local services. They may be concerned with differences in what people pay in different areas of the country. However, in focus group research, most people thought that the fairest tax is one that is related to an individual’s ability to pay, particularly meaning their income. Many of the submissions I have received criticise council tax because it is not adequately related to an individual’s income.

**S.52** The importance of this issue in public debate and in generating strong criticism of council tax led me to focus my analysis strongly on ways in which fairness could be improved.



## Council tax and ability to pay: Council Tax Benefit

**S.53** Council Tax Benefit (CTB) aims to ensure that council tax liability takes account of ability to pay. It provides a full or partial rebate from council tax for those on low incomes, depending on a household's council tax liability, income and savings.

**S.54** If everyone entitled to CTB took it up, council tax liability would be a relatively constant proportion of people's income throughout the income distribution – in fact being relatively progressive to income for those on low incomes and regressive to income only in the upper three deciles.

**S.55** However, the current system of CTB does not achieve this result in practice, mainly because of poor take-up. Of all means tested benefits CTB has the highest number of people eligible, but also the highest proportion of unclaimed benefit, particularly amongst older people. The Department for Work and Pensions is taking steps to simplify the process for claiming CTB, and I am interested in examining the extent to which this and other changes might improve take-up.

**S.56** Some commentators also criticise other aspects of the design of CTB, such as the fact that people with savings over £16,000 are not normally entitled to it. Submissions to my Inquiry pointed out that pensioners with savings over the existing limit of £16,000 can pay a relatively high proportion of their income in council tax, particularly those in the lowest income groups.

**S.57** I will return to the issue of CTB reform in greater detail in my final report next year.

## Revaluation to improve link to property value

**S.58** One of the ways to improve council tax as a property tax would be to update the property valuations on which it is based. The system is currently based on 1991 property values. The Government has decided not to go ahead with revaluation in 2007. Whilst I understand this decision, I believe that revaluation will be necessary if council tax is to remain credible as a property based tax in the long term.

**S.59** The Government made a commitment that the total amount of revenue collected by council tax would not increase as a result of revaluation. What would have changed was the level of tax burden between those properties which had seen slower than average house price growth since 1991, towards those properties which had seen more rapid increases in house prices. Households whose property moved up the bands would, other things being equal, have to pay more in council tax and households whose property moved down the bands would pay less in council tax.

**S.60** In my view the debate over council tax revaluation was hindered by poor public understanding of how revaluation might work. Concern over potential “losers” from revaluation tended to ignore the “winners” who would benefit from revaluation because their properties had increased in value more slowly than average. Postponing revaluation means those people continue to pay more than they should if up to date house prices were used to determine their council tax. However, this issue, which might have been seen as one of fairness, has not been discussed fully in the media.

**S.61** The extended timetable and wider remit also enable me to consider a broader



set of options, possibly including more radical ones. These might include moving to the use of detailed point valuations for properties rather than assigning them to bands. This is what is intended in Northern Ireland, although the context for reform is different there. I will continue to look at the experience of the rest of the UK and other international examples.

## **Reform options and ability to pay**

**S.62** Many submissions to the Inquiry argued that adding extra bands might improve the “fairness” of council tax as a property tax, because it enables council tax to be more precisely linked to property value at the top and bottom. Those in the lowest value houses can pay less, and those in the highest value houses pay more. This was welcomed in focus groups.

**S.63** However, as set out in Annex A, detailed modelling of the impact of a range of possible reform options suggests that reform of council tax structure through adding additional bands does not appear to have a big impact on fairness in terms of the link between council tax (before or after Council Tax Benefit) and ability to pay.

**S.64** This is contrary to expectations. It reflects the fact that people living in houses within a specific band tend to have widely different income levels – people in higher bands may be “wealthier” by virtue of owning a more valuable house, but will not necessarily have a higher income. So reducing the council tax bill for people in Band A, for example, will reduce the bill not only for some people on low incomes, but also for some on middle and high incomes. In contrast, an increasing tax bill for those in the highest council tax bands will impact on some people with low incomes, as well as those who are at the top end of the earnings scale.

**S.65** My work so far suggests that the most direct means of addressing the issue of perceived fairness (in terms of the link to ability to pay) and regressivity of council tax is likely to be through reform of the Council Tax Benefit system, rather than through restructuring council tax along the lines I have so far explored. I will examine reform options, and their likely costs (which would have to be met through additional revenues or cuts in spending elsewhere) in my final report. Nevertheless there is a positive correlation between property value and income, and I am interested in exploring further options to reform the structure of council tax, including the system of discounts and exemptions, which might improve the “fairness” of the tax in terms of how it is perceived and its impact on different people, areas and the economy.

## **OTHER TAXATION AND FUNDING ISSUES**

**S.66** I undertook various pieces of analysis and research on the other elements of my remit – local income tax, business rates, and other taxes and charges. I do not intend to go into detail at this stage, as these questions are tightly bound up with issues about the future role and functions of local government. I will therefore continue to consider the respective merits of these other taxation and funding options and return to them in my final report. However, there are some points that can usefully be made now in order to inform further debate.

### **Local income tax**

**S.67** A number of the submissions I received and some of the local authorities I spoke to argued that local taxation should be based on income rather than property value. The public attitudes analysis I undertook suggested that participants thought

that linking tax liability to individual ability to pay was seen to be the fairest form of taxation. However, people were dubious about the idea of having an additional tax alongside council tax to fund local spending (which would be the implication of retaining council tax, as recommended by the Balance of Funding Review) and about the potential effects on different types of households, including working families. Work conducted for the Balance of Funding Review and afterwards by CIPFA, and submissions I have received, show that while it would be possible to introduce a local income tax alongside council tax, it would be a substantial task and would require a considerable time to implement.

## **Business interests and business rates**

**S.68** One of the highest profile issues to emerge in my discussions with stakeholders, and in a number of submissions, was the question of whether local authorities should have a role in setting business rates. Most local authorities argue that the freedom to set the business rate should be returned to local authorities. A large number of businesses and representative organisations expressed concern that local control of rates would make tax bills less predictable from year to year, and could lead to an increase in the taxes paid by businesses. They were also worried that local rates would not be an accountable tax because of the lack of a business voice in local authority decisionmaking.

**S.69** However, there was a range of views amongst the business community. Some of those I spoke to supported the idea of some local discretion over rates in order to fund investment in transport and road improvements and regeneration activity, provided that businesses were consulted and had a strong influence over how the additional money was spent. Others commented that their links with the local authority had weakened since the nationalisation of business rates.

## **Land taxation**

**S.70** Some people argue that there would be economic efficiency and equity benefits from taxing the value of land, rather than of the property that occupies it. Submissions I have received have highlighted a number of economic arguments in favour of such a tax.

**S.71** However, there would be a number of challenges to implementing a Land Value Tax in England. Replacing council tax and business rates entirely would lead to significant changes in household and business tax liabilities. It might have disadvantages as a local tax, since it is linked to the value of the land under the property, not to the number of households using local services. It would also require further work to survey and value all land in the country, as there is currently no national register of land ownership.

**S.72** The Government has now announced a consultation on a tax on planning gain (the Planning Gains Supplement), and envisages that local authorities would retain most of the revenue for investment in infrastructure, which could improve the incentives for local government to encourage growth in housing supply. Whilst the new prudential borrowing powers are an important new flexibility, local authorities may be constrained in making full use of these powers by current constraints on revenue to finance additional borrowing. I am particularly interested in exploring taxes which could improve the incentives faced by local authorities by providing a link between resources and local development and population change.

## Tourist-related taxes

**S.73** A number of submissions to my Inquiry have suggested taxes on tourist activity as a way of raising revenue for authorities, and ensuring that visitors contribute to the public service they use. The most frequent proposal was for a local tax on accommodation. I am interested in exploring this issue further.

## Other taxes and charges

**S.74** Experts and stakeholders suggested a number of other taxes, in addition to those mentioned above, as potential sources of revenue for local government. They included:

- localising existing national taxes such as Vehicle Excise Duty or corporation tax;
- litter, waste and other environmental taxes;
- congestion/road user charges and other transport related charges;
- payroll taxes; and
- business activity taxes

**S.75** Congestion charging has already been introduced in London and Durham and the possibility of further schemes is being studied in seven more areas. Some of these taxes would be capable of providing substantial revenues, others would be of relevance only to a small number of authorities. However, some would be extremely difficult or even impossible to localise for administrative or legal reasons, for example VAT and Corporation Tax.

## User charges for services

**S.76** The total that local authorities receive from sales, fees and charges is significant, with just over 10 billion raised in 2003-4. The introduction of user charges for certain services could provide new revenue sources, which could be used to offset council tax revenue. They might also have the potential to increase transparency and accountability at the local level by allowing local authorities discretion over how services should be managed and delivered.

**S.77** Charging for services is a controversial issue with a number of potential advantages and risks. My public attitudes research highlighted a general resistance to charging for key services, though I believe it is potentially interesting as a possible way of improving public understanding of the costs of services, and of managing pressures more effectively. It remains an issue I intend to explore further and return to in more detail in my final report.

## Equalisation

**S.78** The needs for and cost of delivering public services differs in different parts of the country, and the amount of money that local authorities can raise from council tax also varies. One of the ways in which government grant is used is to 'equalise' tax and service levels in different parts of the country by aiming to provide the resources necessary for all parts of the country to enjoy an acceptable level of public services.

Higher grants are therefore provided to areas with greater needs, higher costs and with a smaller capacity to raise money from council tax.

**S.79** The equalisation process is an integral part of the local government funding system, which aims to allow public services to be delivered to a similar level of quality at a similar level of council tax in all areas of the country. It will continue to remain an important part of the system but the trade-offs need to be understood in order to consider fully where changes at the margin could lead to improvements. The trade-offs which need to be understood include:

- **Balancing complexity and simplicity:** Providing resources to the areas that need them, and taking account of local levels of need for services means that the grant system has to be somewhat complex. However, it does mean that apparently technical changes can have substantial implications for the grant received by each authority. This can have the effect of diverting effort away from getting the best from existing sources of revenue or seeking to generate more income locally.
- **Ensuring effective accountability:** The importance of central government grants in local budgets means that it can be difficult for local residents, taxpayers and service users to see a clear link between changes in the quality and efficiency of local services and changes in the level of tax they are expected to pay.
- **Balancing incentives for growth and redistribution of resources:** The grant given to a local authority takes into account the business rates it receives and the amount of council tax it can collect locally. There is little financial gain for a local authority if the number of businesses or houses, or the population of its area increases, or if the success of the local economy or popularity of the area leads to an increase in the value of land and property in it. This means there is little financial incentive for authorities to promote economic development and provides no financial reward for creating a successful and prosperous area, or resources to help respond to residents' concerns.

**S.80** I am particularly interested in exploring the issue of incentives further. The Government has recently introduced the Local Authority Business Growth Incentive scheme to give local authorities some financial benefit from growth in their business rates base and I would welcome views on it, and other possible incentive measures and reforms.

## **NEXT STEPS**

**S.81** This report does not exhaustively report on the wide range of analysis conducted by the Inquiry team, nor the full depth and breadth of submissions to the Inquiry so far. I welcome views on my work to date and on the issues raised in this report, and will report fully on funding issues in my final report to ministers at the end of 2006.

## **Responses & Enquiries**

**S.82** I would welcome your views on the proposals and issues outlined in this report, particularly in response to the questions set out on pages 9-10.

**S.83** Responses should be submitted to the Inquiry by **Monday 13th March 2006**.

**S.84** I would prefer to receive responses electronically where possible. Please send responses by e-mail to: [SirMichaelLyons@lyonsinquiry.org](mailto:SirMichaelLyons@lyonsinquiry.org)

**S.85** Alternatively if you are not able to respond via e-mail, please send your response to:

Lee Burge  
Room 3.12  
Lyons Inquiry into Local Government  
1 Horse Guards Road  
London  
SW1A 2HQ

**S.86** It would assist my analysis of the responses if you could set out your comments under the relevant questions or clearly indicate to which paragraphs and/or consultation question they refer.

**S.87** All responses will be made public unless confidentiality is specifically asked for. If you wish your comments to be treated in confidence please state this clearly in your response. However, correspondents should be aware that confidentiality cannot always be guaranteed, for example where a response includes evidence of a serious crime. Any automatic confidentiality disclaimer generated by your organisation's IT system will not be respected unless you specifically include a request in the main text of your response. All responses will be included in statistical summaries of comments received and views expressed.