



meeting **CORPORATE STRATEGY AND CO-ORDINATION SELECT COMMITTEE**

Date **10TH May 2004**

agenda item number

Report of the Director of Resources

WHY CHANGE THE COUNCIL TAX SYSTEM?

1 PURPOSE OF THE REPORT

To provide members with background information on the reasons for considering changes to the methods of financing local government. This will assist the Committee in scrutinising some of the alternatives to the existing Council tax system.

2 COUNCIL TAX – INTRODUCTION AND INCREASES

The Council Tax system was introduced in 1993-94 following the demise of the old Community Charge (Poll Tax) and reintroduced a property based tax similar to the old rating system. In 1993/94 the Council Tax raised £8.9 billion nationally. In 2003/04 the tax is expected to raise £18.9 billion - an increase of 113% in 10 years. In this time Council Tax has shown a real terms increase (i.e. after deducting inflation) of 55%. For Nottinghamshire County Council, in the five years since 1999/2000 Council Tax has risen by 32.8%.

3 PRESSURES ON COUNCIL TAX

3.1 Service Improvements

In recent years the government has provided additional grant to help authorities to improve services. With the additional grant came an expectation that Council Tax payers would fund their share of the increases, particularly for Education and to a lesser extent Social Services. As a result, the government's plans (Comprehensive Spending Reviews) have anticipated Council Tax increases in the region of 5%-6% in recent years.

The Current Comprehensive Review (CSR) figures show a planned increase in Council Tax of 6.1% for 2005/06. With the government's continued commitment to increasing Education spending and the continuing demographic (e.g. increasing numbers of pensioners) pressures on Social Services, it will be difficult for the next CSR to keep planned Council Tax increases down to the rate of inflation.

3.2 Inflation

In recent years, locally, we have faced escalating costs due to items such as:

- The minimum wage
- Lack of competition for bus services and road materials
- Landfill Tax
- Pensions

These pressures were reflected in figures produced nationally by the Office for National Statistics which showed that costs incurred by the public sector are increasing by 8.7%.

3.3 “Gearing Effect”

In 2003/04 local authorities received 74% of their funding from Central Government through grant and non-domestic rates. The amount authorities receive is fixed each year in relation to the government’s planned expenditure for local authorities. Where inflation increases costs by more than the rate of inflation, or authorities decide to increase or improve their services by more than the government assumptions, then the whole cost falls on the taxpayer. As the council tax only covers 26% of local authority spending, if spending is increased by an additional 1% then Council Tax needs to increase by up to 4% to raise the additional funds.

3.4 Effect on pensioners and the lower paid

Essentials such as housing and therefore Council Tax often represent a higher proportion of income for pensioners and the lower paid than other sectors of the community. In particular many pensioners still live in the home they bought when they had a larger family. With pensions tied to the rate of inflation, significant increases in Council Tax can cause pensioners financial difficulties.

4 THE CALL FOR ALTERNATIVES

4.1 Balance of Funding

Since the introduction of the Community Charge in 1990/91, Business Rates have been taken out of local authority control. In a situation where only 26% of local authority funding is determined locally, there is no clear relationship between increases in spending and Council Tax. The Local Government Association has campaigned vigorously for a change in this situation, due to the reduction in local accountability and the effects of gearing on Council Tax rises.

4.2 Ability to Pay

Over the years, as council tax bills have risen higher than levels of inflation, the general public have increasingly expressed concern about the lack of relationship between council tax and people’s ability to pay. This concern has led to a number of calls from pressure groups for a change to a local income tax. Nottinghamshire County Council has supported this solution for a number of years.

4.3 Pensioners

The least well off pensioners are entitled to financial assistance with their Council Tax bills. Many pensioners do not claim these benefits or are not entitled to benefits because of the amount of savings they hold. Often the increase in pensions is barely sufficient to cover Council Tax increases. Those pensioners with savings are reluctant to use their children's inheritance or move to a smaller house. Over the last two years the pensioners lobby has become more vociferous at a national level. Locally, a group of pensioners came to talk with the Leader at County Hall early this year and have also visited Nottingham City Council.

5 RESPONDING TO THE CALL FOR ALTERNATIVES

5.1 Balance of Funding Review

Partly as a result of pressure from the LGA and local authorities, in the 2001 Local Government White Paper the government announced that there would be a "Balance of Funding Review". This review, however, will now not only look at the balance between central and local funding of councils but also at the system of paying for local government. The review group is due to publish its findings in the summer of 2004.

The results of the review by the Corporate Strategy can be used to assist in any further responses by the County Council to the Balance of Funding Review.

5.2 2004 Budget

In the 2004 Budget the government announced an additional payment of £100 to pensioners to help alleviate the effect of council tax increases this year. In addition the government provided local authorities with an extra £340 million grant to help keep down Council Tax increases, but this may be for 2004/05 only.

5.3 Reduced Council Taxes for pensioners

This year a number of authorities (particularly Kent CC) considered the option of reducing Council Tax bills for all pensioners. There were a number of difficulties with this approach and, in the end, no authorities offered reductions to pensioners.

5.4 Nottinghamshire County Council

For a number of years Nottinghamshire County Council has supported the call for a change to a local income tax and the return of Business Rates to local authority control. These views were reiterated in our submission to the "Balance of Funding Review" (appendix A).

During the next few weeks the Committee proposes to consult with the public and produce a report on the options before the government's review is published. In particular it is proposed to hold three focus groups at the start of June so that people can be informed of the various options and give their views. It is also hoped that the local media will publicise this review and so lead to further public responses.

6 THE OPTIONS

Nottinghamshire County Council's consultation and report will consider 4 options:

- revised council tax system
- local income tax
- local income tax and council tax hybrid
- local purchase tax

7 RECOMMENDATIONS

It is recommended that:

- (i) the Committee considers the presentation on alternatives to Local Income Tax; and
- (ii) Consultation and further work is carried out to produce a report to the next meeting of the Committee on 21st June 2004.

ARTHUR DEAKIN
DIRECTOR OF RESOURCES

Background Papers available for inspection

Nil

NOTTINGHAMSHIRE COUNTY COUNCIL

BALANCE OF FUNDING REVIEW

Question 1: Do you think that a change in the Balance of Funding would improve Local Government's accountability, efficiency, flexibility or other factors?

It is important that Local Authorities are perceived as being accountable for the decisions that they take, so that the public can easily understand where accountability lies. If there were to be a stronger link between spending decisions and tax implications, then people are more likely to begin to show more interest in local affairs. There would also be efficiency gains, because the attention of members and senior staff would be less directed towards grant distributional issues and more directed to achieving improvements in performance in services provided. A more flexible finance system should allow Authorities to respond more speedily to issues that arose, and thereby appear to be more responsive to customer's needs

Question 2: Are there serious problems with the current Local Government taxation system, and if so, what are they? How can we best address them?

The Council Tax system is nearing the limit of its acceptability as a fair tax. Nevertheless, it is an important local property tax and should be retained, perhaps with a more progressive banding arrangement. The impact of Council Tax on asset-rich, income-poor pensioners needs to be addressed because this is undermining the credibility of the whole system. Some action needs to be taken to protect people on relatively low incomes from paying disproportionate amounts of Council Tax. Problems will persist as long as Local Authorities are as dependent on Government grants as they are at present, and the solution is to allow additional local taxation sources that will ensure that a much higher proportion of expenditure is funded through local taxing decisions.

Question 3: What do you consider the most important principles and objectives and why? What are the implications of your chosen priorities.

Accountability is the most important principle for a democratic organisation. This accountability needs to be demonstrated not only in a financial sense, but also in the way that Local Authorities show themselves to be responsible to the Electorate for the variety of decisions that are taken. The principles of equity, fairness and buoyancy in the tax base are all important but should be subservient to the principle of accountability. A revised system with increased flexibilities and funding available will support the ability of Local Authorities to work in partnership with others, because they will not feel constrained by the impact of one highly visible taxation decision.

Question 4: Does the present Local Government finance system support accountability? If so, how? Is accountability the most important (or even the only) key principle for a workable system?

Accountability is distorted when three-quarters of funding comes from Government Grants, and local decisions can lead to significantly higher Council Tax increases because of the gearing effect. We continue to suffer from the distribution formula, which, despite some improvements, provides much higher levels of funding for pupils in South East counties than for Nottinghamshire.

There needs to be faster progress in reducing the amount of funding that is paid through specific grants.

Question 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?

Some of the research work does indicate a link between funding levels and election turnouts, and there is no doubt that turnout is now lower than when local funding proportions were higher. If there were to be more funding locally, then there would be increased focus on how those decisions were taken and that might well be reflected in levels of involvement in local elections, and other forms of local participation. However, the search for improvements in voting levels also needs to consider more modern ways of allowing people to vote, because there are numerous examples now of how people will participate in decision-taking if it is easy for them to do so.

Question 6: What else distorts the accountability of Local Authorities to their Electorates? How and why? What can be done about it?

In any multi-tier arrangement for the provision of local services, the Electorate will always be confused about who is responsible and accountable for those services. The fragmentation into separate Police and Fire Authorities, as well as County, District and Parish Councils makes this worse. People still talk about "the Council" as one entity. Drawing more services back into local democratic control should help achieve a greater understanding. It is unreasonable to expect the present fragmented arrangements to be ever understood.

Question 7: How important is equalisation? Would a change in the balance of funding provide an opportunity for less equalisation or more?

The pursuit of equalisation in Grant arrangements is something that needs to be given some priority, but absolute equity will never be achieved. In the last 30 years, attempts to find a more equitable solution have always foundered on the problem of higher spending levels in London, and it may be that this could be addressed by having a separate Grant amount and distribution arrangements in London from the rest of the Country. But if Local Authorities have wider discretion over funding sources, the inevitable defects of equalisation measures might not seem so important.

Question 8: How easily would equalisation work if there were no Central Grant and Local Government were funded entirely from local sources?

Some Central Grants are needed to achieve equalisation. It seems that the research work already carried out for OPDM has demonstrated that equalisation of some sorts can be achieved with less money than is currently being put through the total grant arrangements, thereby suggesting that more money could be raised locally without disturbing national equalisation arrangements.

Question 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?

The issue of gearing is at the heart of the blurring of accountability under present arrangements, and it is clear that raising larger amounts of funding through local taxation would significantly reduce this particular problem. Spending decisions in Local Authorities are driven primarily by the continuing rise in expectations, linked to demographic requirements, and taxation decisions are driven by a combination of the level of grants available, coupled with how tax increases would compare with what other similar Authorities are doing. The availability of a wider basket of

possible taxation methods would undermine that comparison and therefore focus more closely on individual organisation's spending decisions.

Question 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 cases?

Our impression of overseas comparisons of Local Government arrangements is that they seem to have much more stability than we have in the UK. We seem to have an attitude in the UK that achieving solutions to problems is to be found by meddling with structures rather than addressing problems directly and providing organisations with the competence to deal with matters that arise. Structural changes should not take place in isolation from consideration of financing arrangements. One other lesson from overseas experience is they often seem to have much smaller ratios of elected representatives to population i.e. there is more democratic representation.

Question 11: Should the Review commission research on different issues? Are the research proposals on the table realistic and suitable?

Many respondents will be saying that major change is essential, and that Local Income Tax should feature highly in any new arrangements. Hence, it is clear that research should be directed towards the practicability of achieving this. The County Council has had a policy of supporting a local income tax for the last 30 years.

Question 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.

Major change is essential. The evidence is that successive attempts at tinkering over the years has not been successful. We need a major change that can then form a stable position for many years to come.

Question 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?

We believe that the time has come for the introduction of a local Income Tax, a return to being able to set the business rate locally, and access to an array of possible taxes. Income Tax is paid by a wider range of people than Council Tax, and services provided by Local Government are used by people generally rather than just Council Tax payers. With developments in technology, it should be possible to align local tax rates with place of residence, particularly if the Tax was administered on a sufficiently wide basis. Local income tax is more progressive and more buoyant, and so a share of rising prosperity can more easily be directed towards investments that benefit the community. But it will need to be recognised that local income tax is replacing some of national taxation and not adding to the overall tax burden.

The business community will be concerned about setting Tax rates locally, but provided there are constraints built in to avoid any unreasonable use of the powers, along the lines of the reserves powers being kept by Government on prudential borrowing regulations, then it ought to be possible to avoid abuse of those powers. The objective is for Local Government to be a trusted partner with Central Government in the delivery of important services to local people.

Other local taxes could be considered. For instance, it might be possible to operate a fuel tax or a wider sales tax on a county or regional basis. In some areas, a tourist tax might be appropriate to spread the cost of providing services amongst visitors to the area.

Clearly, if local authorities had access to more types of taxation, they would need to exercise care that overall taxation burdens were not radically increased without some democratic legitimacy.