

Leicester
City Council

CABINET

1st MARCH 2003

The Balance of Funding: a combination option

Report of the Chief Finance Officer

1 Purpose of the Report

- 1.1 The purpose of this report is to apprise Cabinet of the LGA's recent discussion document "The balance of Funding: a combination option", and to request that the City Council considers (and, if it so chooses, supports) the proposals contained within the document.

2 Summary

- 2.1 The Balance of Funding Review is chaired by central government. It seeks to examine current sources of local government income, and consider whether or not to allow local authorities greater access to locally-determined sources of revenue.
- 2.2 The LGA published its discussion document on 15 January, with the aim of developing a range of financial proposals to be considered by the Review. The LGA proposes that a range of taxes, not just council tax, be available to local government.
- 2.3 The proposals consist of:
- a reformed council tax.
 - a re-localised non-domestic rate.
 - a local income tax.
 - a range of other new taxes and charges.
- 2.4 The LGA believes that such proposals would better serve local democracy and local accountability.

3 Recommendation

- 3.1 Cabinet is asked to note the report, and decide whether it wishes to write to the LGA offering support for the principle of the combination option.

4 Financial and Legal Implications

- 4.1 This report discusses issues relating to the local government finance system and is thus entirely concerned with future financial issues. None of these, however, is quantifiable.
- 4.2 There are no direct legal implications arising from this report (Joanna Bunting).

5 Other Implications

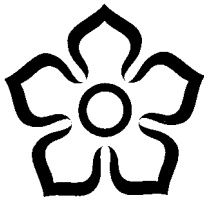
OTHER IMPLICATIONS	YES/NO	Paragraph References Within Supporting information
Equal Opportunities	No	
Policy	No	
Sustainable and Environmental	No	
Crime and Disorder	No	
Human Rights Act	No	
Elderly/People on Low Income	No	

6 Author

- 6.1 Ciaran Guilfoyle, Financial Strategy

Decision Status

Key Decision	No
Reason	N/A
Appeared in Forward Plan	No
Executive or Council Decision	Executive (Cabinet)



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The Balance of Funding: a combination option – Supporting Information

Report of the Chief Finance Officer

1 Background

- 1.1 On 15 January the LGA launched a discussion document entitled “The Balance of Funding – a combination option”, with the intention of submitting its proposals to Nick Raynsford’s Balance of Funding Review, and of stimulating a wider debate about the future of the local government finance system.
- 1.2 The various proposals contained within the paper (which has all-party backing at the LGA) relate to possible new sources of funding for local authorities. These include a reformed council tax, a relocalised business rate, a local income tax and a variety of local charges.
- 1.3 The LGA hopes that such new sources would, if adopted, better serve local democracy and local accountability. It is increasingly recognised that local government’s lack of financial autonomy, as exemplified by its high dependence on government grant, has a detrimental effect on local democracy, confuses responsibility for decisions in the minds of local voters, and thwarts local ability to address local need.
- 1.4 The remainder of this supporting information report examines and assesses the LGA’s proposals in greater detail.

2 A Reformed Council Tax

- 2.1 This is perhaps the strongest section of the paper, since it ties in with ideas that are already being discussed within the public domain. Previously, both SIGOMA (of which we are a member) and the Association of London Government have undertaken research and lobbying with regard to increasing the number of council tax bands, adjusting their relative weights, and increasing the frequency of revaluation. This work was no doubt encouraged by the Government’s announcement of a revaluation, beginning in 2005 and coming into force in 2007.
- 2.2 Research undertaken previously has generally shown that, since property prices have risen so drastically in the south of England compared to the north, the amount of council tax that the Government would expect to be raised in

the south would increase commensurately. This would mean that government grant to local authorities in the south would decrease, resulting in more resources for those further north, including Leicester.

3 Progressive Localisation of the Non-domestic Rate

- 3.1 Recent controversy surrounding council tax increases has meant that other possible sources of income have become more salient than ever. The LGA's Balance of Funding document therefore raises the prospect of a relocalised non-domestic rate.
- 3.2 Currently, non-domestic rates are collected locally, but set nationally (in line with the Retail Price Index). They are then redistributed among authorities on a *per capita* basis, and to all intents and purposes they are considered a part of government grant. As such, the non-domestic rate provides no flexibility in local funding, and does not influence relations between a local authority and its business community.
- 3.3 The Government has recently tried to overcome these drawbacks by introducing the Local Authority Business Growth Incentives scheme as part of the Local Government Act. This will allow authorities to retain a small portion of the growth in non-domestic rates that are attributable to economic growth. However, the amounts that can be raised through this scheme are unlikely to impact significantly on most local authorities' council tax levels.
- 3.4 The LGA recognises that the business community itself is unlikely to support re-localisation, and so it suggests an interim arrangement whereby authorities would be given limited power to vary locally the nationally-set rate. Again, this would be of financial benefit to the City Council: in 2003/04 an additional 1% on Leicester's non-domestic rate (ie. a poundage of 44.8p instead of 44.4p) would have generated an additional £0.8m, allowing a 1.2% reduction in council tax.

4 Local Income Tax

- 4.1 Local Income Tax (LIT) is perhaps the most radical idea contained within the LGA's document. The LGA's rationale for promoting it is, firstly, that it would provide a buoyant source of local income to local authorities and thereby reduce gearing, and secondly, that it would bring the local government finance system more into line with many European countries.
- 4.2 Significant gains might accrue to local government if ever it is given the power to vary local income tax. However, there are two barriers that will make implementation of such a scheme difficult:
 - set-up costs
 - redistributive effect on tax-payers
- 4.3 The set-up costs of a local income tax would not necessarily be prohibitive, but LIT would require changes to the systems used by the Inland Revenue, and the establishment of much closer links between the Inland Revenue and local authorities. There is a risk that the cost of this could fall on local government.

- 4.4 The redistributive effect on tax-payers of a direct LIT may also be prohibitive. Some members of the public would find that reductions in their council tax bill did not offset additional deductions from their pay-packet. It is for this reason that the LGA proposes, initially, that a proportion of income tax be 'assigned' to local government but set nationally, and treated in much the same way as the non-domestic rates are treated now.
- 4.5 Once the scheme has been accepted by the public, local authorities could be given limited powers to vary the rate in their own areas. In the early stages, therefore, this system would not necessarily result in additional resources for local authorities, since income tax gains would be offset by reductions in government grant.

5 Other new taxes and charges

- 5.1 In addition to the sources of funding listed above, the LGA also proposes the creation of a basket of local taxes and charges, which will generate further resources for local authorities. These include a localised road tax, congestion charging, and a tourist tax.
- 5.2 Many of these new taxes have been mentioned already within the Balance of Funding Review, and congestion charging is already in place in London and Durham. It is not unlikely, therefore, that such additional sources will be supported in the Review's final report (although the small amounts involved mean that they are unlikely to significantly alter the balance of funding).

6 Assessment of Document

- 6.1 The LGA states that, taken as a whole, its proposal has the potential to reconnect local people with local government: reducing the effect of gearing will mean that, in the eyes of the public, the local financial picture will not be distorted, and that small increases in expenditure can be matched by similarly small increases in taxation. In short, local government would become much less reliant on central government.
- 6.2 By replacing a large proportion of government grant with income from buoyant and variable sources, the government would allow authorities more flexibility in financing expenditure and determining local needs.
- 6.3 As a combination proposal the effect on Leicester would probably be to reduce the problem of gearing, where spending decisions have a disproportionately high impact on council tax levels.
- 6.4 However, even though the LGA's proposals will reduce gearing generally, they will not change the fact that different authorities are geared differently. In other words, authorities in poor and deprived areas will still find they have less of a tax base on which to call in order to fund additional expenditure; those in richer areas may have such a large taxbase that it will be necessary for them to receive a negative grant. Some authorities will therefore still rely on higher than average tax increases.

7 Conclusion

- 7.1 “The Balance of Funding – a combination option” has been put forward as an attempt to generate debate, and as such it should be welcomed.
- 7.2 The proposals contained within the paper are not unreasonable, and many have a fair chance of being further developed by central government if they are given enough support.

8 Background Papers

- 8.1 Local Government Association – The Balance of Funding: a combination option

9 Author

- 9.1 Ciaran Guilfoyle, Financial Strategy