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Report On The Funding And Structure Of Local Government

Part I - Introduction and Executive Summary

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1. INTRODUCTION

This report represents the outcome of an independent study conducted for Isitfair into the “proper” role of Local Government and how it might best be financed. Given its subject matter and timing, this report will almost inevitably be dubbed “The Alternative Lyons Report”. In fact I have deliberately chosen my terms of reference so as to be very similar to those given to Sir Michael Lyons for his own “official” report.

The report itself is subdivided into six main parts. The first part of this report deals with the terms of reference that I have defined for myself, (section 2), and a summary of my findings, (section 3).

The second part of my report addresses various philosophical issues. These relate to the proper roles of Local and Central Government, as well as the principles that should underlie any taxation designed to fund them.

The third part of my report examines how well the current systems of Local and Central Government activities, responsibilities and finance meet the criteria established in the first, more philosophical part of this report.

The fourth part of my report examines some of the supposed “solutions” to the problem that have been proposed, either to the Lyons Inquiry or to Isitfair, which I believe are unlikely to work. In all cases I describe my reasons for rejecting these alleged “solutions”.

The fifth part of my report examines some of the options which, I believe, ought to lead to a better match than we currently have to the somewhat idealised criteria for taxation and the roles of Local and Central Government as discussed in the second part of this report.

The final part of my report contains a number of very detailed statistical appendices.

In writing this report, I have made extensive use of the published submissions to the “official” Lyons Inquiry as well as to Sir Michael’s two Interim Reports themselves and a number of private submissions, which Isitfair has received, as well as letters and articles published in the national and local newspapers

In arriving at the conclusions described in this report, I have carried out extensive statistical investigations and modelling activities. The data for these analyses has been obtained almost exclusively from government sources - in particular the Office for National Statistics web-site, the web-site for the Office of the Deputy Prime Minister, (as it then was), that for the Department for Work and Pensions and the Inland Revenue and Customs web-site.

Much of my statistical work overlaps with similar work carried out for Sir Michael Lyons. Where this is the case, I find that I get very similar results, (which ought to be reassuring for both of us). However I do not in all cases draw exactly the same inferences. In some areas my analyses have gone somewhat deeper than that described in the Lyons Interim Reports. In others I have contented myself with a much less detailed examination. In this report I have attempted to highlight those areas where I agree with Sir Michael's results - especially where these run counter to the "accepted wisdom" - as well as where I adduce somewhat different conclusions from what are essentially the same results from a statistical standpoint.

2. TERMS OF REFERENCE

In arriving at my terms of reference for constructing this report, I have deliberately chosen to follow, as closely as possible, the terms of reference given to Sir Michael Lyons. I have, however, modified these terms of reference in some instances in order to convert them into those which I believe Sir Michael should have been given. I have also allowed myself considerably more "political freedom" to "think the unthinkable" than I believe that Sir Michael has been given, or has allowed himself, in investigating particularly controversial areas.

As a result, I have decided to address some of the possible answers to the following main questions:

- What is the most suitable structure for delivering "local" services?
 - With regard to strengthening local democracy / giving local people a real say
 - With regard to incentivising those who deliver the services to provide good value for money
 - With regard to making those who deliver the services accountable:
 - To local electorates for what **they** pay for
 - To national electorates for what **they** pay for
- What is the least painful way of funding "local" services?
 - What is "fair" / likely to be acceptable to the majority of tax payers - especially those who have to pay the most - as well as those who have the least means out of which to pay
 - How can we link the necessary taxation more closely to people's ability to pay
 - What are the various Local Authorities likely to be satisfied with
 - What is the most cost efficient way of raising the funding - consistent with considerations like "fairness", acceptability and so on.

- What are “local” services?
 - What services should be provided free at the point of use and which services should be charged for or subject to co-payment
 - Who should provide the services and who should pay for them
- What is the “best” balance between Local and Central Government

It is almost inevitable that any serious investigation of these matters will result in forays into other areas. For example, is it really meaningful to consider the “fairness” or otherwise of any one particular tax without examining it in the context of other taxes? It would seem to me that the “fairness” of any given tax is much less important than the “fairness” of the tax system overall. Provided that the “unjustified losers” from one tax are the “unjustified winners” from another, and provided that the amounts involved are comparable, then is anyone really unfairly treated overall? Similarly, any discussions on tax, which fail to take into account any countervailing benefits, are probably futile. What really matters is the **overall** effect of **all** taxes and benefits when **taken together** on particular types of individual or groups of citizens. It is perfectly possible to devise a “fair” scheme, (provided that the criteria for “fair” are rigorously defined), at the macro level from what are a set of wholly “unfair”, (defined in the same way), taxes and benefits at the micro level. In any case, does it really matter if someone pays £1000 more tax than is really "fair" if, at the same time that person also receives £1000 more in cash benefits than he really "should do" from the point of view of "fairness"? I appreciate that not everyone will see things this way. Many “losers” from one aspect of the system may feel aggrieved while (conveniently?) “forgetting” those parts of the system where they are winners.

3. SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

3.1 The existing system

I discuss the existing relationship between Local and Central Government and the way in which Local Government is funded in Part III of my report. I conclude that:

- The existing division of powers and responsibilities between Local and Central Governments is about as far away from the ideal as it could possibly be. I also conclude that this is at least part of the cause of low turnouts at local elections
 - There is no meaningful connection between local taxation and local expenditure. Indeed, what relationship that does exist is an inverse one!
- The existing Council Tax system is “unfair” and is only poorly related to an individual’s ability to pay
 - The Council Tax system discriminates unfairly against certain Regions, (primarily the South and especially the South West), and against certain types of Local Authority, (primarily the Shire Districts), in the sense that people living in those Authorities and Regions suffering such discrimination pay significantly more in Council Tax than other people living on similar incomes elsewhere

3.2 Some “improvements” that probably won’t work

I discuss the more important “fixes” for the system proposed to, and published by, the “official” Lyons Inquiry in Part IV of my report. I conclude that:

- Simply making the Council Tax more progressive by altering the Band Multipliers or adding new Bands to the top and bottom of the range will actually make things worse
 - It would actually increase the degree of unfair discrimination against certain Regions and types of Local Authority. More people would end up paying more Council Tax than the average for their income bracket
 - The gains for the “winners” will be fairly small whereas the losses for the smaller number of “losers” will be much more painful. Many of these people are **already** suffering
- Adopting the Northern Ireland approach of an *ad valorem* tax will also make things worse in terms of both discrimination and affordability
 - Given that this is simply a more progressive / less regressive form of Council Tax, this conclusion is hardly surprising
- The likely gains from improving Council Tax Benefit, especially those improvements designed to increase take up rate, are likely to be fairly small. There appears to be an underestimate of how effective Council Tax Benefit is currently. Nevertheless I do discuss some improvements that **might** work in Part V of my report.
- The case for the repatriation of the business rates is unproven. With certain safeguards for business it would not necessarily be damaging. However, the idea that it would increase accountability is not supported by the evidence.
- The case for a land value tax or a buildings tax on business seems to be somewhat weak. The current rating system would appear to be a better compromise.
- There does not appear to be much of a case for introducing a local sales tax. Most of the benefits of such a tax would appear to come from it being a **sales** tax whereas most of the drawbacks would appear to come from it being **local**.
 - The biggest drawback concerns the **displacement** of economic activity. This would be less of a problem if Local Authorities were to be much larger. However, this would conflict with what appears to be the desire for more localism

- The conventional form of local income tax, where each Local Authority sets its own rate would be horrendously complex administratively and very expensive for employers. I do however discuss an alternative form of local income tax in Part V of my report.

3.3 Some improvements that probably will work

I discuss various options for ameliorating the problems of Council Tax and the relationship between Local and Central Government in Part V of my report.

- I examine the possibility of dispensing with local taxation altogether and replacing the Council Tax with increases to national taxation. I conclude that only Income Tax, VAT and possibly IHT could reasonably be “tweaked” enough to replace the lost revenue from Council Tax.
 - The biggest drawback to this approach is that Local Government would have no funds of its “own”. There is a real danger that it would become merely the **agent** of Central Government thereby making local democracy something of a myth.
 - The only way that I can see around this particular problem is for all Local Governments to be given exactly the same per capita grant as each other, (as happens with NNDR). Although it is asking rather a lot, Central Government would have to resist the temptation to instruct Local Governments as to how these monies should be spent. Such a system will only work if Local Government is **forbidden by law** to spend the money on things that Central Government is supposed to be responsible for. Without this safeguard, Central Government can under or over-fund other “local” activities and blackmail Local Authorities to make up the difference.
- I consider a number of possible options for truly local taxation but I conclude that only a local income tax, a local property tax or a poll tax are really “workable”.
 - Any local income tax needs to be based on **allowances**. Basing a local income tax on different **rates** would be an administrative nightmare - for both government and employers
 - Any local domestic property tax needs to be based on resale **prices** of the dwellings concerned. However, the amount of tax payable should be calculated with respect to relative **local** house prices. Basing the amount payable on national prices will re-create all the current problems of the Council Tax.
 - With a tax base linked to property values, any Resource Equalisation between Authorities needs to be based on the incomes of the residents of those Authorities - not on how expensive or how cheap housing might be in each Authority.

- Any reintroduction of a poll tax needs to take account of ability to pay. This means that it could only ever be a **supplementary** local tax. I conclude that a **small** poll tax element, probably combined with a reformed property tax, offers a number of advantages over the present system of taxation
 - I recognise that there are real political difficulties about any approach that appears to represent any sort of return to the old days of the poll tax. However, as I emphasised in the introduction, this document is **not** written specifically in order to be “politically acceptable”.
- Although I believe that the potential benefits from increasing Council Tax Benefit are somewhat overstated in the December 2005 Interim Report of the Lyons Inquiry, I do believe that it could be made more acceptable by: integrating the benefit with the Income Tax system; undertaking the benefit assessment remotely; ignoring savings in setting entitlements, (savings generate income so assessing income would seem to be a better approach - and why should liquid wealth be taxed whilst illiquid wealth escapes scot free?)
 - I also suggest that local democracy would be better served if the **level** of CTB payable were to be: based on **average** Council Tax bills for a given band across the country as a whole; restricted to something less than 100% of the average bill.
 - Another possibility which I think merits serious consideration is to legislate that nobody should be required to pay more than X%, (to be determined), of their gross income in local taxation. This would be easier to administer if Council Tax Benefit were to be integrated with the Income Tax system as I suggest above.

One of the problems that I have encountered in undertaking this study is the inadequacy of government data on the relationship between incomes and property Bands. Indeed, I find it amazing that anybody should propose **any** major changes without first looking at such data. Collecting adequate data would be a good deal less expensive, and a good deal more productive, than some of the fine-tuning on property valuation that is alleged to be going on. Increasing the precision of a fundamentally flawed system is a complete waste of time and money. Indeed, it merely means that the results will be more precisely wrong!

Because of this, my report contains **no** firm recommendations - other than what **not** to do. I do believe however that I have identified some realistic options for proper analysis to be based on real survey data rather than the very coarse grained data available on government web-sites. Most of my exploratory work has been based on data on **gross personal** incomes, (obtained from the Inland Revenue), whereas a more sensible measure of affordability and fairness would be based on **net disposable household** incomes. Unfortunately nobody seems to have bothered to collect this absolutely vital information.