

A Survey of UK Local Government Finance

Stuart Adam
Carl Emmerson
Anoushka Kenley

The Institute for Fiscal Studies

A Survey of UK Local Government Finance

*Stuart Adam, Carl Emmerson and Anoushka Kenley**

Institute for Fiscal Studies

August 2007

Acknowledgements

We are grateful to the Economic and Social Research Council for funding through the research grant RES-172-25-0002 and for co-funding through the ESRC Centre for the Microeconomic Analysis of Public Policy at IFS (M544285003). The authors thank Judith Payne for copy-editing. All errors are the responsibility of the authors.

* **Addresses for correspondence:**

stuart.adam@ifs.org.uk, carl_emmerson@ifs.org.uk

Contents

1. Introduction.....	4
2. The structure of UK local government.....	5
Scottish Parliament and Scottish Executive	7
Welsh Assembly and Welsh Assembly Government.....	8
Northern Ireland Assembly and Northern Ireland Executive.....	9
Greater London Authority	9
Local Government Act 2000	10
3. Local government expenditure	11
3.1 Current expenditure.....	12
3.2 Capital expenditure	12
4. Financing of UK local authorities	14
4.1 Block grants.....	17
4.2 Ring-fenced grants.....	19
Dedicated Schools Grant.....	20
4.3 Other sources of finance.....	20
Sales, fees and charges	20
Housing Revenue Account.....	22
Revenue reserves.....	22
4.4 Financing of capital expenditure	23
5. Council tax	25
5.1 Council tax in Wales.....	30
5.2 Domestic rates in Northern Ireland	32
5.3 Council tax benefit.....	33
Second adult rebate	34
Criticisms of council tax benefit	35
6. Conclusions and options for reform.....	36

1. Introduction

This paper provides an overview of the current system of local government finance in the UK.

Section 2 provides a description of the structure of local government in England, Scotland, Wales and Northern Ireland. Section 3 summarises the long-term trends in the importance of local government expenditure in the UK economy and the composition of current and capital spending. Section 4 describes the financing of local authorities, with a description of the income that they receive from central government (both general block grants and grants that are ring-fenced for certain services) and the income that they receive from user charges.

The only significant local tax across Great Britain is council tax. This is described in Section 5 (which also contains a description of the recently reformed system of domestic rates in Northern Ireland). Council tax benefit is also described in Section 5.

Given that reform of local government finance is a live issue in England, Scotland and Northern Ireland, Section 6 concludes with a brief discussion of options for reform.

Much of the data presented in this paper are taken from the following sources:

<http://www.local.communities.gov.uk/>

<http://www.local.communities.gov.uk/finance/stats/lgfs/2007/>

<http://www.scotland.gov.uk/Topics/Statistics/Browse/Local-Government-Finance>

<http://www.statswales.wales.gov.uk/ReportFolders/ReportFolders.aspx>

<http://www.doeni.gov.uk/>

2. The structure of UK local government

The United Kingdom is constitutionally a unitary state: ultimate sovereignty resides with the UK Parliament, and it is up to Parliament to decide what powers and responsibilities (if any) it devolves to local or regional bodies, and how such bodies are organised and financed. This contrasts with federations such as Germany and the United States of America, where the autonomy of subnational authorities (*länder* in Germany or states of the USA) and the division of powers between federal and subnational governments are constitutionally entrenched.

Historically, the UK has been relatively centralised even compared with other unitary states. Since the current Labour government came to power in 1997, devolved administrations have been set up in Scotland, Wales and Northern Ireland (described below). Moves towards locally elected regional assemblies in England (other than in London, also described below) stalled after one was rejected in a referendum in the North-East. In principle, devolution to the constituent countries of the UK means that many policy areas – with the notable exceptions of foreign and defence policy – have been decentralised. However, as shown in Section 4, tax (and social security) policy remains almost entirely the preserve of the UK central government, meaning that, crucially, devolved and local authorities have little control over their overall budgets.

Local government in the UK is split between single-tier and two-tier council structures.¹ Scotland, Northern Ireland and Wales have entirely single-tier local government structures, while in England both forms of local authority exist. A two-tier system exists across rural England, with 34 County Councils, which cover areas with populations between 500,000 and 1½ million, primarily responsible for the provision of education, social services, transport and fire services.² Within each County Council area, there are between 4 and 14 District Councils, a total of 239 in England, whose responsibilities include housing, local planning, building regulation, refuse collection and environmental health. These District Councils are also responsible for the collection of council tax and the administration of housing benefit and council tax benefit. The two tiers may share responsibility for recreation and cultural matters.

Elsewhere in England, responsibility for all the services provided by County and District Councils is held by a single tier of authority. In London these are called London Borough Councils and in six other urban areas they are known

¹ A useful map of UK local authority boundaries can be found on the Office for National Statistics website at http://www.statistics.gov.uk/geography/downloads/UK_LADUACty.pdf.

² Other responsibilities include strategic planning, consumer protection, refuse disposal, smallholdings and libraries.

as Metropolitan District Councils. A further 46 Unitary Authorities exist, created from previously two-tier local governments. Typically, these involve the county town – such as Plymouth, Leicester and Stoke-on-Trent – being a Unitary Authority while the rest of the county – in these cases Devon, Leicestershire and Staffordshire respectively – remains on a two-tier basis. However, Unitary Authorities often collaborate with neighbouring Unitary Authorities or County Councils through ‘joint boards’ to provide some services (such as fire, police and public transport) collectively where this is believed to help deliver a more efficient provision of services than having these services delivered by smaller units. Table 2.1 sets out the number of local councils of each type across England, Scotland, Wales and Northern Ireland.

Table 2.1. Number of local councils across the UK

<i>Type of council</i>	<i>Number</i>
<i>England</i>	
<i>Two-tier areas</i>	
County Councils	34
District Councils	239
<i>Single-tier areas</i>	
London Boroughs	32
Metropolitan Districts	36
English Unitary Authorities	46
Isles of Scilly	1
City of London	1
<i>Scotland</i>	
Single-tier Unitary Authorities	32
<i>Wales</i>	
Single-tier Unitary Authorities	22
<i>Northern Ireland</i>	
District Councils	26

Source: http://www.statistics.gov.uk/geography/faq_numbers.asp.

Prior to 1996, local government in England and Wales was dominated by a two-tier system of local government comprising (shire) counties and non-metropolitan districts, other than Greater London, the Isles of Scilly and the six metropolitan areas where there was only one tier of local authority. Wales was split into eight counties and 37 districts. Scotland was also split in a similar way into regional councils and district councils, although, similarly to England, there were also three island councils that exercised county- and district-level functions. A single-tier system has existed in Northern Ireland since 1973.

Following the Local Government Commission review of local government structure set up by the Local Government Act in 1992, central government

sought to make local government more efficient and less remote by changing the then dominant two-tier UK local government system. Over the years 1996 to 1998, a total of 46 Unitary Authorities were created in the place of abolished county and district councils – mostly in large towns and cities, such as Blackpool, York and the City of Bristol. The Act also led to the abolition of the two-tier systems in Scotland and Wales entirely, and replaced them with single-tier systems.

In 2007–08, the UK government gave £21.6 billion to English local authorities in general block grant (described in Section 4.1) and £66.5 billion in earmarked grants (described in Section 4.2).³ Responsibility for regional policy and national policy on local government in England lies with the Department for Communities and Local Government (CLG). In Scotland, Wales and Northern Ireland, however, the functions and financing of local authorities are the responsibility of devolved administrations, which are described below. In these areas, local authority funding is entirely channelled through the devolved administrations. The total resources provided by UK central government to each of the devolved administrations are determined by the Barnett Formula, under which the cash increase in funding per person is set equal to the increase in funding allocated by UK central government for spending on England-only services (e.g. health and education in England, but not defence or social security, which are provided UK-wide). Because spending per person is higher in Scotland, Wales and Northern Ireland than in England, equal cash increases imply gradual convergence in spending per person.

Scottish Parliament and Scottish Executive

The Scottish Executive and the Scottish Parliament are the devolved government and legislature respectively of Scotland. The first meeting of the Scottish Parliament took place on 12 May 1999. The Scottish Executive has a budget of around £30 billion for 2007–08,⁴ and the Scottish Parliament has the power to vary the basic rate of income tax for Scottish residents by up to three pence in the pound (which HM Treasury estimates would raise around £300 million for each one pence change in 2007–08⁵), although to date this power has not been exercised.

³ Source: Table 2 of Department for Communities and Local Government, *Local Authority Revenue Expenditure and Financing, England: 2007–08 Budget*, 2007 (<http://www.local.odpm.gov.uk/finance/stats/rev0708june07.pdf>).

⁴ Source: Table 1.4 of Scottish Executive, *Scotland's Budget Documents 2007–08*, 2007 (<http://www.scotland.gov.uk/Publications/2007/01/04090119/2>).

⁵ This will rise to £370 million in 2008–09 because of the widening of the basic-rate income tax band announced in the 2007 Budget. These estimates ignore the revenue effect of any change in behaviour that the tax reform might induce. Source: Paragraph A.8 of HM Treasury, *Financial Statement and Budget Report*, 2007 (http://www.hm-treasury.gov.uk/budget/budget_07/bud_bud07_index.cfm).

The Scottish Parliament has limited legislative powers, and the Scottish Executive has responsibility for education, health, agriculture, economic development, home affairs, local government, social work and many aspects of Scottish law.

There are 32 directly elected unitary local authorities in Scotland, which (in addition to council tax revenues) receive a large part of their funding from the Scottish Executive. Local government is forecast to receive £8.5 billion in 2007–08, plus additional grants to fund specific projects and direct capital grants, bringing the final projected total to £10.4 billion.⁶

Welsh Assembly and Welsh Assembly Government

The National Assembly for Wales is a devolved body that allocates funds it receives from Westminster. It first met on 12 May 1999. The Assembly and Government have powers over a number of important issues, including health, education, planning, culture and economic development. The National Assembly for Wales, although a legislature, does not currently have full primary legislative or fiscal powers, although the Government of Wales Act 2006 did give it some legislative powers in certain areas.⁷ The National Assembly for Wales does hold secondary legislative powers, which can sometimes be used to amend primary legislation, and the Assembly has, for example, considerable discretion over charges for government services such as NHS prescriptions, which could be construed as some level of tax-levying power. The Assembly develops policy in the areas mentioned above, and uses its limited legislative power to pass legislation affecting the people of Wales. The Assembly is responsible for the secondary legislation in respect of council tax, which, as we describe in Section 5.1, is a power that it has recently used.

The National Assembly for Wales has more limited legislative powers than the Scottish Parliament or the Northern Ireland Assembly, partly due to the fact that Wales has had the same legal system as England for several decades, whereas the Scottish and Northern Irish systems retained some distinctness.

The Welsh Assembly Government budget for 2007–08 is £14 billion.⁸ Local authorities in Wales will spend £6.7 billion in 2007–08, £5.6 billion of which

⁶ Further details can be found in Scottish Executive, *Scottish Local Government Financial Statistics*, 2006 (<http://www.scotland.gov.uk/Publications/2006/01/10142605/0>).

⁷ For more details, see <http://wales.gov.uk/gowasub/gowa/?lang=en>.

⁸ Source: <http://new.wales.gov.uk/docrepos/40382/40382313/403821/403821/750268/780318/AnnualBudgetMotion-e?lang=en>.

will be provided through the Welsh Assembly (the remainder being council tax raised locally).⁹

Northern Ireland Assembly and Northern Ireland Executive

The Northern Ireland Assembly first met on 1 July 1998 and it assumed full powers on 2 December 1999. It has full legislative and executive authority over all devolved responsibilities, including education, health, agriculture, culture, social services and regional and social development. The Assembly has been suspended on four occasions, most notably between 14 October 2002 and 8 May 2007. During these periods, the Secretary of State for Northern Ireland (a member of the UK Cabinet otherwise responsible for ensuring that the devolution settlement works satisfactorily and for matters not devolved to the NI Assembly, such as criminal justice) assumed responsibility for Northern Ireland departments. Since 8 May 2007, the Assembly has been back in operation.

There are 26 single-tier councils in Northern Ireland, serving populations of between 16,400 and 267,000.¹⁰ Spending by these councils in 2007–08 is budgeted to be £584 million, of which just under one-third (£183 million) is expected to be provided from the Northern Ireland Assembly, with the remainder financed through local rates on both business and domestic properties.¹¹ These councils provide services similar to those provided by English District Councils, though fewer services than would be provided by local government elsewhere in the UK as NI Assembly departments provide some services. For example, education (although arguably this is no longer a local authority financial responsibility in England either, as described in Section 4.2), fire services, road building, planning, housing and libraries are all provided by government departments in Northern Ireland.

From April 2009, seven new councils will replace the current 26, with increased power in certain areas, such as planning and regeneration.¹²

Greater London Authority

The Greater London Authority Act (1999) introduced the election of a mayor and an assembly for the Greater London region. The Mayor of London sets policy on factors that affect the Greater London area, beyond the remit of

⁹ Source: Table 1 of <http://www.statswales.wales.gov.uk/tableviewer/document.aspx?FileId=945>.

¹⁰ Source: http://www.doeni.gov.uk/index/local_government/structure.htm.

¹¹ Source: http://www.doeni.gov.uk/index/local_government/lg_funding.htm.

¹² Source: Review of Public Administration, *Better Government for Northern Ireland: Final Decisions of the Review of Public Administration*, 2006 (<http://www.archive.rpani.gov.uk/bettergovernment.pdf>).

Borough Councils – for example, transport, economic development and strategic development. The Mayor also sets budgets for organisations such as the Greater London Authority, London Transport and London police and fire services. In addition, in 2003 the Mayor introduced a congestion charge on driving in central London, with net revenue raised in 2006–07 of £123 million.¹³ The Assembly checks the Mayor’s activity. London is different from the rest of England in having both unitary local government (Borough Councils) and a second, separate tier of authority.

Local Government Act 2000

The Local Government Act 2000 was intended to force local authorities to shift away from the traditional committee-based decision-making system, to one of four alternative executive arrangements – two forms including elected mayors, a cabinet form and a committee form for smaller authorities. The Act requires local authorities to hold binding referendums on whether to have a directly elected local mayor, if local people indicate enough interest in the matter. For example, Doncaster MBC, Torbay and Hartlepool BC have elected mayors. An elected mayor would hold co-decision powers with the council regarding annual budget and policy framework, and in order to reject or amend a mayor’s budget or policy proposal, the council must do so by a two-thirds majority.¹⁴ The Act does not apply in Scotland.

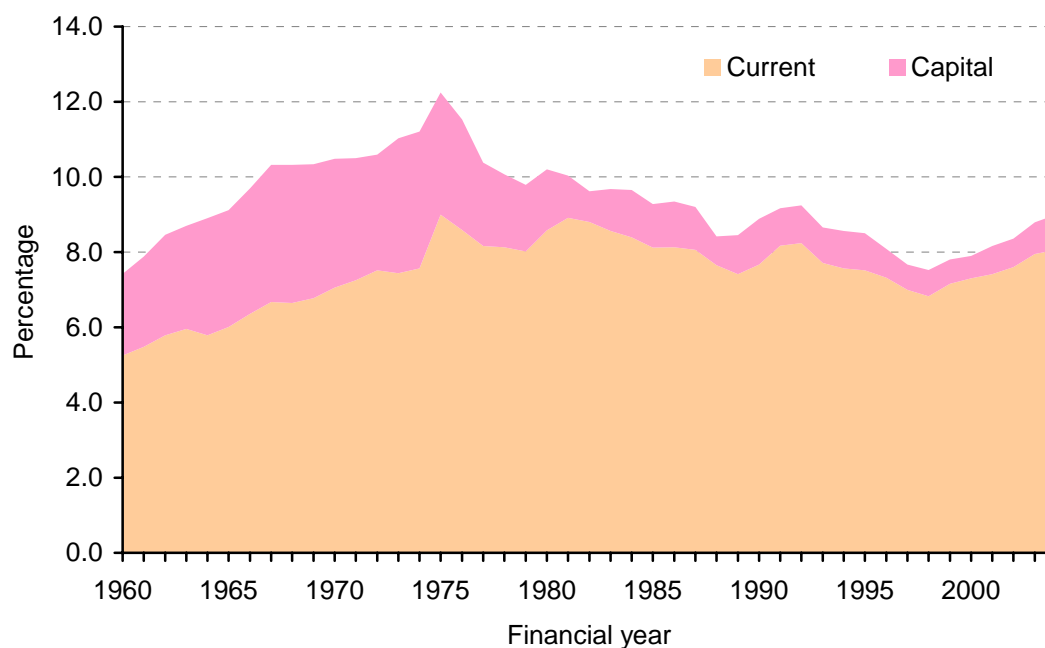
¹³ Gross revenue raised was £213 million, with £90 million spent on running the scheme. Source: Table 6.2 of Transport for London, *Central London Congestion Charging: Impacts Monitoring*, Fifth Annual Report, July 2007 (<http://www.tfl.gov.uk/assets/downloads/fifth-annual-impacts-monitoring-report-2007-07-07.pdf>).

¹⁴ The Act also contained measures aimed at reforming management structures and improving scrutiny of committees, amongst other things. For further details, see <http://www.opsi.gov.uk/Acts/acts2000/20000022.htm>.

3. Local government expenditure

In total in 2006–07, local government expenditure across the whole UK was £145.9 billion, around a quarter of the £550.4 billion total public spending,¹⁵ or just under a tenth of national income. As shown in Figure 3.1, local government spending peaked at 12.2% of overall spending in the UK economy in 1975, then declined to 7.5% in 1998, the lowest level seen for at least 35 years, and has since increased, reaching 9.0% in 2004. Over the period from 1960 to 1975, around 30% of local government expenditure was on capital spending (spending on physical assets such as school buildings and street lighting, as opposed to current spending, which covers wages and other day-to-day running costs). This is in sharp contrast to the period since 1981, when capital spending has represented only about one-tenth of local government expenditure. In large part, this is due to a sharp decline in expenditure on housing.¹⁶

Figure 3.1. UK local government expenditure as a percentage of domestic expenditure



Source: Chart 1.5f of Office of the Deputy Prime Minister, *Local Government Finance Statistics England No. 16*, 2006
(<http://www.local.odpm.gov.uk/finance/stats/lgfs/2005/lgfs16/h/lgfs16/chapter1.html#e>).

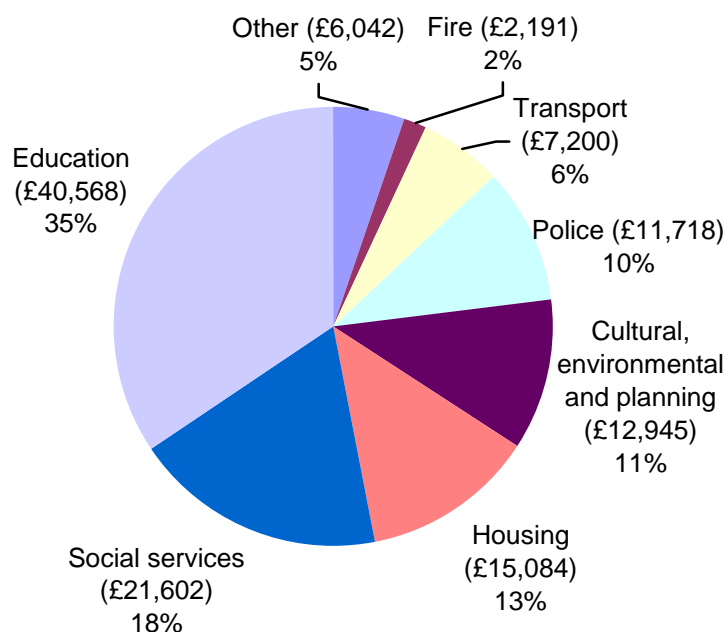
¹⁵ Source: Table B6 of HM Treasury, *Public Finances Databank*, 23 July 2007
(http://www.hm-treasury.gov.uk/economic_data_and_tools/finance_spending_statistics/pubsec_finance/psf_statistics.cfm).

¹⁶ For more details, see T. Clark, M. Elsby and S. Love, 'Trends in British public investment', *Fiscal Studies*, 2002, vol. 23, pp. 305–342.

3.1 Current expenditure

As shown in Figure 3.2, by far the largest constituent of local government current expenditure is education, on which £40.6 billion was spent in 2005–06. About half this amount was spent on social services. Other large single components of local authority service expenditure are cultural, environmental and planning services, housing and police services.

Figure 3.2. Local government current expenditure in England, by service, 2005–06
(£ million and % of total)



Note: Spending is gross of any income from sales, fees and charges.

Source: Table 3.2b of Department for Communities and Local Government, *Local Government Finance Statistics England No. 17*, 2007

(<http://www.local.odpm.gov.uk/finance/stats/lgfs/2007/h/xlsfiles/LGFS17-3-2ab.xls>).

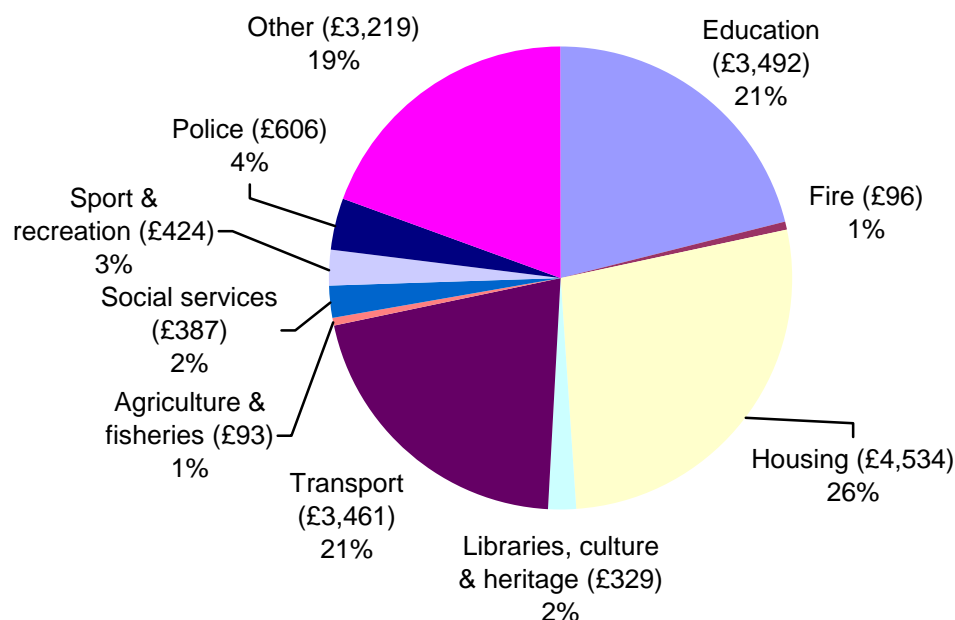
3.2 Capital expenditure

The composition of local authority capital spending in England is shown in Figure 3.3. While education is also a relatively large component of this measure of spending, the largest share of capital spending – nearly a quarter of the total – is on housing. Furthermore, capital spending on transport (£3,461 million) is nearly as large as that on education (£3,492 million). In contrast, while social services receive 18% of current spending, they receive only 2% of capital spending.

A significant form of capital expenditure is not counted in these figures. Expenditure financed by the private sector through the Private Finance Initiative (PFI; see Section 4.4) is currently entirely excluded from official measures of local authorities' capital spending. In 2005–06, local authorities

signed deals that should deliver a total of £0.9 billion of capital spending through PFI, 62% of which was in education.¹⁷

Figure 3.3. Local government capital expenditure in England, by service, 2005–06 (£ million and % of total)



Note: Spending is gross of any income from sales, fees and charges.

Source: Table 4.1c of Department for Communities and Local Government, *Local Government Finance Statistics England No.17*, 2007

(<http://www.local.odpm.gov.uk/finance/stats/lgfs/2007/h/chapter4.html>).

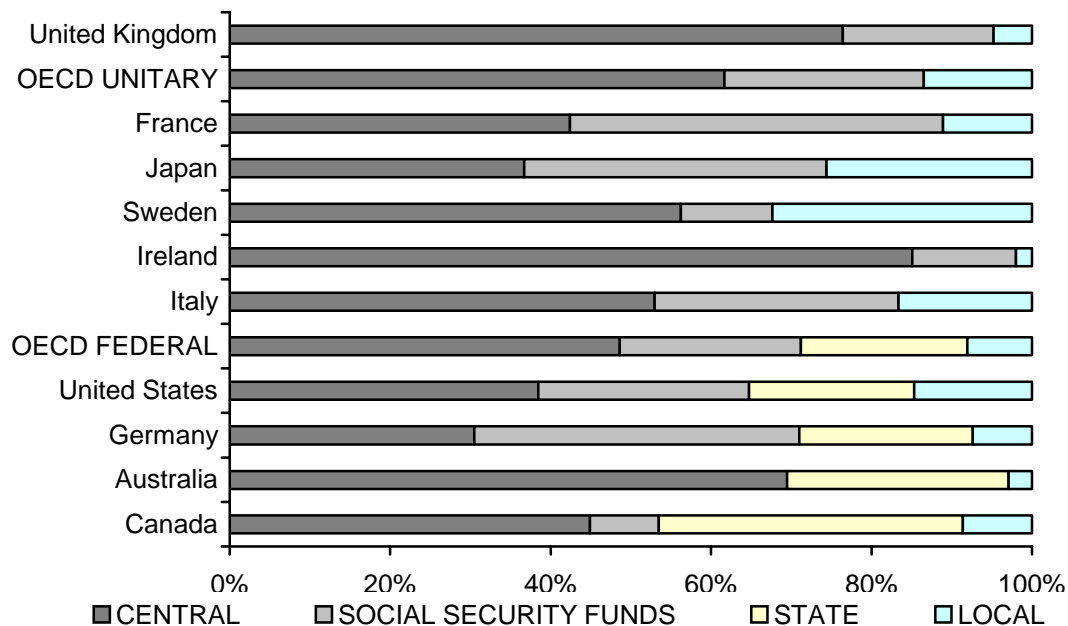
¹⁷ Source: Table 4.5a of Department for Communities and Local Government, *Local Government Finance Statistics England No. 17*, 2007

(<http://www.local.odpm.gov.uk/finance/stats/lgfs/2007/h/xlsfiles/LGFS17-4-5a.xls>).

4. Financing of UK local authorities

By international standards, UK government finances are highly centralised. Figure 4.1 compares the distribution of revenues by levels of government in the UK to the averages of OECD unitary countries and OECD federal countries, and a selection of individual unitary and federal countries. The UK has 95% of tax revenue going to central government, a share that is exceeded only by Ireland.

Figure 4.1. Revenues by level of government, 2004



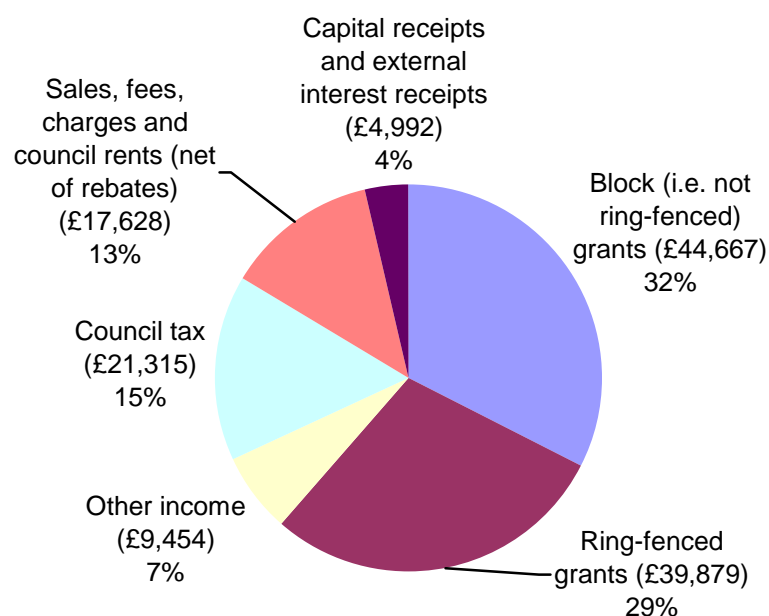
Note: Revenue is generally attributed to levels of government on the basis of their legal entitlement rather than their control over the tax rate (or base). Thus in both Germany and Australia, the state level of government receives a substantial part of its revenues from taxes whose rates are set at national level (although in consultation with state governments). However, business rates in the UK count as central government revenue despite being notionally redistributed to local authorities, since this revenue is clawed back through reduced Revenue Support Grant and so does not affect local authority finances: see Section 4.1. Source: OECD.

The main sources of income for local authorities in the UK are council tax, government grants, user charges (in particular, rents on council-owned properties), interest receipts, capital receipts, and borrowing. Local authorities can budget to pay for current spending – wages and other day-to-day running costs – from only some of these income sources: they cannot sell assets or borrow deliberately to finance current spending, and some grants from central government may only be used for capital spending.

The composition of local authorities' funding in 2005–06 is shown in Figure 4.2. Income from central government that is not earmarked for a specific use (formally Revenue Support Grant (RSG) and redistributed national non-

domestic rates) makes up one-third of local authority income. A further 29% also comes from central government but is earmarked for certain specific uses. Council tax revenue (without deducting the part of council tax benefit paid for by central government) raised just 15% of total local government income, with a further 13% coming from sales, fees, charges and council rents. In England in 2006–07, a new Dedicated Schools Grant (DSG) was introduced. This is described in more detail in Section 4.2, but the key detail is that it represents a large increase in ring-fenced grants (since the DSG – as its name suggests – is earmarked for spending on schools) and a correspondingly large cut in non-ring-fenced grants (formally RSG).

Figure 4.2. Total local government income in England, by source, 2005–06 (£ million and % of total)



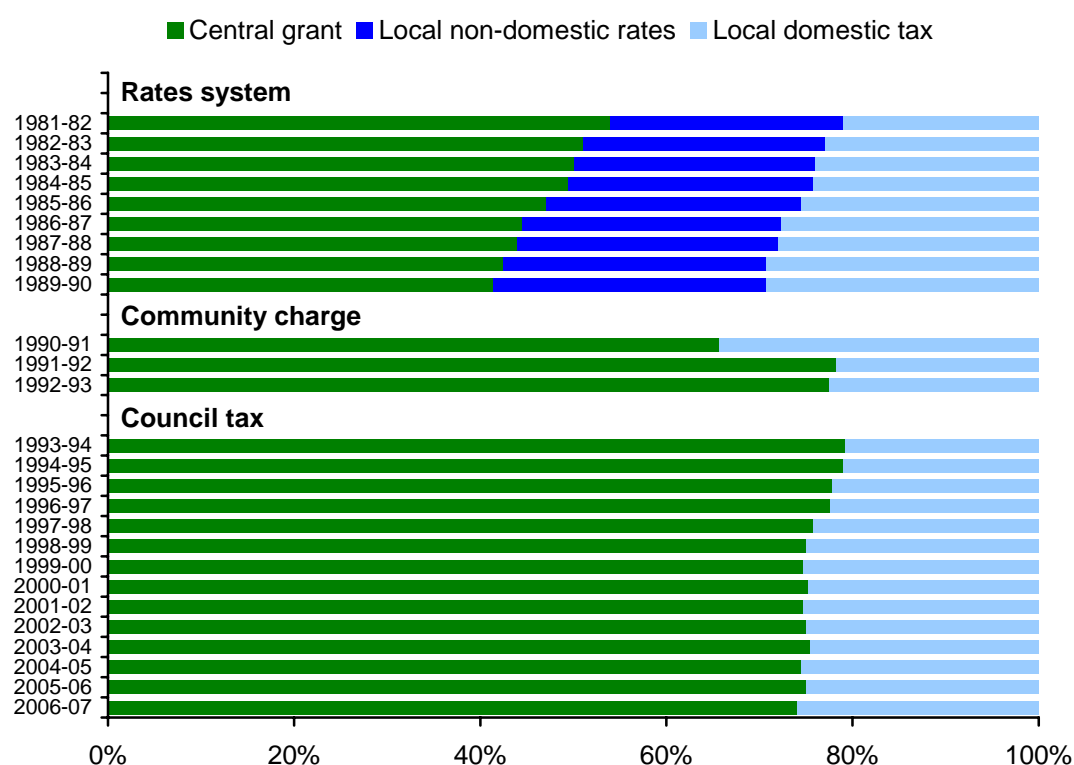
Notes: Block grants comprise Revenue Support Grant and redistributed national non-domestic rate revenue. Ring-fenced grants include Police Grant, Standard Spending Assessment Reduction Grant, Central Support Protection Grant, City of London offset, Transitional Reduction Scheme Grant and General GLA Grant. Council tax includes council taxes financed from Council Tax Benefit Grant but excludes council taxes financed from local authority contributions to council tax benefit.

Source: Table 2.1a of Department for Communities and Local Government, *Local Government Finance Statistics England No. 17*, 2007

(<http://www.local.odpm.gov.uk/finance/stats/lgfs/2007/h/chapter2.html#a>).

A more commonly quoted statistic is that council tax raises one-quarter of local government finance, which is true of a narrower but widely used measure of local authority income. As shown in Figure 4.3, in 2006–07 one-quarter of this measure of local authority income came from council tax, with the remaining three-quarters coming from central government.

Figure 4.3. Composition of (narrowly measured) local government income over time, England



Note: Measure of local government income used includes Revenue Support Grant, specific and special grants within Aggregate External Finance, redistributed business rates and council taxes; it equals revenue expenditure less that covered by changes in reserves.

Sources: Chart 3.5e of Office of the Deputy Prime Minister, *Local Government Finance Statistics England No. 16*, 2006

(<http://www.local.odpm.gov.uk/finance/stats/lgfs/2005/lgfs16/h/lgfs16/chapter3.html#e>) and Table 3.5c of Department for Communities and Local Government, *Local Government Finance Statistics England No. 17*, 2007

(<http://www.local.odpm.gov.uk/finance/stats/lgfs/2007/h/xlsfiles/LGFS17-3-5c.xls>).

Figure 4.3 shows the sources of this narrower measure of local authority income since 1981–82. Government grants can be seen falling as a percentage of total funding over the 1980s, with increases in the proportion financed from local rates, a tax on the rental value of property which at the time applied to both domestic and non-domestic properties. In 1990–91 in England and Wales, domestic rates were replaced with the community charge (a flat-rate per-person levy, or poll tax; the community charge replaced domestic rates in Scotland one year earlier) while non-domestic rates were centralised. This led to a large decline in the proportion of local authority income raised through locally determined taxes, but was also associated with a large increase in the proportion financed through the local domestic tax. In 1991–92, there was a large increase in central government grant as the new Major government sought to finance a £140 reduction in each adult’s community charge bill by increasing the main (national) VAT rate from 15% to 17½%. Since 1991–92, while grant income from central government has increased, revenues from

council tax (introduced in England, Scotland and Wales from 1993–94) have increased more quickly, so the percentage of total income coming from council tax has grown.¹⁸

This section goes on to describe in more detail the income from central government grants (Sections 4.1 and 4.2) and other, more minor, sources of local authority income (Section 4.3). The financing of capital expenditure is described in Section 4.4. A comprehensive description of council tax (and council tax benefit) is left to Section 5.

4.1 Block grants

The largest component of local authority funding comes as a block grant from Whitehall (or the relevant devolved administration) which is not ring-fenced for any specific service area but may be spent as the local authority chooses.

Central government determines how much block grant to pay to local authorities in such a way that if every local authority spent at the level judged appropriate by central government, council tax rates for properties in a given band (see Section 5) would be uniform within England, Scotland and Wales. Similar arrangements apply in Northern Ireland. The result is redistribution from areas with a large council tax base relative to their assessed spending needs to areas with a small council tax base relative to their needs. This is known as equalisation.

Primarily, central government takes a view over how much local government might spend in a year (other than through earmarked grants – see Section 4.2) and how much of this would be covered by a ‘standard’ level of council tax. The difference between the two is how much grant central government pays in aggregate. For each individual local authority, it makes an assessment of the authority’s relative spending need. This will depend on the size, and some of the observed characteristics, of the population in that area. For example, spending need for social services for older people depends on the number of individuals aged 65 and over plus additional amounts depending on the proportion of these individuals who are aged 90 or over, the sparsity of the population, the proportion on low incomes, the level of deprivation in the area and an adjustment for area costs. Central government also assesses how much council tax revenue the local authority would receive if the local authority chose to set council tax at the ‘standard’ rate assumed by the government. The difference between total spending need and the standard amount of council tax revenue is the total amount of block grant that the authority will receive. The government guarantees a minimum level of grant increase every year, so if

¹⁸ Average council tax bills have risen in real terms in all years from 1993–94 to 2006–07. Band D council tax rates have risen in real terms in all years from 1993–94 to 2006–07 apart from between 1993–94 and 1994–95 when they fell by 0.4%. See Section 5 for more details.

under normal calculations an authority would receive less than the minimum increase, the grant will be increased by the minimum.¹⁹

The fact that the total block grant from central government is such a large proportion of the income of local authorities, as was shown in Figure 4.2, makes it more important that the appropriate level is assessed accurately. This places a lot of weight on the calculation of each authority's spending need, which in turn depends on the factors that are taken into account in this calculation. Therefore judgements over whether certain factors should or should not be included in the calculation – and changes in the weight put on these factors – can have a large impact on the total income of individual local authorities.

In England, Scotland and Wales, block grant notionally has two components: redistributed national non-domestic rates (NNDR) and Revenue Support Grant. In England in 2005–06, these provided £18.0 billion and £26.7 billion respectively, but because of the introduction of a big new grant earmarked for school spending in April 2006 (Dedicated Schools Grant – see Section 4.2), RSG in 2006–07 fell to just £3.4 billion (while redistributed NNDR provided £17.5 billion).²⁰

Revenue from NNDR, or business rates – a tax on the rental value of business property which is set centrally for each of England, Scotland and Wales²¹ – is redistributed to local authorities in proportion to the number of people living in each authority, while RSG is paid out of general government revenues. In practice, however, there is absolutely no difference between these two payments. Central government first determines how much in total to give to each local authority, as described above, then deducts the amount that local authorities will receive in redistributed NNDR and gives the remainder as RSG. Since RSG is adjusted to keep the total payment to each local authority as determined centrally, the split between the two components is meaningless: one could equally legislate that revenue from any national tax be redistributed to local authorities, but if grants were adjusted so that local authorities' finances were unaffected then such a rule would be wholly inconsequential. The split between redistributed business rates and RSG matters for only two reasons. The first is a practical one: RSG cannot fall below zero, so if a local authority's share of NNDR exceeds what central government has determined it should

¹⁹ Strictly, the minimum guaranteed increase applies to block grant plus Police Grant and including a special payment to the Greater London Authority.

²⁰ Source: Table 2.4a of Department for Communities and Local Government, *Local Government Finance Statistics England No. 17*, 2007 (<http://www.local.odpm.gov.uk/finance/stats/lgfs/2007/h/xlsfiles/LGFS17-2-4a.xls>).

²¹ For more information on business rates, see <http://www.mybusinessrates.gov.uk/>. Northern Ireland operates a slightly different system of regional rates and locally varying district rates.

receive then the redistributed NNDR acts as a minimum. This issue has become more pertinent recently as the expansion of ring-fenced grants has been accompanied by a reduction in RSG (see Section 4.2). The second reason that the split between RSG and redistributed NNDR matters is political: business rates were under local control until 1990, and many (such as the Local Government Association, the Local Government Information Unit and the Chartered Institute of Public Finance and Accountancy) argue that they should be returned to local control, so it is arguably useful to know how significant they might be as an autonomous source of revenue.

4.2 Ring-fenced grants

Central government also pays ‘specific grants’ to local authorities, which are formally ring-fenced for a specific service. Local authorities can choose to top up spending in these areas from their general resources, but cannot spend less. This ring-fencing, or hypothecation, is therefore only a binding restriction when a local authority would otherwise choose to spend less than the specific grant on a particular function. If the local authority intended to spend the same as, or more than, the amount of specific grant on a particular service then the ring-fencing is not binding and the impact of the specific grant should be the same as block grants. If the local authority intended to spend less than the amount of specific grant on a particular service area then the hypothecation is binding. Under this scenario, the specific grant is helping to achieve the objectives of central government, but at the expense of providing less discretion to local authorities than would have been the case had the payment been made in the form of a block grant. On the other hand, even with binding specific grants, local authorities might have some discretion over how the money is allocated within the broad policy area concerned, meaning greater local discretion than if the projects were run directly from Whitehall.

Specific grants have grown since the current Labour government came into power in 1997, both in absolute terms and as a proportion of total grant finance. In England in 2005–06, specific grants totalled £39.9 billion, only 10% smaller than the £44.7 billion that was paid in block grants (see Figure 4.2). The areas to which specific grants are allocated include education and police, and within these categories the service to which the grant is allocated – for example, teachers’ pay reform or nursery education – is specified. By far the largest increase in specific grants under Labour has been in spending on schools, which is now by far the largest destination for specific grants.

The trend towards greater use of earmarked grants, and particularly earmarked grants for schools, continued in April 2006 with the introduction of the Dedicated Schools Grant. This change essentially represents the payment of a large specific grant hypothecated for schools spending, with a correspondingly large reduction in the size of block grants. The change is dramatic: in 2007–08,

ring-fenced grants are substantially larger (at £66.5 billion) than block grants (£21.6 billion).²²

Dedicated Schools Grant

Prior to 2006–07, schools funding in England was provided for in local authorities' general funding based on central government's assessment of local authorities' school spending needs. As of 2006–07, each local authority's schools budget is provided by a central government specific grant instead of as part of block grant. The Dedicated Schools Grant is based on a formula, with a guaranteed minimum increase in per-pupil funding (set at 5% in both 2006–07 and 2007–08), with the option for local authorities to top up spending with revenue from other sources if they wish.

The grant still goes to schools via councils. As with other ring-fenced grants, the hypothecation is only meaningful if councils would have otherwise chosen to spend less on schools than mandated by the size of the DSG. However, given that the grant is worth at least 5% per pupil more than councils were previously spending, it is more likely that the hypothecation will bind. To the extent that this is the case, the move to a Dedicated Schools Grant represents a very substantial reduction in the spending power of local authorities – and conversely an increase in the power of Whitehall, since it will, for the first time, be able to guarantee minimum spending levels in schools in every local authority in England, which it was previously unable to do.

A potential advantage for schools is that they will receive multi-year budgets. The intention is that these will be set on a three-year basis – although due to the timing of the spending review process, the first allocation has been made for two years. A further consultation is considering whether there are sufficient benefits to justify moving to a system of academic- rather than financial-year payments to schools.

4.3 Other sources of finance

Sales, fees and charges

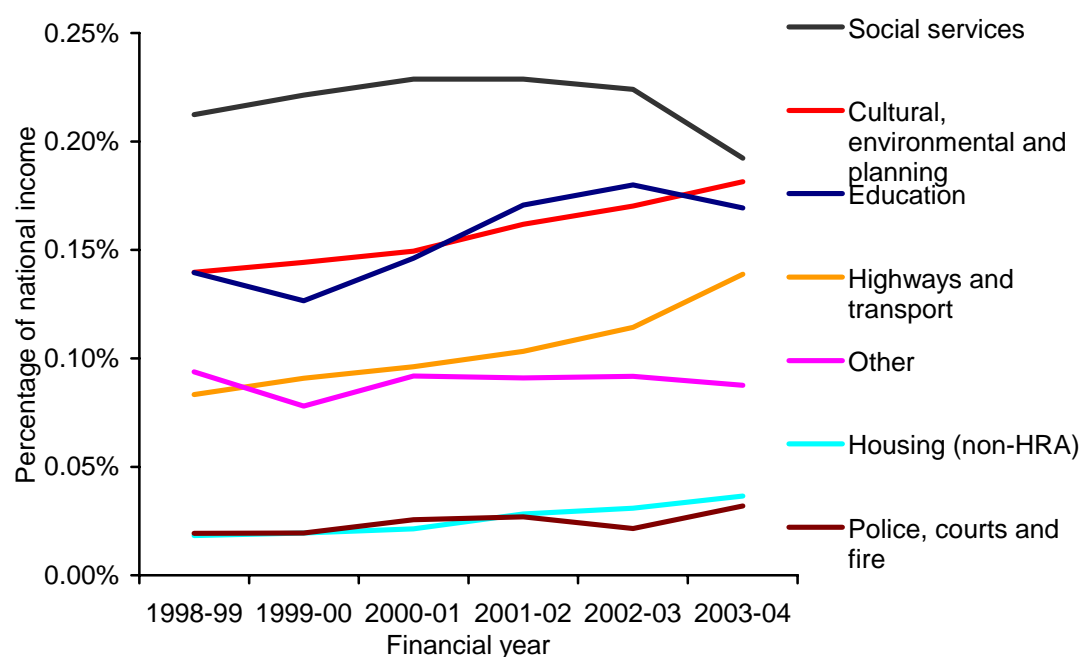
Local authorities have the power to charge for discretionary services they provide (including in mandatory service areas where they provide a level beyond the statutory minimum). Thus councils are able to charge for any service they provide, with the exception of election procedures, police and fire services, library book borrowing and provision of certain forms of education. Areas where charges are typical include local leisure facilities, advisory services and extending social services beyond mandatory requirements. Within practical limits, authorities are under a duty to prevent income from charges

²² Source: Table 2 of Department for Communities and Local Government, *Local Authority Revenue Expenditure and Financing, England: 2007–08 Budget, 2007* (<http://www.local.odpm.gov.uk/finance/stats/rev0708june07.pdf>).

exceeding the cost of provision: the intention is to enable local authorities to provide or improve services they would not otherwise provide or improve, by allowing them to cover costs, rather than to generate a new income stream that could be spent on other services. Of course, the local authority could be charging for a service that it would have been prepared to offer free at the point of use, in which case the charges will be generating resources that can be allocated to other areas of service provision.

In 2005–06, charges for services (including rents) provided 13% of local authorities' income (as shown in Figure 4.2). Revenue raised from sales, fees and charges has increased very slightly in recent years: from 0.7% of national income in 1998–99 to 0.8% of national income in 2003–04.²³

Figure 4.4. Income from sales, fees and charges as a percentage of national income



Note: HRA = Housing Revenue Account, explained in the next subsection.

Source: Table 2.5a of Office of the Deputy Prime Minister, *Local Government Finance Statistics England No. 16*, 2006

(<http://www.local.communities.gov.uk/finance/stats/lgfs/2005/lgfs16/h/lgfs16/xlsfiles/LGFS16-2-5a.xls>). GDP figures from Table A1 of HM Treasury, *Public Finances Databank*, 23 July 2007 (http://www.hm-treasury.gov.uk/economic_data_and_tools/finance_spending_statistics/pubsec_finance/psf_statistics.cfm).

²³ Source: Table 2.5a of Office of the Deputy Prime Minister, *Local Government Finance Statistics England No. 16*, 2006

(<http://www.local.communities.gov.uk/finance/stats/lgfs/2005/lgfs16/h/lgfs16/xlsfiles/LGFS16-2-5a.xls>). GDP figures from Table A1 of HM Treasury, *Public Finances Databank*, 23 July 2007 (http://www.hm-treasury.gov.uk/economic_data_and_tools/finance_spending_statistics/pubsec_finance/psf_statistics.cfm).

The level of revenue raised from sales, fees and charges varies by service and also by the characteristics of the area. This is not surprising as both the size of the available 'tax base' and also the desired level of charge are likely to vary both between different services and across different areas. For example, urban authorities are more likely to be able to raise revenue from car parking than rural authorities. In part, this is reflected in Figure 4.4: education, which is the largest local service by current expenditure (as shown in Figure 3.2), was in 2003–04 only the third largest service by income from sales, fees and charges, which will reflect the fact that local authorities are unable, or unwilling, to charge for the majority of service provision in this area. The large increase between 2002–03 and 2003–04 in the area of public transport (within the highways and transport series) is due to the introduction of the congestion charge in central London.

Housing Revenue Account

The rental income from council-owned property and the expenditure on that property are ring-fenced in something known as the Housing Revenue Account (HRA). The intention is to prevent both council taxes being raised in order to subsidise council tenants and the reverse situation where council tenants' rents are increased in order to reduce council tax bills. The main items of HRA expenditure are the costs of managing and maintaining the dwellings and other properties (such as shops and garages), the cost of servicing any related debts and the cost of paying housing benefit paid to council tenants. The main income items are rents received from tenants and subsidies received from central government towards, for example, maintaining the housing stock in its current condition.

Revenue reserves

Reserves are accumulated surplus income, acquired when local authorities receive funding beyond their expenditure needs. They are used to finance future spending and provide working balances. On 1 April 2005, reserves in England totalled £11,091 million, of which £1,498 million were school financial reserves, £6,827 million reserves earmarked for other spending areas and the remaining £2,766 million unallocated reserves.²⁴ These unallocated reserves were equivalent to 3.1% of the coming year's expenditure, although there was considerable variation between different types of authority: across shire District Councils, reserves averaged 19% of expenditure, whereas across other types of local authority, they averaged between 2% and 4%.²⁵

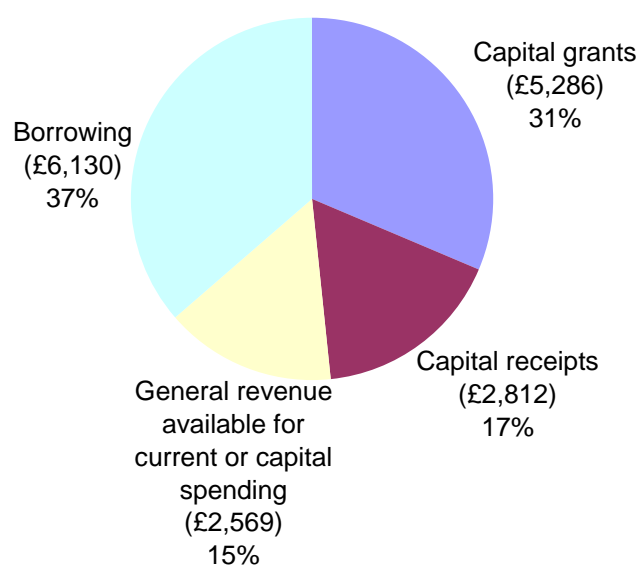
²⁴ Source: Table 3.8a of Department for Communities and Local Government, *Local Government Finance Statistics England No. 17, 2007* (<http://www.local.odpm.gov.uk/finance/stats/lgfs/2007/h/xlsfiles/LGFS17-3-8a.xls>).

²⁵ Source: Chart 3.8b of Department for Communities and Local Government, *Local Government Finance Statistics England No. 17, 2007* (<http://www.local.odpm.gov.uk/finance/stats/lgfs/2007/h/chapter3.html#h>).

4.4 Financing of capital expenditure

As noted above, local authorities are restricted in the sources of income they can use to finance current expenditure. For capital expenditure, however, they have a wider range of financing options, including borrowing, the sale of assets and grants provided explicitly for capital expenditure projects, and these additional options are used to finance the bulk of capital spending. As shown in Figure 4.5, only about one-sixth (15%) of total capital spending by local authorities in 2005–06 was financed from sources that could (at least formally) have been used to pay for current expenditures (predominantly council tax, block grant or funds from the Housing Revenue Account (see Section 4.3)). Just over half came from either capital receipts (17%) or borrowing (37%), with the remainder coming in the form of different types of grants. In some cases (almost two-thirds of borrowing in 2005–06), central government provides help with meeting the cost of interest payments on this borrowing as part of block grant or HRA subsidy. The vast majority of capital receipts are from the sale of assets, with 59% of revenue from asset sales coming from the sale of housing in 2005–06.²⁶

Figure 4.5. Sources of local government capital expenditure funding budget, 2005–06 (£ million and % of total)



Source: Table 4.2a of Department for Communities and Local Government, *Local Government Finance Statistics England No. 17*, 2007 (<http://www.local.odpm.gov.uk/finance/stats/lgfs/2007/h/xlsfiles/LGFS17-4-2a.xls>).

²⁶ Source: Section 4.4 of Department for Communities and Local Government, *Local Government Finance Statistics England No. 17*, 2007 (<http://www.local.odpm.gov.uk/finance/stats/lgfs/2007/h/chapter4.html#a>).

Capital grants are typically aimed at specific projects and could be received either from central government or from other sources, such as the National Lottery, English Heritage, non-departmental public bodies and the European Structural Fund.

A large part of capital spending and its finance are not included in these figures: spending delivered through the Private Finance Initiative (PFI). This is where the public sector enters into a long-term contract with the private sector for the provision of a service. Under these arrangements, the private sector typically borrows to finance a capital asset that it has designed, built and will then operate to an agreed, contracted standard in return for a stream of payments from the public sector. The main justification for the PFI is that risks that are better handled in the private sector are transferred to the private sector.²⁷ Local government PFI projects expanded rapidly in the years up to 2003–04 but their value has declined slightly since then, and contracts signed in 2005–06 had a capital value of £913 million, compared with conventionally delivered capital spending in that year of £16,797 million.²⁸

²⁷ This and other arguments for the PFI are discussed in section 3.2 of T. Clark and C. Emmerson, ‘Improving public services?’, in A. Dilnot, C. Emmerson and H. Simpson (eds), *The IFS Green Budget: January 2002*, IFS Commentary no. 87, 2002 (<http://www.ifs.org.uk/budgets/gb2002/index.php>), and the sources cited therein.

²⁸ Sources: Table 4.2a and 4.5a of Department for Communities and Local Government, *Local Government Finance Statistics England No. 17*, 2007 (<http://www.local.odpm.gov.uk/finance/stats/lgfs/2007/h/chapter4.html>).

5. Council tax

Council tax is the only significant local tax across all of England, Scotland and Wales; a different system (described in Section 5.2) applies in Northern Ireland. Council tax is forecast to raise £27.8 billion in 2007–08. A total of £4.3 billion will be paid out in council tax benefit, which is essentially central government paying part or all of the council tax bills of those on low incomes who make a claim. Thus net receipts of council tax are forecast at £23.5 billion, 4.2% of total (tax and non-tax) receipts.²⁹ Revenue raised by council tax is not ring-fenced for any particular spending items.

Council tax was introduced on 1 April 1993. Each property in England, Scotland and Wales was allocated to one of eight valuation bands according to an assessment of its value in 1991, though the cut-off points between bands were different in each country. Local authorities set the overall level of council tax by choosing a rate for Band D properties, with the levels for other bands then determined as ratios of the Band D rate. The ratios, set by central government, are set out in Table 5.1. Those in the lowest band (A) pay two-thirds of the Band D rate, while those in the top band (H) pay twice the Band D rate. The bandings and ratios have remained unchanged in England and Scotland since the introduction of council tax. Wales has recently reformed its banding structure, as described in Section 5.1.

Table 5.1. Council tax bands in England and Scotland, and the council tax billing ratio

<i>Band</i>	<i>Property value: England</i>	<i>Property value: Scotland</i>	<i>Tax rate relative to Band D</i>
A	Up to £40,000	Up to £27,000	$\frac{6}{9}$
B	£40,001 to £52,000	£27,001 to £35,000	$\frac{7}{9}$
C	£52,001 to £68,000	£35,001 to £45,000	$\frac{8}{9}$
D	£68,001 to £88,000	£45,001 to £58,000	1
E	£88,001 to £120,000	£58,001 to £80,000	$\frac{11}{9}$
F	£120,001 to £160,000	£80,001 to £106,000	$\frac{13}{9}$
G	£160,001 to £320,000	£106,001 to £212,000	$\frac{15}{9}$
H	Above £320,000	Above £212,000	2

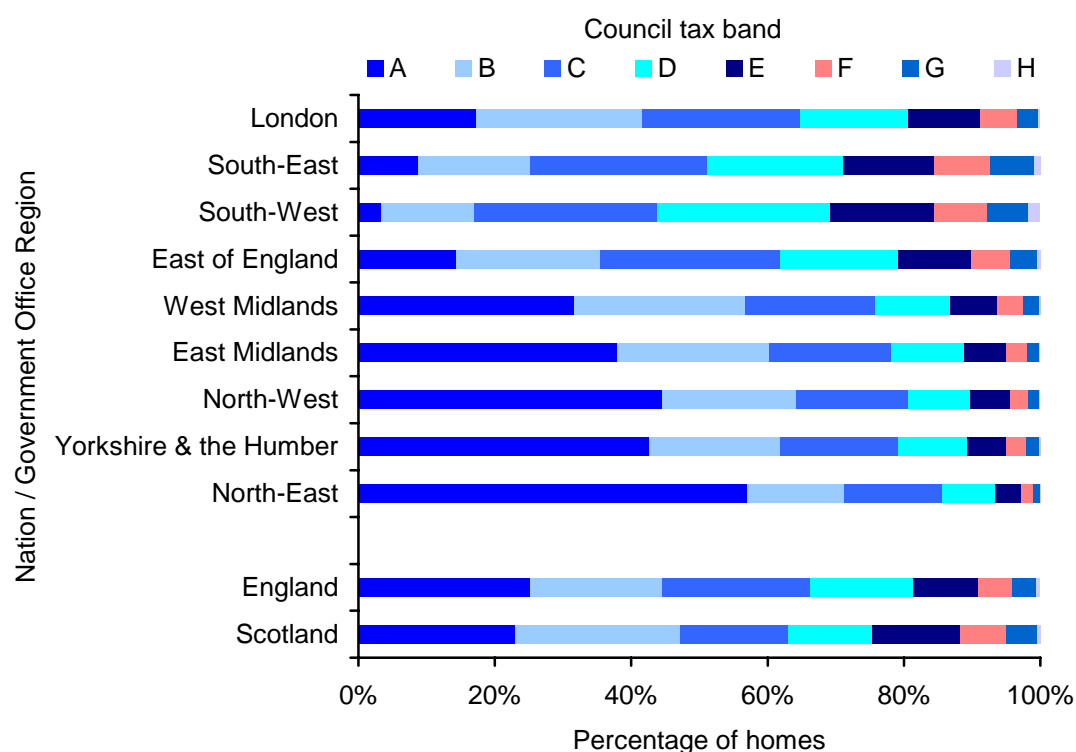
Sources: England from Department for Communities and Local Government, *Local Government Finance Statistics*, 2007

(<http://www.local.odpm.gov.uk/finance/stats/data/ctbdwell2007.xls>); Scotland from Scottish Executive, *Council Tax in Scotland*, 2003
(<http://www.scotland.gov.uk/library3/localgov/ctvb-00.asp>).

²⁹ Figure for net receipt of council tax from table C8 of HM Treasury, *Financial Statement and Budget Report*, 2007 (http://www.hm-treasury.gov.uk/budget/budget_07/bud_bud07_index.cfm). Figure for expenditure on council tax benefit from table 3 of Department for Work and Pensions, *Benefit Expenditure Tables*, 2007 (http://www.dwp.gov.uk/asd/asd4/medium_term.asp).

Across England, two-thirds of properties are in Bands A to C, with one-quarter of all properties in the lowest band. In contrast, less than one-tenth fall in the top three bands. As shown in Figure 5.1, this pattern is subject to dramatic regional variation: 58% of properties in the North-East fall into Band A, compared with just 3% in the South-West and 17% in London. This is despite the fact that 1991 was not a year in which house prices in London were particularly high relative to the rest of England: indeed, since 1991, house prices have, on average, grown considerably more quickly in London than across the rest of England.

Figure 5.1. Distribution of properties across bands, England and Scotland

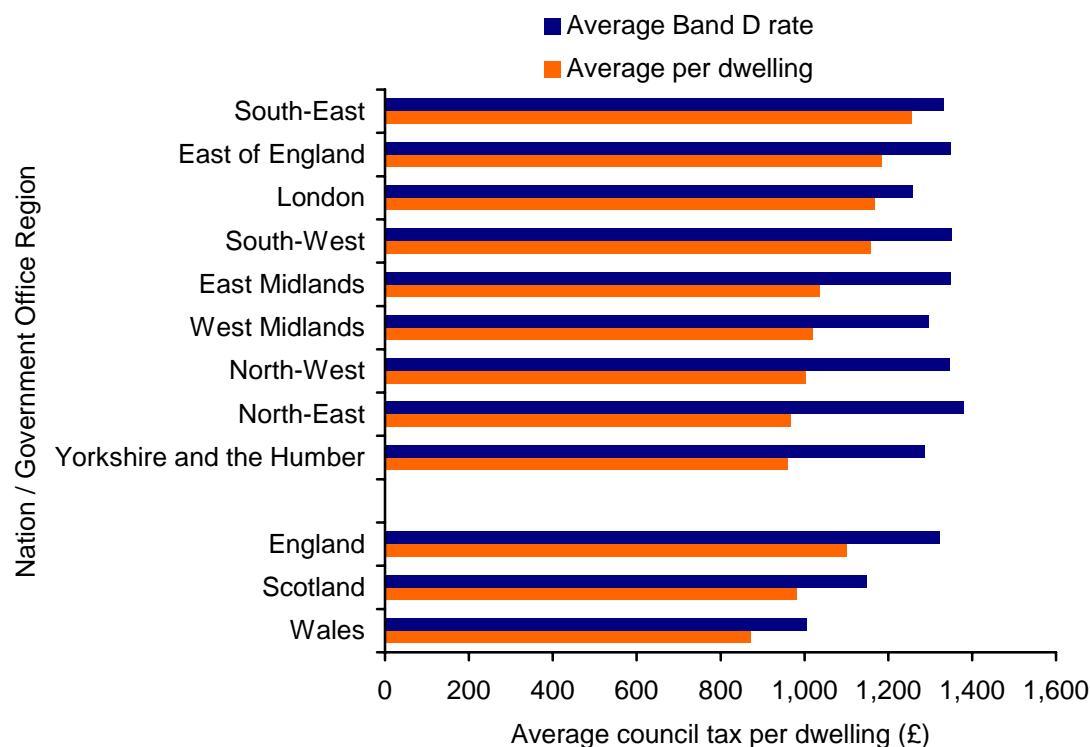


Source: England as at 26 March 2007 from Department for Communities and Local Government, *Local Government Finance Statistics*, <http://www.local.odpm.gov.uk/finance/stats/data/ctbdwell2007.xls>; Scotland as at 4 September 2006 from Scottish Executive, *Statistics*, <http://www.scotland.gov.uk/Topics/Statistics/Browse/Local-Government-Finance/ChargeableDwellings040920>.

Since most properties are below Band D, most households pay less than the Band D rate. Because of this, and also because of discounts and incomplete collection (see below), the average Band D rate in England for 2007–08 is £1,321, but the average amount paid by households is only £1,101. The level of council tax varies both across regions of Great Britain and within those regions. As shown in Figure 5.2, the area with the highest average Band D rate in 2007–08 is the North-East (£1,380), while the lowest region in England is London (£1,258), with Scotland (£1,149) and Wales (£1,005) having even lower

average Band D rates. Across the whole of England, the lowest Band D council tax rate is in Wandsworth in London (£681), while the highest is in Sedgefield in the North-East (£1,566); in Scotland, Band D rates range from £1,024 in Eilean Siar to £1,230 in Aberdeen City, while in Wales they range from £796 in Pembrokeshire to £1,215 in Blaenau Gwent.³⁰

Figure 5.2. Average council tax per dwelling, 2007–08

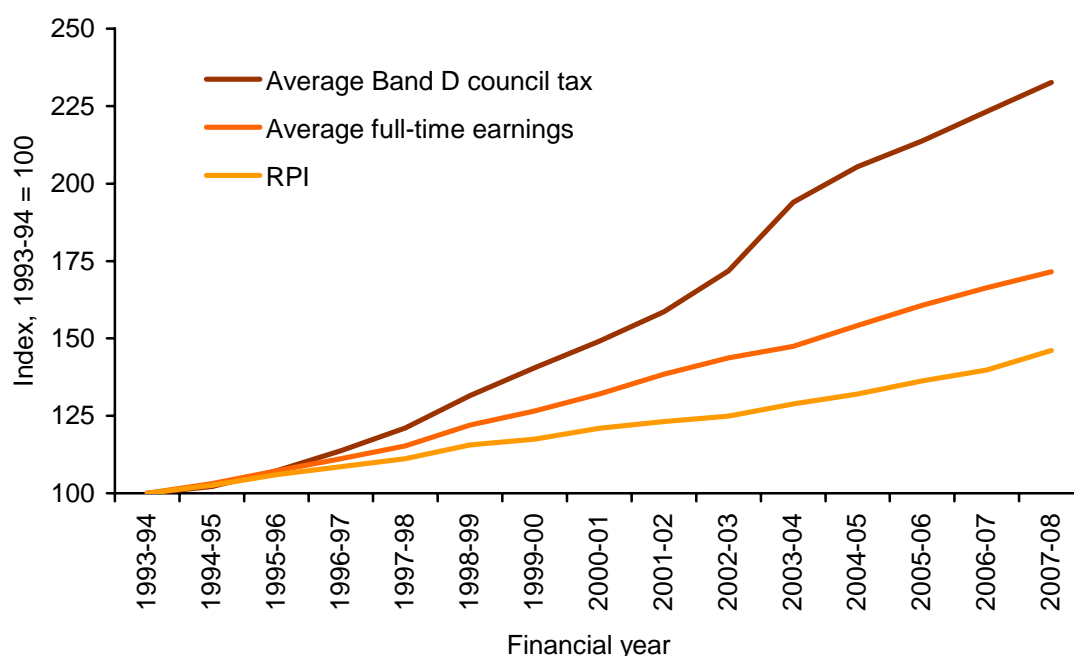


Sources: England from table 4 of Department for Communities and Local Government, *Local Government Finance: Council Taxes, 2007/08*, 2007 (<http://www.local.odpm.gov.uk/finance/ctax/ctax078.htm>); Scotland from Scottish Executive, *Local Government Finance: Datasets* (<http://www.scotland.gov.uk/Topics/Statistics/Browse/Local-Government-Finance/DatasetsCouncilTax>); Wales from table 5 of CIPFA, *Finance and General Statistics 2007–08*, 2007 (<http://www.cipfastats.net/uploads/Finance%20and%20General%20200708%20Commentary67200739147.pdf>).

³⁰ Sources: England from CIPFA, *Finance and General Statistics 2007–08*, 2007 (<http://www.cipfastats.net/uploads/Finance%20and%20General%20200708%20Commentary67200739147.pdf>); Scotland from Scottish Executive, *Local Government Finance: Datasets* (<http://www.scotland.gov.uk/Topics/Statistics/Browse/Local-Government-Finance/DatasetsCouncilTax>); Wales from Statistics for Wales (<http://www.statswales.wales.gov.uk/ReportFolders/ReportFolders.aspx>).

As is also shown in Figure 5.2, at least when looking at the average rate of council tax across regions within England, there is considerably more variation in the average per-household rate of council tax than there is in the average Band D council tax rate. Within England, average council taxes are highest across the south of England and lowest across the north of England. The lack of a positive correlation between average Band D rates and average household bills is due to the fact that, on average, properties in the south of England are in higher council tax bands. For example, as was shown in Figure 5.1, in the North-East 86% of properties are in Bands A to C, whereas only 44% of properties in the South-West fall into these bands. As a result, a lower Band D rate in, for example, the South-West than in the North-East can still deliver a higher average tax bill per household in the South-West than in the North-East.

Figure 5.3. Growth in average Band D council tax rates across England compared with growth in the retail price index and growth in average earnings



Sources: Council tax rates from Department for Communities and Local Government, *Local Government Finance: Council Tax* (<http://www.local.odpm.gov.uk/finance/ct.htm>); RPI and average earnings indices from National Statistics Online (<http://www.statistics.gov.uk>), series CHAW and LNMM respectively, both measured in April at the start of the financial year in question.

Since council tax replaced the community charge in April 1993, the growth in average Band D rates has outstripped both inflation and growth in average earnings. Figure 5.3 shows that over the 14-year period from April 1993 to April 2007, the average annual Band D council tax in England rose by 133% in nominal terms (or 6.2% per year on average), compared with growth in the retail price index (RPI) of 46% (2.7% per year) and growth in average earnings of 72% (3.9% per year). As a result, while the average annual Band D council tax in April 1993 was equal to 1.8 times average full-time weekly earnings, by

April 2006 this had risen to 2.4 times. The biggest increases in average Band D council tax rates occurred in April 1998, April 2002 and April 2003, while April 1994 and April 2007 saw increases slightly below the rate of RPI inflation.

From 1991–92 to 1998–99, central government imposed maximum local tax increases for every local authority, and by the end of this period more than four out of five councils chose to budget at this maximum. This ‘universal capping’ ended in 1999–2000, but central government kept the power to impose caps on individual local authorities. These powers were not used between 1999–2000 and 2004–05, but have been used in a few cases since then.

Council tax bills are reduced by 25% if only one taxable adult lives in the household. Second and empty homes were previously subject to a 50% reduction, but the 2003 Local Government Act gave councils in England the power to charge up to 90% on second homes and 100% on empty homes, along with the power to grant discretionary discounts and exemptions. Given that many owners of second homes are only eligible to vote in a different local authority, it is not surprising that many local authorities have chosen to reduce the discount they are offered. In 2006–07, 209 of the 354 billing authorities in England reduced the discount for second homes in their region and 158 reduced the discount on long-term empty properties.³¹

Some groups of adults are ignored for the purposes of counting the number of taxable adults in a residence. The largest such group is students undertaking full-time educational courses at a higher-education institute; others include persons in detention, the severely mentally impaired, persons for whom child benefit is still payable beyond the age of 16, members of religious communities, nursing-home patients, carers and residents of hostels or night shelters.³²

Legal liability for council tax usually rests with the occupants, though in certain circumstances (such as unoccupied homes) the owner is liable.³³ If a property has more than one occupant, liability is shared between them,

³¹ Source: Section 2.2 of Department for Communities and Local Government, *Local Government Finance Statistics England No. 17*, 2007 (<http://www.local.odpm.gov.uk/finance/stats/lgfs/2007/h/chapter2.html#b>).

³² For a full list of those eligible for council tax discounts, see annex B of Department for Communities and Local Government, *Local Government Finance Statistics England No. 17*, 2007 (http://www.local.odpm.gov.uk/finance/stats/lgfs/2007/h/annex_b.html).

³³ Other cases where the owner, rather than the resident(s), is liable for council tax are where the property is a residential care home or nursing home, a house of religious communities or dwellings of ministers of religion and houses in multiple occupation (dwellings containing people who do not form a single household but pay rent separately for different parts of the dwelling).

although in owner-occupied homes only the owner(s) is/are liable, not (for example) a lodger or an elderly relative living in the property. If a couple share a dwelling, they are both liable, even if there is only one name on the bill. Regardless of how many people share liability, only one council tax bill is issued for each property.

Collection rates have improved since the introduction of council tax, with the English in-year collection rate increasing from 92.6% in 1993–94 to 96.8% in 2005–06.³⁴ However, the collection of council tax continues after the financial year ends, so the actual collection rate is somewhere above these levels.

5.1 Council tax in Wales

Until recently, Wales used the same council tax system as England. However, a revaluation came into effect on 1 April 2005, based on property values as at 1 April 2003. Updating property valuations also necessitated changing the cut-off points between bands to take account of growth in house prices since 1991. The Welsh Assembly also proposed that valuations should take place every eight years, with the next one due in 2013. Table 5.2 sets out the original bands used – which, as in England, were based on April 1991 house prices – and the new bands. In addition to uprating the thresholds, a ninth band has been added (Band I), with properties in this band facing council tax $^{21}/_9$ times the Band D rate.

Table 5.2. Council tax bands in Wales before and after revaluation

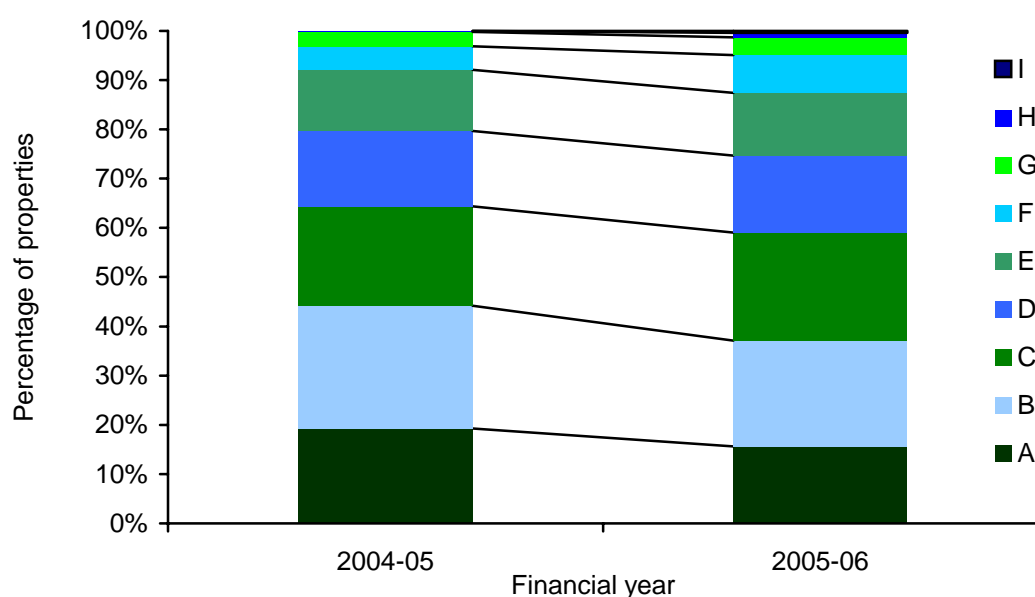
<i>Band</i>	<i>Property value (April 1991 values)</i>	<i>Property value (April 2003 values)</i>	<i>Tax rate relative to Band D</i>
A	Under £30,000	Under £44,000	$^6/_9$
B	£30,001 to £39,000	£44,001 to £65,000	$^7/_9$
C	£39,001 to £51,000	£65,001 to £91,000	$^8/_9$
D	£51,001 to £66,000	£91,001 to £123,000	1
E	£66,001 to £90,000	£123,001 to £162,000	$^{11}/_9$
F	£90,001 to £120,000	£162,001 to £223,000	$^{13}/_9$
G	£120,001 to £240,000	£223,001 to £324,000	$^{15}/_9$
H	£240,001 and above	£324,001 to £424,000	2
I	n/a	£424,001 and above	$^{21}/_9$

Sources: http://www.voa.gov.uk/council_tax/Counciltax-aguide.htm#A3;
<http://new.wales.gov.uk/topics/localgovernment/finandfunding/counciltax/banding/?lang=en>.

³⁴ Source: Table 2.21 of Department for Communities and Local Government, *Local Government Finance Statistics England No. 17*, 2007
<http://www.local.odpm.gov.uk/finance/stats/lgfs/2007/h/xlsfiles/LGFS17-2-21.xls>).

The stated intention was that a quarter of properties would move up at least one band and that a quarter would fall by at least one band.³⁵ However, in practice, one-third moved up at least one band and less than one in ten moved down. Figure 5.4 shows the distribution of properties across the bands in 2004–05 (the last year with the original banding) and in 2005–06 (the first year with the new banding). There were particularly large falls in the percentage of properties falling in Bands A and B, and increases in the percentage of properties in the top four bands. Despite this, it was still the case that only 12.8% of properties fell into Bands F, G, H or I, with just 0.4% of properties falling into the new top band (Band I).

Figure 5.4. Distribution of properties into council tax bands before and after revaluation, Wales



Source: Statistics for Wales

(<http://www.statswales.wales.gov.uk/TableViewer/tableView.aspx?ReportId=411>).

The fact that more properties moved up a band than down does not mean that average council tax bills necessarily rose. As long as both local authorities' spending decisions and their income from non-council-tax sources (including that from central government) were not changed, the average council tax bill would also not be affected. All that would happen is that the Band D rate would fall by enough to compensate for the fact that more properties were in higher bands. However, the average council tax bill in Wales rose by 9.1% between 2004–05 and 2005–06 in nominal terms (for comparison, the average rose by 4.3% in the same year in England).³⁶ One reason that larger increases in local

³⁵ Source: Welsh Assembly Government Press Release, 'Sue Essex announces new council tax valuation bands', 24 September 2003 (<http://wales.gov.uk/news/archivepress/localgovculpress/locgovpress2003/715236/?lang=en>).

³⁶ Source: Table 8 of CIPFA, *Finance and General Statistics, 2005–06*, London, June 2005.

taxes might be expected during changes to the operation of the local tax (such as council tax revaluations) is that the accountability of local authorities for their spending decisions might be relatively weak. Alternatively, central government might take the opportunity to award a lower grant settlement relative to the demands that it was placing on local authorities to provide services.

A system of transitional relief was introduced in Wales in order to smooth the tax increases that some households faced. No property was liable for more than a single-band increase in the first year after revaluation, more than a two-band increase in the second year or more than a three-band increase in the third year. This help was automatic: there was no need to apply for it.

5.2 Domestic rates in Northern Ireland

The community charge was never introduced in Northern Ireland, and the system of domestic rates that preceded it in the rest of the UK remained largely unchanged there – still based on 1976 rental values assessed using evidence from the late 1960s – until April 2007, when a major reform took effect.

Domestic rates in Northern Ireland are now levied as a percentage of the estimated capital value of properties as on 1 January 2005, though properties valued at more than £500,000 are treated as if that were their value. The tax has two parts: the Northern Ireland Executive levies a ‘regional rate’ (0.36% in 2007–08) across the whole of the province, while each District Council levies a ‘district rate’. In 2007–08, the (unweighted) average district rate levied is 0.28%, with the lowest rate in Castlereagh (0.19%) and the highest in Craigavon (0.34%).³⁷

There is a system of rebates for those on low incomes, similar to council tax benefit in the rest of the UK (see Section 5.3). In addition, there is a 25% discount for properties that are adapted for use by a resident with a disability, and households containing only full-time students or trainees are exempt from the tax altogether. Because the April 2007 reform entailed large changes in households’ bills, a system of transitional relief was introduced: for those whose bills are more than a third higher than they would have been under the old system, the increase is being phased in over a three-year period.

The next revaluation is due in 2012 based on 2010 valuations, after which the frequency of revaluations may be increased to ensure that the valuation list is kept up to date and that those experiencing relatively low house price growth see relative reductions in their rates.

³⁷ Further details of domestic rates in Northern Ireland can be found at <http://www.ratingreviewni.gov.uk/archive/domestic.htm>.

There may be further reform before this, however. In June 2007, the Minister of Finance and Personnel announced a review of the new system, looking both at reforms that might be made to the current system in 2008–09 and at longer-term options for more fundamental change.

5.3 Council tax benefit

Council tax benefit (CTB) is a means-tested social security benefit. It is administered by local authorities, but in contrast to council tax, its level is set by central government and it is financed almost entirely by central government. As of November 2006, it was being paid to 5.1 million claimants, around half of them pensioners, and claimants were receiving an average of £14.06 per week.³⁸

CTB is calculated by comparing a family's income with a centrally determined measure of minimum needs (which depends on age, whether single or in a couple, number and ages of children and any disability).³⁹ If family income is below this measure of need – or if the family is receiving income support, income-based jobseeker's allowance or pension credit guarantee,⁴⁰ which in practice accounts for most CTB claimants – then CTB covers the entire council tax liability. Where income exceeds assessed minimum needs, CTB is gradually withdrawn, with each £1 of income above this level reducing CTB entitlement by 20p.

'Non-dependant deductions' reduce the householder's CTB to take account of incomes of other adult residents of the household who are assumed to make a contribution towards the bill. No deductions are made in respect of residents who share liability for the council tax bill (see page 29) or pay rent to the householder on a commercial basis: typically, non-dependant deductions are made in respect of adult children or elderly relatives living with a home-owner. The level of deduction depends on the income of the non-dependants, with larger deductions for non-dependants with higher incomes who are in full-time work.

³⁸ Source: Department for Work and Pensions, *Housing Benefit & Council Tax Benefit Quarterly Summary Statistics: November 2006* (http://www.dwp.gov.uk/asd/asd1/hb_ctb/hb_ctb_quarterly_nov06.asp).

³⁹ Income for CTB purposes is measured after deducting income tax and National Insurance contributions and adding tax credits; actual savings income is ignored except for pension income, but non-pension savings (other than in housing or other physical assets) above £6,000 are assumed to generate income of £1 a week for each £250 of savings (£500 for those aged 60 or over), and savings above £16,000 eliminate entitlement altogether.

⁴⁰ For brief descriptions of these benefits, see D. Phillips and L. Sibieta, *A Survey of the UK Benefits System*, IFS Briefing Note no. 13, 2006 (<http://www.ifs.org.uk/bns/bn13.pdf>); for full details, see Child Poverty Action Group, *Welfare Benefits and Tax Credits Handbook 2007–2008*, 2007.

Income support (and other benefits such as income-based jobseeker's allowance and pension credit guarantee) aims to provide a national minimum income for all. Council tax benefit aims to ensure that this minimum income is maintained even after council tax has been paid.⁴¹ Council tax is the only UK tax with a specific benefit attached to it, the rationale being that poor households cannot be easily compensated for local variations in tax through nationally uniform benefits: without CTB, we would observe variations in the incomes of the poorest between local authorities. While it may be argued that those whose local authorities spend more receive more benefits in terms of local services, particular local services provided may not benefit a particular CTB claimant or reduce his or her need for disposable income.

For CTB claimants, council tax increases have no effect on the net amount of tax paid, since any excess of income over needs does not change: benefits increase to keep the net amount of council tax paid by the claimant the same. A local authority's decision to increase council tax has costly implications for central government, since not only will the CTB bill rise for existing claimants, but also more people will become entitled to the benefit as higher council taxes mean a greater excess income is needed for CTB to be withdrawn entirely.

Second adult rebate

Second adult rebate (SAR) is an alternative to the main council tax benefit: a claimant who is entitled to both receives whichever is larger. SAR is payable where only one person is liable for a household's council tax bill (see page 29) and there is a low-income non-dependant ('second adult') living in the household. A non-dependant for this purpose is defined as for non-dependant deductions (see above), and so excludes anyone paying rent as well as anyone jointly liable for the council tax bill. SAR reduces the household's council tax bill by 25% if the second adult is on income support, income-based jobseeker's allowance or pension credit, and is reduced as the second adult's income rises, to the point where it disappears. The logic behind SAR is that a low-income second adult could not be expected to contribute to the council tax bill, so the liable person should receive a 25% discount as if he or she were the only resident, with this discount removed as the second adult becomes more able to contribute.⁴² In practice, SAR is received by far fewer people than main CTB.

⁴¹ Housing benefit similarly seeks to ensure that the same minimum income is available after rent has been paid.

⁴² This logic is not quite consistent, however: an owner-occupier is eligible for SAR if he or she lives with both a commercial lodger and a low-income non-dependant, even though the owner-occupier would not receive the 25% single person's discount for council tax if the low-income non-dependant were not resident.

Criticisms of council tax benefit

Council tax benefit plays an important role in helping low-income families, but it has a number of downsides that have given rise to fierce criticism. One is that the means test creates disincentives to work and save, since additional income and assets can reduce entitlement. This is particularly pertinent when combined with taxes and other withdrawn benefits: in extreme cases, an extra £1 earned can be subject to income tax and National Insurance contributions and also lead to reductions in tax credits, housing benefit and council tax benefit, leaving the individual only 4½p better off.

As with other means-tested benefits, CTB is also criticised because its complexity and the stigma attached to it mean that many potential beneficiaries either do not know that they are entitled or are unwilling to claim it. The Department for Work and Pensions estimates that in 2004–05, between 32% and 38% of eligible families (and between 42% and 47% of eligible pensioners) did not claim their entitlement, and that around a third of total CTB entitlement went unclaimed.⁴³

It is also argued that CTB weakens local accountability. Since recipients pay none or only part of their council tax bill, they have little or no incentive to hold councils to account over their spending: they have an incentive to demand improved service provision from local government, because they will face no extra cost.

⁴³ Source: Table 4.1 of Department for Work and Pensions, *Income Related Benefits: Estimates of Take-Up in 2004/2005*, 2006 (http://www.dwp.gov.uk/asd/income_analysis/final0405.pdf).

6. Conclusions and options for reform

UK government finances are highly centralised by international standards, and the past 30 years have seen central government taking increasing control over the finances of local government. Perhaps the most important example is the centralisation of non-domestic rates in England and Wales in April 1990, which resulted in only around one-quarter of local authority spending being raised locally.

In recent years, the increasing use of specific grants for local government services – the most extreme example being the introduction of the Dedicated Schools Grant (DSG) in April 2006 – has continued a trend of increasing central control over local spending decisions. One result of the increased central control over local spending is that a larger proportion of councils' remaining discretionary spending is now financed by local taxation – achieving one of the objectives of the recent Balance of Funding Review,⁴⁴ albeit not in a way that was envisaged.

Local government finance has been the subject of perpetual reviews over the past decade. In Northern Ireland, a review resulted in reform, but the new system is now itself being reviewed. In Scotland, the Local Government Finance Review Committee (widely known as the Burt Review) recommended abolishing the council tax banding system and simply taxing a percentage of the value of each property⁴⁵ – similar to Northern Ireland's new system – but no action was taken, and debate over reform is ongoing.

In England, the Balance of Funding Review was followed by the Lyons Inquiry, which then had its remit expanded and end-date delayed twice, before finally reporting in March 2007.⁴⁶ The Lyons Inquiry recommended increasing local authorities' autonomy by reducing the degree to which grants from central government are ring-fenced, ending capping of council tax, and allowing councils to add a local supplement to business rates and to charge for domestic waste collection. It recommended retaining council tax, but proposed that:

- a revaluation of domestic property take place, and that subsequent revaluations occur regularly and automatically;

⁴⁴ See Department for Communities and Local Government, *Local Government Finance: Balance of Funding Review*, 2004 (<http://www.local.odpm.gov.uk/finance/Balance.htm>).

⁴⁵ See Local Government Finance Review Committee, *A Fairer Way*, 2006 (<http://www.localgovernmentfinancereview.org/report/docs/lgfr-report.pdf>).

⁴⁶ See *Lyons Inquiry into Local Government* (<http://www.lyonsinquiry.org.uk>).

- two new council tax bands be introduced throughout England, one at the bottom and one at the top, with the possibility of more bands being introduced in Inner London;
- council tax benefit be renamed and automated to try to increase take-up, and the capital limit above which pensioners lose eligibility for the benefit be increased or abolished.

If council tax is to be retained, a revaluation would be very sensible, and regular revaluations even more so. If a property tax is desirable, it is surely more sensible to base it on the current values of properties than on their values 16 years ago, as is the case now in England and Scotland. Regular pre-announced revaluations would make changes in individual bills less sharp and would enable individuals who are buying homes to take future council tax bills into account more easily.

As well as being up to date, it also seems logical that a property tax should be related as closely as possible to the actual values of properties. This could be done by adding more bands to allow finer discrimination (as happened in Wales and was recommended for England by the Lyons Inquiry), or, more radically, by doing away with bands completely and simply taxing a proportion of the actual value of the property (as happened in Northern Ireland and was recommended for Scotland by the Burt Review), which seems both fairer and simpler to understand than a banded system.

Either adding more bands or abolishing banding altogether – but especially the latter – would make the tax more progressive with respect to property values. Since, on average, those living in more expensive homes also have higher incomes, it would also make the tax more progressive with respect to incomes. There would, however, undoubtedly be some low-income individuals living in high-value properties who would lose from such a reform. This might increase concerns, already widespread with council tax, over whether it is right that some low-income families (notably pensioners) face a local tax bill that is high relative to their current income. To some extent, such people could be supported through a targeted benefit such as council tax benefit. But in any case, it is not obvious that those living in relatively expensive properties who have relatively low disposable incomes should necessarily be considered poor: set in the context of a tax system that already imposes much larger taxes on income and expenditure, a tax on property value might help to capture other complementary aspects of ability to pay, such as wealth or expected lifetime income. A slightly different concern is that, even if we do not think of such people as poor, they may lack the cash flow to pay the tax comfortably. Moving to a cheaper home or taking in a lodger are, of course, options; as a less extreme response, those who own their own properties might be able to use formal equity-release arrangements in order to remain in their home and finance their local tax bill, although if reasonable formal equity-release arrangements are not available on the marketplace, the government could

consider giving older home-owners the option to defer their tax until they die or the property is sold.

As noted in Section 4.1, a widely advocated means of increasing local authorities' fundraising autonomy is to return business rates to local control. The economic rationale for levying business rates at all is not clear: taxing the use of property – as opposed to other inputs – by businesses is an inefficient distortion towards businesses using less valuable premises to operate. But even if business rates persist, relocalising them would be problematic. There is a danger of reduced accountability: the true incidence of the tax is particularly opaque, and the individuals who ultimately bear the burden of the tax may not be aware of it or even live in the local authority concerned, leading to a lack of democratic checks on business rate increases. In addition, given that non-domestic property is far from evenly distributed across England, there would presumably need to be an even more redistributive system for allocating grants (for example, the tax base in cities would be far larger than the tax base in rural areas). This in turn could reduce accountability further, since local authorities would not lose revenue if businesses were driven out of the area by high tax rates. The alternative of not having a full equalisation system strengthens incentives for local authorities to run business-friendly policies, which is an argument often made in favour of relocalising business rates. However, the absence of full equalisation might over time come to be seen as increasingly unfair, as areas with high growth in their non-domestic-rate tax base would be able to spend more on local services at a lower cost to the local taxpayer than other areas. For example, introducing such a system in April 1993 based on fixed April 1991 property values would have benefited London (which has experienced relatively large increases in both non-domestic and domestic property values) over most other parts of the country even more than keeping council tax fixed on April 1991 valuations has.

A radical but welcome reform to either council tax or business rates (preferably both) would be a move away from taxing *property* values and towards taxing *land* values. This would remove the unwelcome distortion that property-value taxation causes by discouraging investment in developing land and in increasing the value of property.

The other major reform that was seriously considered by all the reviews of local government finance – although not recommended outright by any – is the introduction of a local income tax (LIT), either as an additional local tax or as a replacement for council tax. The latter is currently supported by the Liberal Democrats and by the Scottish National Party (which is now the single largest party in the Scottish Executive). The attractions of a LIT are obvious, with income commanding wide public support as a measure of an individual's ability to pay. On the other hand, there is a strong case for retaining some role for land or property taxation: as noted above, housing consumption can capture complementary aspects of ability to pay when used alongside income and expenditure (which are already taxed on a much larger scale nationally). In

addition, land/property taxes also cause less economic distortion than most other taxes: for example, they do not create disincentives to work in the way that an income tax does, although this advantage is offset by some of the disadvantages of means-tested council tax benefit discussed in Section 5.3. Land and property are also suitable as a local tax base because of their immobility: unlike others, this tax base will not tend to move between local authorities in response to differential tax rates.

In practical terms, a local income tax – whether introduced alongside or in place of a property tax – now seems a viable option, whereas the 1976 Layfield Report considered a LIT but concluded that the technology required would not be available for another 10 years.⁴⁷ Complexities remain over whether a local income tax should apply to all forms of income (which affects the ease with which the revenue could be collected), how to deal with the cyclical and unpredictability of tax revenues (since, currently, local authorities cannot plan to borrow to finance current expenditures), and whether there should be a cap on the amount of tax that would have to be paid (in order to avoid providing too strong an incentive for very high-income individuals to live in local authorities with the lowest LIT rates).

A local sales tax would not be allowed under current EU rules and in any case would be likely to lead to ‘cross-border’ shopping and economically inefficient tax competition. Finally, further environmental taxes, like the congestion charge in central London, could be introduced, but the Balance of Funding Review concluded that local taxes on bases other than income, sales or property would be unlikely to raise very large sums or make a major contribution to local government finance.

⁴⁷ Layfield Committee, *Report of the Committee of Inquiry into Local Government Finance*, Cmnd 6453, HMSO, London, 1976.