

Liberal Democrats Policy Consultation

Local Government Finance Policy

Consultation Paper 103

Clear Print Version



This consultation paper is presented as the first stage in the development of Party policy for local government finance. It does not represent agreed Party policy. It is designed to stimulate debate and discussion within the Party and outside.

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Comments should reach us as soon as possible and in any event no later than 30th November 2011.

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Contents

Contents	4
Executive Summary.....	5
Introduction	7
1.1 Policy background	7
1.2 Consequences of Localism.....	7
1.3 Local government resourcing.....	8
Local revenue raised	10
2.1 Local income tax	10
2.2 Local property taxes	13
2.3 Other taxes and revenues	16
2.4 Fees and charges	16
Equalisation and central funding	18
3.1 Equalisation	18
3.2 Central funding	22
Local financing.....	23
Appendix I.....	24
Appendix II.....	25

Executive Summary

Liberal Democrats strongly believe in localism – providing people and communities with the freedom, opportunities and resources to make decisions and manage their affairs. Within an effective and fair local democratic structure, localised control of resources is crucial for encouraging, supporting and delivering appropriate policies. This consultation paper outlines a potential basis for Liberal Democrat policy on local government finance and how this can support local communities to achieve better and fairer outcomes.

This paper sets out a four pillar approach for local government finance built on income tax, property tax, fees & charges and special local measures with a fair and clear equalisation mechanism to share resources between areas. This includes a hypothecation of locally-raised income tax revenues as a step towards a locally administered income tax. It includes a revised form of property taxation to make it more efficient (through basing it on undeveloped land values), targeting wealth and localising control of rates. It would also give public bodies a much freer hand to raise reasonable revenues for local preferences, characteristics and resources.

These changes would be balanced with a clearer and more equitable system to provide areas across the countries with the resources that they need. Central government would have a role addressing local need, change and innovation in partnership with local communities and governments. Local government would have much greater financial freedoms and flexibilities based on a wider and more diverse revenue basis, abilities to borrow and investment according to local requirements.

Below are the specific propositions for the foundations of fairer and more progressive local society:

- Local bodies to have discretion on the use of funds allocated to them for local activities and services, subject to local democratic control and reasoned assessment of the benefits and protections of local people and communities.
- Local authorities to have more balanced revenue streams based on income, earnings, activities and resource use.
- Local authorities to receive directly a hypothecated share of local residents' and workers' income tax and national insurance receipts as a progression towards a locally-determined income tax.

- Local residential and property taxes based on undeveloped land values of assets with rates determined by local authorities.
- Local authorities to be allowed to raise other taxes, fees, charges and revenues where there are the local opportunities to raise funds in innovative ways.
- Central government to retain a fund to support local needs, change and innovation through combinations of direct grants and matching funds to local authorities and other local bodies.
- Local government collectively in cooperation with central government to establish an understandable, predictable and sustainable equalisation system which provides both incentives for authorities to promote local growth while ensuring that all authorities have sufficient resources to meet the needs of the local people and communities.

Introduction

1.0.1 The government published in July 2011 the Local Government Resource Review consultation proposing local retention of business rates. The consultation is open until 24 October. Through the influence of Liberal Democrat ministers and parliamentarians, the propositions and questions cover some key local government issues for Liberal Democrats. However, the agreed propositions do not set out a complete restructuring of local government finance with some important Liberal Democrat objectives and issues not covered. Additionally, the Localism Bill is currently working its way through parliament with Liberal Democrats in both houses and in the wider party working hard to steer it in our direction. Both of these measures only take us so far in achieving our aims. We will continue to push for further reforms in the remainder of the Parliament and in our next General Election Manifesto. The Federal Policy Committee will be running a tax policy working group to develop and elaborate party tax policies. For these to be radical and practical, we need to agree what our key ideas are and how they could be implemented. This paper is an initial step to take forward that discussion.

1.1 Policy background

1.1.1 Liberal Democrats care deeply about the ability of individuals and communities to determine their own life paths and meet their potential, ensuring they have the freedom, responsibility and equitable resources to do so. We have a deeply rooted belief in the rights and abilities of local individuals and communities to make decisions for themselves. With greater freedom and control, communities can realise practical benefits through more innovative, tailored and sustainable local policies.

1.1.2 In recent years, localism has become a favourite topic across the political parties and the wider public sector, though there remains some disagreement as to what it encompasses. Lord Greaves and Lord Tope, in an amendment to the current Localism bill, define localism as “a political and administrative system and culture ... [where] each decision should be made at the lowest practical and effective level ... underpinned by basic rights for all persons ... [which] focuses public decision-making on bodies which are elected, representative and accountable” (see full definition in Appendix II). This definition has been used as the basis for this paper.

1.2 Consequences of Localism

1.2.1 Localism requires a clear understanding that power and its distribution, control and use is central to the way in which we live in our communities. Local powers are best used where there is strong case for different delivery and outcomes between places, close links between local costs and benefits and effective structures reflecting local communities' views and needs in decisions. Councils need to be able to access and control sufficient resources to deliver the required services and investments. Local bodies must be able to work with different service providers from the public, private and voluntary sectors and across public boundaries. Communities require sufficient opportunities and information to judge the local use of resources on their behalf. As Liberal Democrats, we want to return and secure as much of this power to people and their communities as is practical.

1.2.2 Local control over their localities has been seriously undermined for many decades and will take some significant political and social changes to shift. Local bodies need to move from local delivery bodies of national priorities to effective agents for their local population within a given national policy direction. Both formal and informal political systems need to formulate priorities and participate in agreeing rules and decisions. Delivery and cooperation structures must be designed for use by and for the benefit of individuals and groups from across the community, both those that share our Liberal Democrat political beliefs and those that do not. We need to establish ground rules which ensure a solid foundation for all communities to make effective decisions while protecting individuals' rights and needs.

1.2.3 Individual, community and national levels must better engage with each other. Successfully dealing with important social, economic and environmental issues usually requires cooperation and coordination of activities and resourcing. Communities, central government and collective local government should welcome and encourage greater and deeper collaboration between organisations and across boundaries (both geographic and sectoral).

1.3 Local government resourcing

1.3.1 Access to and control of public resources is crucial for successful service delivery. As Liberal Democrats, we want to increase significantly the share of resources which are determined and controlled at local levels rather than being under monopoly control of central authorities. Local responsibility and delivery requires sufficient and appropriate resources to achieve the local areas' strategic objectives. Resource measures – both taxes and charges – can also be useful tools to address wider policy goals, e.g. behavioural change towards more sustainable patterns of consumption. Resources need to be linked to meeting clear public objectives so that people can understand

how resources are being used on their behalf and for their benefit. This information will help enable them to respond effectively as constituents and at the ballot box.

1.3.2 Empowered local governments, supporting a wide range of communal interests, need a broad, flexible and robust tax base linked to the local area. Such revenue bases allow different authorities to raise revenues which best reflect and support local circumstances and strengths. Local areas should not have to rely entirely on their own resources where these are insufficient to meet their needs, however. Equalisation based on total funding packages is required to ensure that no area is trapped in a cycle of deprivation and need. Over time, communities would be expected to implement more appropriate and locally-driven policy and improvements which could improve economic and social performance. However, realistically there will always be an important social and economic role for a fair and efficient redistribution between different communities. The key outcome is to ensure that all places have the resources needed to provide their residents with good and appropriate services at a reasonable cost.

1.3.3 The levels and effective control of funds by local government institutions is a crucial factor in delivering the services which impact on local area outcomes. The means through which these resources are directed and used to address particular issues is vital. Local authorities need greater certainty and control over the finances to allow them to better design and plan their services. There should therefore be an agreed set of rules through which local authorities, with the Local Government Association, determine an allocation system that is fair, transparent and practical. The system would allow central and local government to update and amend the formula as circumstances and preferences change.

1.3.4 Increasing local revenue resources and capability would be a real advantage in opening up the ability of local communities to invest effectively in their communities and economies both through direct funding and through borrowing. With greater control over resources, they could develop financing mechanisms which work best for their circumstances. They would no longer come to central government to play off competing claims with other localities to secure additional funding. Instead, councils could show potential lenders, including pension funds, the risks and returns that they could expect to receive for their investments. Central government support would support investments which were innovative or addressed long-term development of areas in need.

Local revenue raised

2.0.1 Local authorities raising more of their revenues enables greater local control of resources and better alignment of costs and benefits (especially wider costs). Issues would need to be addressed, though, around differing resource bases between locations, cross-boundary impacts and the potential for concentrated risks related to local financial mismanagement and misfortune.

2.0.2 This paper outlines a revenue system involving both local income and wealth (through property holdings). The local government revenue system would be based on four pillars: (i) income taxes (both residence and workplace), (ii) property taxes (both residence and businesses), (iii) fees & charges and (iv) specific locally appropriate schemes. This approach complements wider Liberal Democrat party tax policy to shift more taxation towards wealth and to the local level while retaining links to the ability to pay and flexibility to match circumstances.

Question:

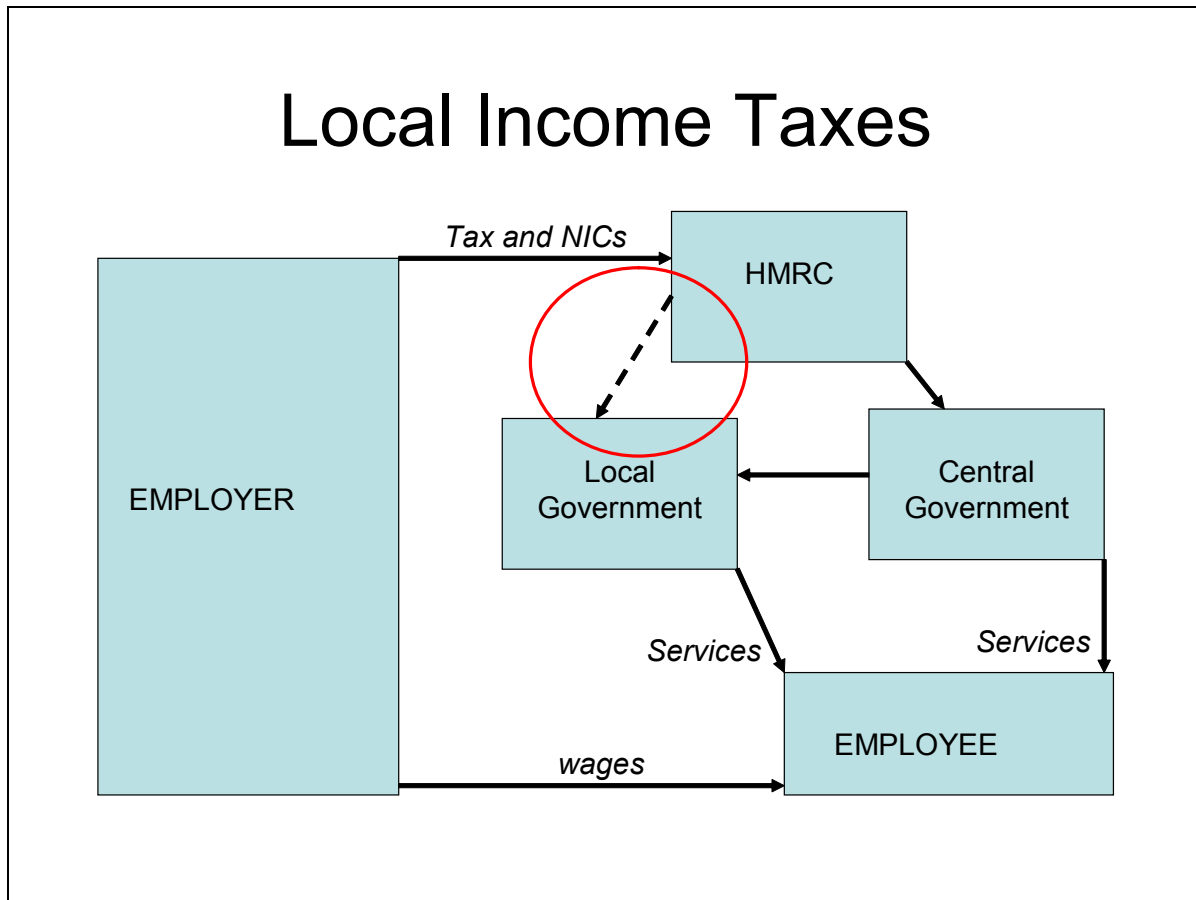
1. Does the 'four pillar' approach of income tax, property tax, fees & charges and specific local taxes provide a good basis for local government finance? If either fewer or more approaches were considered, what are the trade-offs between simplicity and a broader tax base?

2.1 Local income tax

2.1.1 Those who can afford to pay should make a greater contribution. Income taxes need to make a significant contribution to local government revenues reflecting the ability of their communities and economies to support their services. The Liberal Democrat position is that there should be a locally-variable income tax.

2.1.2 However, in the short-term, to increase local financial control and responsibility, we could directly allocate a share of local income tax receipts to local government on a formula basis. In addition, because the tax base should also be linked to those who make use of services, whether or not they reside in the local area, we could allocate a share to authorities on both a residential and workplace basis. These would be raised through the existing PAYE system to collect the tax with the only additional requirement for

taxpayers to provide postcodes for their primary residence and workplace. There would be no additional tax burden on the economy as this is simply a re-routing of revenues directly to local authorities. The diagram below shows how the new system would work with the local income tax transfer to local authorities represented by the circled dashed line. This approach would not raise the overall total level of taxation, but simply give greater local control over a share of the existing revenues.



2.1.3 The revenues raised would be included in the local government equalisation so overall resources are more fairly and effectively apportioned across the country. This would build local government's capacity to handle increasing shares of resources to prepare them for the responsibility and potential of an ultimate switch to a fully local income tax.

Question:

2. Is the approach of dividing income tax between an individual's place of residence and work a useful one? If so, what split between the local authorities should be looked at, e.g. 50-50, based on associated costs?

Residents:

2.1.4 A share of basic income tax would be allocated directly to local councils based on receipts raised from local residents. A fixed level for all taxpayers across the country would be suggested initially, which HMRC would pay directly to councils from central collection. Over time, this could be made more flexible for local areas to set the rates.

Workers:

2.1.5 On a similar basis as with residents, a fixed share of employer national insurance contributions would be assigned to local authorities (though this could be income tax instead). These would be allocated to the local authority where the person was normally based. As with residential income tax, receipts would be collected by HMRC and then allocated directly to local authorities. Again, there could be an evolving scope for local authorities to be able to set their own rates.

Question:

3. Are there concerns about the democratic mandate with regard to workplace based taxes if people are not eligible to vote in the local authority where they work?

Net Impact:

2.1.6 A dual workplace and residence income tax system allows different areas to use their individual economic and social strengths to support their activities. The local area tax base, which supports services used by residents, commuters and visitors, would no longer simply be provided on the incomes of their “midnight”¹ population but also on their “noon-time”² population as well. Important economic centres, such as Manchester, would receive 2½ times as much in workers’ income tax contributions as from local residents’ income tax, reflecting the extent of highly-skilled inward commuting. More residential areas, such as the Wirral, would receive about twice as much in residents’ contributions as from local workers. There are also often significant differences in income levels between local workers and residents. For Derby, the median worker earns £27,340 whereas the median employed resident earns £21,794³. It seems unfair that the lower earnings residents of Derby should alone have to bear the city’s costs which also benefit the wider Derby labour force. This approach helps to balance the costs with services provided

¹ Those people who sleep in the areas, i.e. residents

² Those people who spend their daytimes in the areas, i.e. non-commuting residents, commuters from outside, visitors

³ ONS. Annual Survey of Hours and Earnings 2010

as local workers benefit from many council services, such as highways, sanitation and police, which they may not always contribute to directly.

2.1.7 A consistent national rate would remove the financial incentive for residents and businesses to choose one authority over another simply on the impact on their tax bill. However, in this case, where councils have successfully used their resource base to build strong residential and business locations, people and companies would be attracted to them, expanding their tax base organically. Over time, we could move to a more flexible local system as used in Scotland where councils or groups of councils could adjust income tax rates around a central level. This could give much greater autonomy as strong local government develops.

Question:

4. How should we progress from a consistent national rate for local income taxes to allowing greater local freedom over rates of tax? Should we simply move to complete local flexibility? Or could we consider a series of bands?

2.2 Local property taxes

2.2.1 Liberal Democrats believe that we need to balance taxes on earnings, profits and consumption with measures that include wealth. As a key step towards shifting the tax system towards wealth, this paper focuses on making local residential and commercial property taxes fairer and more efficient.

2.2.2 This paper outlines a move to a land value tax based on the unimproved value of land to encourage more efficient land use. Alongside locally-based income tax, property taxation would shift from the unfair non-domestic rates and outdated council tax to a land taxation system, with differential rate for residential and business property. Councils would be able to balance their receipts from residential and businesses sources to fit local circumstances, capacities and needs. This idea not only increases local authority control but also has an important distributional, efficiency and environmental impacts.

2.2.3 In many ways, implementing a land value tax would be much easier than current assessments as modern techniques could use continually updating Land Registry data to value parcels in specific areas. This would enable the system to capture land value uplifts in closer to real time. We would need to shift the legal responsibility for the tax onto the property owner, as opposed to the resident, to cover parcels with multiple occupancies. This

requires primary legislation but would be an equivalent shift to the end of domestic rates in 1995.

Residential property:

2.2.4 Council tax based on 1991 valuations would be replaced by a residential property tax based on regularly assessed land value. The system could be based on banding to limit disputes on individual assessments (though this could still be an issue around the boundaries of the bands).

2.2.5 Liberal Democrats believe that local authorities should be free to set their own levels of property tax, based on democratic leadership, but that revenue equalisation would be based on charging a typical rate, i.e. a notional rate (see box below). This enables councils that have taken difficult decisions to keep additional revenues raised without worrying about losing equalisation funds but also prevents other councils from subsidising tax cuts through the equalisation system.

2.2.6 There is a strong need to move towards a more constant and consistent valuation system for residential property, rather than the current fossilised rates. An appropriately trained set of assessors would be needed, as well as an appropriate framework for them to operate within. We could build on the continuing experience of Northern Irish domestic rates to design an effective system.

Questions:

5. Is an improved residential property tax an appropriate means to taxing personal wealth? What allowances and reliefs should local councils be required to apply?

6. Should assessments be based on unimproved land values or the value of both the land and buildings?

7. Reflecting 2010 manifesto policy, should we introduce, in addition to the revised local property tax, a 1% national levy on residential properties valued at more than £2 million which would be allocated to local authorities based on their need?

Business property:

2.2.7 This paper suggests shifting the basis of non-domestic rates from rentable value of land and buildings to a system based on regularly assessed

land value. The system could be based on banding to limit disputes. Local authorities would have ability to adjust rates but would also need to show that they had assessed the impact on different types of businesses and properties.

2.2.8 A system similar to that outlined on domestic property rates could be used for business rates, including land-value assessments. This would encourage sustainable and efficient business land usage while also incentivising investment in buildings and properties. Land-value would be assessed on the current permitted use value to allow land with significant restrictions, e.g. green belt, would be taxed at a rate reflecting their current – and not higher potential - price. The implementation of a minimum level of value to area could be considered, which could protect agricultural and similar land with low average values from excessive charges. However, we would look for a much flatter tax rate to ensure that we support business activity, though we might want to consider some specific reliefs for start-ups and micro-businesses. The implications for derelict and abandoned properties would also need to be carefully considered. Councils could have similar freedom on business rates as with property taxes to adjust them as they see appropriate, subject to a shadow rate for equalisation. In the longer-term, the business and domestic rates could be brought onto a similar platform with only the rates paid on values differing.

Questions:

8. Should assessments be based on unimproved land values or the value of both the land and buildings?

9. Is it appropriate to use a de minimis average rate below which the tax would not be applied which would largely protect agricultural and rural land holdings?

10. Should councils be allowed or required to provide concessions on business property taxes for specific sectors and activities where the financial return in relation to land-value may be low but the wider social value is higher, e.g. rural shops and pubs, derelict buildings brought back into community use? If so, how could these concessions be structured and applied?

11. What would be the interaction between localised land value taxes and the wider policy and planning goals on desired geographical form, i.e. more dense versus more distributed developments?

2.3 Other taxes and revenues

2.3.1 Local councils should have the right and ability to raise additional taxes that they see appropriate for their circumstances. Not all places would be able to apply each levy, but this should not block those that were willing and able. Councils could also raise revenues to cover the costs of specific extra costs and services that they bear. For example, a small per drink surcharge in town centre bars and pubs, borne by drinkers themselves, could offset additional policing and health costs that drinkers impose on councils, and therefore residents, in many towns and cities. There are likely to be many other opportunities which councils should be free to consider and implement (subject to other legal constraints).

2.3.2 Where developments in the locality impact on the local environment, local residents and business should share in the value created and be compensated for any disruption and loss of amenity. Examples could include wind farms, new development which increases through-traffic on local roads and noise and light pollution from new transport, e.g. high speed rail or airport expansions. This could be through a combination of one-off fees, continuing charges and investments in kind. These funds could be distributed either directly to residents or used by the local authority and other representative bodies to provide additional services and/or lower charges and taxes.

Question:

12. Is it acceptable that some councils may be able to raise additional revenues using specific local circumstances and resources which may not be available to others?

2.4 Fees and charges

2.4.1 Councils will want – and should – charge users for some of their services. As a party, we recognise the need for those that can to contribute to public services used while protecting the vulnerable. Local authorities need to have the freedom and incentives to charge most users for appropriate services, such as swimming and video rentals, while protecting free access for particular services (e.g. schools) and users (e.g. the unemployed). Councils should be encouraged to charge appropriate levels of fees and charges where appropriate to offset costs and influence behaviour while ensuring that protections for access are in place. For financial purposes,

reasonable fees and charges could be treated in a similar way to property taxes and business rates in equalisation by establishing a notional level of fees and charges that a council would be expected to collect based on national averages and local circumstances (see box below). Councils that chose not to charge typical rates for services would need to find the funds from elsewhere in their budgets rather than relying on cross-subsidies from other councils. Those that chose to charge for more services would be able to use these resources on other council activities.

Question:

13. Should councils be given additional freedoms and flexibilities to raise or lower a wider range of fees and charges to meet local needs and preferences? What services should be free at point of use as a matter of national policy (eg. as is already the case for borrowing library books?)

Equalisation and central funding

3.0.1 While local authorities need to have a broad degree of control and influence over their financial resources, there is a need to ensure that a reasonable share of resources can be equitably and effectively distributed between areas based on their needs. This paper therefore outlines a system of revenue equalisation and a small but continuing role for central government to address these issues. These areas can become very technical, and this paper consciously remains at the level of principles rather than getting into the exact details of rates, levels and amounts. These would need to be modelled in greater detail if the general direction is supported.

3.1 Equalisation

3.1.1 Given the significant differences in local area revenue-raising opportunity, especially with regard to need, there is the need to have a clear and stable equalisation system to shift resources from the wealthiest to the neediest areas. As Liberal Democrats, we believe that all areas need to have suitable resources to have the ability to meet their responsibilities and potential. This requires a degree of reallocation.

3.1.2 CLG's current 'black box' funding regime, where councils wait for Whitehall civil servants to establish their settlement through some complex and unclear formula, could be eliminated, with local government given a clearer revenue stream and responsibility. Central and local government together need to agree and to manage equalisation of resources using a transparent system resulting in equitable and sensible outcomes for all authorities – rich or poor, rural or urban. This should be set out as a publicised formula which would apply across a number of years. The equalisation needs to apply across the whole of local government revenues, e.g. from income, property, other taxes and fees and charges, so that differences between the mix of revenues between councils balance out where applicable. In order for this to operate effectively and fairly, there is a need to provide protections where councils are responsible for setting their own rates from others who might manipulate the system. This would be through a notional rates structure as set out in the box below.

Question:

14. How should the equalisation system be established? Is the collective local government 'family' the right body to determine and manage equalisation? Should this instead be under the control of a separate body, independent of both central and local government?

Notional Rates

Protecting councils from others playing the equalisation system is a vital consideration. To do so, a notional rate for council tax and fees & charges could be established which would serve as the baseline for the equalisation mechanism. It is not a restraint on council actions but rather provides them with the foundation to make difficult but appropriate financial decisions. Without these protections, councils who chose to raise council tax rates or fees & charges levels to provide for improved local services would see these additional revenues taken away through the equalisation system. Conversely, councils that chose to slash taxes and fees & charges could be excessively subsidised through the equalisation system.

Example I: Council A – which is exactly average on its financial activity - decides to charge more for evening swimming sessions in order to provide subsidised swimming training for children on weekends. Without a notional fees & charges rate, the additional finance raised would be assessed as new income and force them to pay more into the equalisation fund thus limiting their ability to provide the training.

Example II: Council B decides to remove all charges for planning applications. Without a notional fees & charges rate, the Council would be able to claim that it has fewer resources relative to its needs and would therefore be able to claim more from the equalisation fund which would come from councils that were charging their residents fairly.

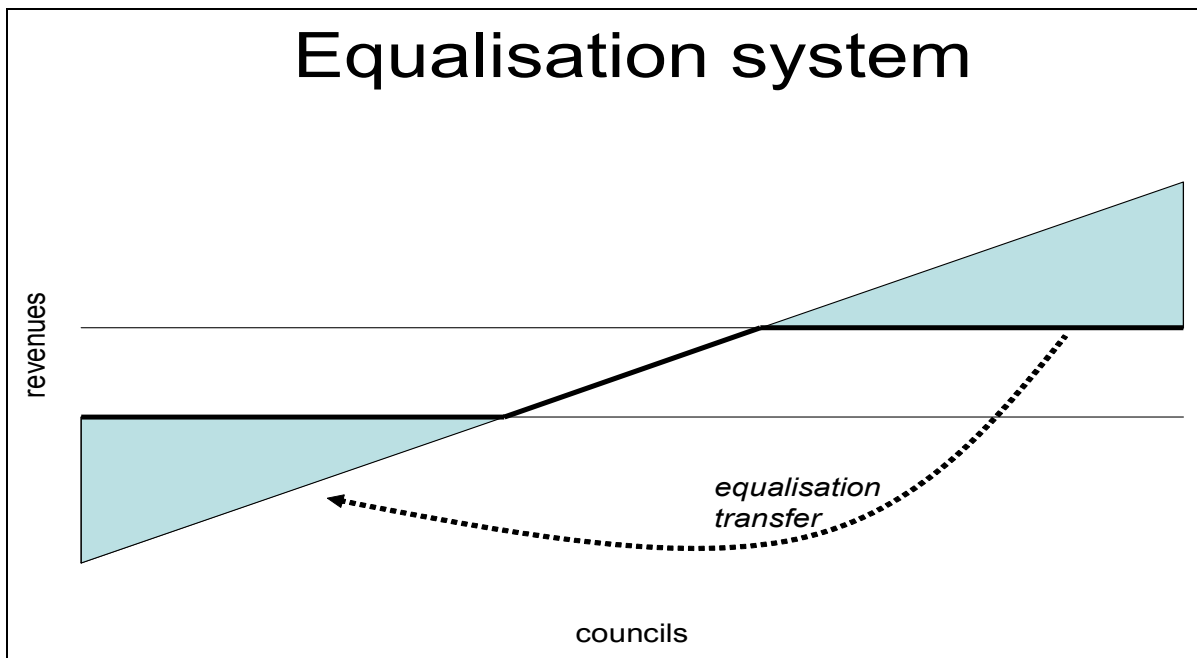
Question:

15. Are notional rates an appropriate protection for local councils to use the equalisation system in a fair and appropriate way?

Proposed Approach:

3.1.3 This paper outlines the establishment of a floor-and-ceiling mechanism for local authority equalisation. This would ensure that all councils received a minimum revenue level which would be funded by transferring funds from councils who have reached the ceiling or, if there is a “taper” formula, are approaching the ceiling. All councils would be guaranteed revenues on a per resident basis (adjusted for various components of need, daytime population and other circumstances) at some set percentage of the median income per head.

3.1.4 The diagram below shows how the system could work with councils arranged from lowest to highest average revenues across the horizontal axis. In the system, every council's revenues from the range of sources (including adjustments for notional rates for locally determined rates) would be determined. This would then be allocated on a common per head basis which would make adjustments for the structural demands and needs on the local council, based on deprivation, transport patterns, regional role, etc. This would provide all councils with an assessed need which could be compared relatively to the national average requirement.



3.1.5 The equalisation would not necessarily be a simple transfer from those areas with the highest revenues to those with the least. Instead, it would transfer resources to those councils with the greatest excess need from those with more resources than their needs required. Areas with high revenues but also high needs (e.g. city centres) would probably not be net contributors whereas wealthier suburban areas might contribute more from small revenue bases. The equalisation system should be focussed on addressing structural and longer-term differences between local areas needs and circumstances. More pressing and innovative needs would be addressed through the central government role set out in 3.2 below. Appropriate levels for the floor and ceiling would need to be decided after modelling the full impacts. However, initial work suggests that, because of the highly skewed distribution of locally raised revenues towards the highest earners, a floor level close to 90% or 95% of the median value of the undistributed revenues could be realistically considered.

3.1.6 Between the floor and ceiling, councils would retain additional revenues. There could be a scheduled approach as with income tax rates. Councils just above the floor level could retain all their additional revenues, whereas those closer to the ceiling would contribute a share of each additional pound to the central pool for redistribution. This approach would reward authorities between the floor and ceiling who strengthen their financial position and tax base while ensuring sufficient funds was provided for meeting the needs of poorer authorities.

3.1.7 The exact formulation for calculating the equalisation system and the component indicators would need to be determined and agreed by local authorities and central government working together as there are any number of possible iterations. It would need to consider whether it needed to provide (i) a perfectly equitable system where all councils received according to their assessed need, (ii) a system that ensured a guaranteed minimum provision to all but allowed councils to retain some of their additional resources once all councils had met the minimum, or (iii) some balance between the two. The first iteration will be the hardest as subsequent changes can always be compared to the then applicable system. Having determined the adjusted revenues for all councils, those with revenues above the ceiling would put their extra resources into a redistribution pool (represented by the right-hand blue triangle in the diagram below) which would then be transferred to those councils whose resources were below the floor rate (represented by the left-hand triangle below). Councils would then have resources between the floor and ceiling (represented by the bold line). In practice, transferring resources would be done through a centralised system working with HMRC and others.

Modelling:

3.1.8 The Liberal Democrat Policy Unit have undertaken some modelling on 2008/2009 local government finances, using actual business rate and council tax data plus estimated local residential and workforce income tax bases from NAO data.

3.1.9 A baseline assessment⁴ found less than 10% of revenues would need to be redistributed between authorities. The vast majority of money would stay where it was raised. Even using a much stronger adjustment for differing needs, more than 85% of revenues would remain where raised.

3.1.10 Sixty-eight council areas would be net contributors to the redistribution scheme – though the funds would not be coming from current budgets, rather from revenues paid to HMRC. Seventy-five would be neither

⁴ Parameters used were a 125% ceiling and 95% floor with a 60% 'tax rate' between 115% and 125% of median per head revenues

net contributors nor receivers. Two hundred and eleven councils would be net recipients from the system.

3.2 Central funding

3.2.1 Central government – with the involvement from collective local government – continues to have a role to address local need, change and innovation. This role is vital to ensure that we can deliver a reasonably fair series of outcomes while ensuring that local areas have real freedom and responsibility for their affairs. By using the national level and the resources at its disposal, these two fundamental Liberal Democrat beliefs can be balanced. Under this approach, central government funding would support local authorities which:

- Face significantly high levels of deprivation and need.
- Who need medium-term transitional support to manage changes in circumstances and to transition to more sustainable pathways.
- Who are innovating new policies and delivery channels; probably best done through a match-funding system where every partner contributes to the funding (though the shares would differ between particular schemes).

3.2.2 These funds would be split between direct grants and matched funds. Direct grants would support the neediest authorities. For policy innovations and central government objectives, funds could be offered to councils conditional on them providing some level of contribution. This would help central government to distinguish which local government partners and policies would be the most cost-effective for them to support and also incentivise local governments to put their most valued projects forward at realistic costs. To give an idea of the potential scale of these funds, central government retaining 10% of 'local government' funding (based on 2008/2009 figures) would provide £11 billion to support local bodies, initiatives and investments.

Questions:

16. Is it appropriate for central government to continue to maintain a role in local government finance? If so, how should this role be set?

17. Do matching funds have a useful and appropriate role to play in the relationship between central and local governments?

Local financing

4.1 To make the best use of improved revenue streams, local government should have greater financial freedoms and flexibilities. In particular, councils and other bodies should have the ability to borrow against future tax revenues in order to invest now in required infrastructure. We need to move beyond the fear of what councils might do if given the ability to invest and instead welcome what they could do. It would not be a free-for-all as councils would need to meet certain financial requirements and provide a risk-reward trade-off that met the needs of lenders. This paper therefore suggests that HM Treasury allows a certain share of council borrowing to be issued as tax-free bonds. This would be financially-neutral across government but would be a significant cash savings for local authorities and their lenders.

4.2 A borrowing regulatory framework that makes legal borrowing capacities contingent on individual council's financial status and performance would help to protect individuals and communities from financial mismanagement. Councils with the strongest financial bases would be able to extend their powers while those with tighter financial positions would not be allowed to over-extend. The objective would not be to steer policies or actions but to balance the freedoms of local councils to act in their areas' best interest with financial protection for local residents and national taxpayers.

Questions:

18. Is a finance covenant between local authorities and central government the right approach to manage risk? If so, what criteria needed to be included and what limitations applied?

19. Would the ability to issue tax-free bonds make local government finance more flexible, affordable and responsible? How attractive would these be to lenders? What other mechanisms should be considered to raise and leverage finances?

Appendix I

International Examples:

All the approaches proposed above are actively used in various countries across the world with success. Many US cities raise local income taxes which are based on both residential and workplace basis. Swedish municipalities raise much of their own resources through income taxes which are allowed to vary. Australian local councils raise land rates on residential properties based on the assessed land value. Some Swiss cantons have specific taxes on public entertainments tickets to cover the costs to the wider public. Germany distributes income, value added and corporate taxes between the federal, state and local levels, based on a clear and equitable system that is enshrined in their constitution. This is by no means an exhaustive list of applications but rather to show that all the proposed measures are already up-and-running in places which have shown a far greater respect for localism than England.

Appendix II

Lord Greaves and Lord Tope's amendment to the Localism Bill, 20 June 2011:

Purpose of this Act

(1) The purpose of this Act is to promote a political and administrative system and culture which—

(a) is based on the principle that each decision should be made at the lowest practical and effective level, and that where there is a conflict between decisions at a higher or more local level there is a presumption that the local level will prevail unless there are clear and over-riding reasons why it should not,

(b) is underpinned by basic rights for all persons and safeguards against arbitrary discrimination against any person,

(c) focuses public decision-making on bodies which are elected, representative and accountable,

(d) may incorporate minimum standards for the provision of public services that may be established by parliament, government, and elected bodies at a higher level than that at which decisions are made, but otherwise welcomes diversity of provision on the basis of locally determined needs and preferences,

(e) includes a restriction against regulations and orders by government and bodies at higher levels than the minimum absolutely necessary,

(f) shapes the structures of local government in ways that are designed to facilitate the involvement of local citizens, individually and as members of their communities and neighbourhoods,

(g) welcomes and encourages the involvement of local citizens in the design of such structures and participation within them, and

(h) encourages the formation of bodies by local citizens in which they may organise to influence public decision-making, take part in processes of local governance and help to provide local services.

(2) A public body or public official shall when acting under the provisions of this Act have regard to the political and administrative system and culture described in subsection (1) above.

(3) In subsection (2) “public official” means a government minister or employee, or an employee of any body responsible for making decisions on behalf of the government or a local authority.