

# Council tax increases 2003/04

Why were they so high?

**The Audit Commission** is an independent body responsible for ensuring that public money is spent economically, efficiently and effectively, to achieve high-quality local and national services for the public. Our work covers local government, housing, health and criminal justice services.

As an independent watchdog, we provide important information on the quality of public services. As a driving force for improvement in those services, we provide practical recommendations and spread best practice. As an independent auditor, we monitor spending to ensure public services are good value for money.

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## Summary

This report is an attempt to clarify the real issues behind the council tax rises in 2003/04. We believe that a better common understanding of the issues will ensure a more serious engagement between politicians at a national and local level about how they should be addressed. We also believe this will lead to a more informed public engagement with issues affecting council tax rises.

The average increase of 12.9 per cent in council taxes in 2003/04 was the highest since council tax replaced the poll tax in 1993/94. It was 4.7 per cent higher in 2003/04 than 2002/03.

Increases of this level – with a majority of people facing percentage increases in council tax bills in double figures – have a major impact on citizens, particularly those on low or fixed incomes.

The increases were caused by a variety of factors, but there were two principal reasons. First, spending by councils went up by more than had been allowed for in the grant settlement. Second, the effect of the grant regime – whereby 75 per cent of funding comes from central government – was that each 1 per cent councils added to spending above amounts allowed for in the grant settlement increased council tax by 4 per cent.

We found the causes of increased spending by councils included:

- cost pressures such as pay and price increases, increases in national insurance contributions, and increased pension costs;
- additional demand pressures, including, for example, the need to provide social services to increasing numbers of elderly people;
- national policy priorities, such as the requirement to increase funding for schools by an amount determined by government or to meet national waste recycling targets; and
- local policy priorities, such as additional spending on highways.

Work by council auditors found the increases in spending in local government – which averaged 9 per cent – justifiable; but they were not in all cases unavoidable.

Different councils responded to spending pressures in different ways, with some managing budget increases by reducing spending and increasing charges and others using council tax increases as the main way of funding spending pressures. Councils as a whole also reduced their use of balances, partly in response to external expectations that councils would maintain balances at a prudent level.

We also looked at the impact of changes to grant on council tax increases. The 8 per cent national increase in grant for local councils was more than in previous years.

But grant redistribution – which moved grant from London and the south to the midlands and the north – led to some councils putting up council tax more than others. We found a clear association between the size of grant increase a council received and their increase in council tax.

There was, however, no causal relationship between budget and council tax increase and the political parties running the councils. Councils which received lower grant increases generally increased council tax more than those that received higher grant increases, regardless of the political party running the council.

We found that increases tend to be higher in authorities that are not directly elected – 13 of the 20 highest increases in council tax were agreed by police authorities.

There are a number of external pressures on councils to increase spending, and therefore council taxes. These include:

- public expectations that services will improve;
- pressure from central government to spend more to meet government priorities; and
- the role of inspectorates and other regulators in requiring councils to meet more demanding standards.

There is evidence that this additional spending provides better services for the public – for example, improvements found by the Social Services Inspectorate in the provision of social services, and additional funding for road maintenance.

But our report finds there is insufficient countervailing pressure to keep council tax increases down. This came in part from the perceived reduction in the threat of capping, but the main reason was that double-figure increases in council tax were no longer seen as exceptional.

Our report makes recommendations for changes in the short to medium term, including:

- **for government** to increase certainty about future allocations of resources; to provide greater transparency about factors taken into account in grant increases; to reduce direct control over councils through targets and continue to reduce ring-fencing of grants; and to recognise that public engagement is more likely to achieve a balance between council tax rises and service provision which is acceptable to citizens than use of capping powers.

- **for councils** to improve processes for delivering efficiencies in service delivery and carrying out longer-term financial and service planning; to ensure that council appointees to non-elected precepting bodies exercise their duty to protect taxpayers' interests effectively; and to communicate and consult with the public more effectively about council tax and spending decisions.
- **for inspectors and auditors** to increase the focus on efficiency; to balance recommendations for service improvements with the requirements to keep spending within levels which are acceptable to the public; and to indicate clearly the cost implications of recommendations.

Auditors will consider risks relating to authorities' budget-setting processes as part of their audit work for 2004/05; and there will be increased emphasis on cost effectiveness in future rounds of comprehensive performance assessment.

But the study also found that there are fundamental problems with the way council tax operates. Small changes in spending – up or down – can have a big impact on council tax rises. There is a lack of accountability through the grant system – with councils making decisions on how money is spent but central government providing 75 per cent of the funding. And the system is too complex for local citizens to understand.

The review that the Local Government Minister, Nick Raynsford, is chairing on the future funding of local government needs to address fundamental flaws in the local tax system for councils to be able to fully engage citizens in key decisions that affect their lives.

# Introduction

Council tax in England increased by an average of 12.9 per cent in 2003/04.<sup>1</sup> This was the highest increase since council tax was introduced in 1993/94.

There has been considerable public debate about the increases and, in particular, the impact on people with low or fixed incomes.

The Audit Commission is in a unique position to comment on council tax increases. We are an independent body with responsibility for promoting the best use of public money; we have unrivalled access to information about how councils set their budgets and spend their money; and we have expertise in funding of public services.

It is difficult for anybody outside local government circles – and many within these circles – to understand why council taxes should rise by double digit figures when inflation is running at around 2.5 per cent. Part of the explanation of this is that the system is complex and in many cases counter-intuitive.

These debates are not helpful from the citizen's point of view. The choices between spending on services that matter to people and the taxes that are raised to fund these services have a fundamental impact on citizens. But the debate itself often clouds the issues.

This report uses national research and the findings of external auditors to analyse:

- the main factors underlying the 12.9 per cent average increase in council tax in 2003/04 (Chapter 1);
- the wide variation between individual local authorities' council tax increases in 2003/04 (Chapter 2); and
- the underlying causes of higher council tax rises in 2003/04 than previous years (Chapter 3).

The report uses this analysis to develop a series of recommendations in Chapter 4 aimed at local authorities, central government and inspectorates (including the Commission itself).

<sup>1</sup> The increase in council tax referred to throughout Chapter 1 of the report, and in references to regional changes in Chapter 2, is the increase on a Band D property in an area. It covers council tax raised by the council that sends out the bills (district council in county areas, single tier councils elsewhere) and the precepts for other authorities covering the area (county councils, police and fire authorities, and the Greater London Authority). Other references in Chapter 2 to council tax or precept increases are to increases by individual councils or precepting authorities.

# 1

## Main factors underlying the 12.9 per cent average increase nationally

### Introduction

- 1 On 1 April 2003 council tax rates for England increased on average by 12.9 per cent – from £976 per Band D property for 2002/03 to £1,102 per Band D property for 2003/04.
- 2 This was the highest average increase since the council tax system began in 1993. **Exhibit 1** illustrates the percentage annual increase in average Band D bills from 1998/99 to 2003/04.

#### Exhibit 1

#### Percentage increase in average Band D council tax bills for England

Council tax bills increased by 12.9 per cent in 2003 – the highest since the system began in 1993.

Percentage increase



Source: CIPFA Finance and General Statistics 1998/99 – 2003/04

- 3 This Chapter looks at the causes of the increases at a national level. It identifies the factors that contributed to the overall increase in council taxes, the extent to which this was to do with councils as a whole spending more or government funding being inadequate, and the differences in 2003/04 compared with earlier years.

## Factors contributing to the increase

### 4 Causes of council tax increases can be divided into three main groups:

1. the level of support the government provides in its annual finance settlement, which is based on assumptions about what local government will spend to meet local and national needs;
2. decisions by councils to spend more than the government assumed when determining grant distribution; and
3. the gearing factor which means any variations from the assumptions in the grant settlement are magnified.

#### I Primary sources of information in Table 1 are as follows:

- Average council tax in 2002/03 and 2003/04 – CIPFA Finance and General Statistics
- Assumed national council tax increase – ODPM Local Government Finance Settlement Papers 2003/04
- Impact of local government spending increase above assumed levels – derived from ODPM Local Government Financial Statistics England No.14 2003
- Impact of reduced use of balances – derived from ODPM Local Government Financial Statistics England No.14 2003

II Other factors, including changes to the council tax collection rate and changes to surpluses and deficits on council tax collection from previous years, were fairly constant at an aggregate national level and therefore did not affect the council tax increase.

III Prior to 2003/04, formula spending shares were known as standard spending assessments.

IV In 2003/04, this calculation was affected by the decision of the government to replace standard spending assessments (SSAs) with formula spending shares (FSSs). In converting SSAs to FSSs, the government made adjustments to 2002/03 figures to take account of large differences between what councils actually spent on services and SSAs (known as resource equalisation).

**Table 1**

### Components of the council tax increase

	£	Percentage
<b>Base council tax level – 2002/03</b>	<b>£976</b>	<b>–</b>
Increase due to:		
– assumptions used to distribute grant in the local government finance settlement	£36	3.7%
– impact of increases in local government spending above assumptions in the finance settlement	£77	7.9%
– reduced use of balances	£13	1.3%
<b>Total increase</b>	<b>£126</b>	<b>12.9%</b>
<b>New council tax level – 2003/04</b>	<b>£1,102</b>	<b>–</b>

Source: Audit Commission<sup>I, II</sup>

### Assumptions in the local government finance settlement

#### 5 The government builds in assumptions about spending and council tax rises when it makes decisions about how much support to allocate to local councils in the annual finance settlement. It does this by:

- making an assessment of increases in formula spending shares (spending assumptions used in allocating grant);<sup>III</sup>
- deciding how much of this will be met by government grant; and
- assuming that the balance will be met from council tax.

6 In 2003/04, the government increased formula spending shares by 5.5 per cent. They also increased specific grants (that is grants that are paid directly to councils as well as the general formula grant) by 16.2 per cent, leading to a total increase in spending allowed for in the local government finance settlement of 7.1 per cent.<sup>IV</sup>

- 7 The Office of the Deputy Prime Minister (ODPM) calculated that councils as a whole would have to raise an additional 4.4 per cent in council tax to pay for spending increases in line with formula spending shares and specific grant increases. Allowing for estimated increases in the number of council taxpayers of 0.7 per cent, the assumed average increase in council tax was 3.7 per cent.
- 8 In other words, if councils had increased their spending by 7.1 per cent in line with assumptions used for grant allocation in the local government finance settlement – and other things, such as the use of council balances to support council tax increases did not change – the council tax increase would have been 3.7 per cent on average. This is above target inflation of 2.5 per cent but well below the actual average council tax increase in 2003/04 of 12.9 per cent.
- 9 Appendix 1 sets out the calculation of the average increase in the assumed Band D council tax used in the 2003/04 local government finance settlement.

### Spending by councils

- 10 Spending by councils increased significantly above the spending increases used in calculating grant allocations in the local government finance settlement. The local government finance settlement included assumed spending increases of 7.1 per cent. In fact, budgeted spending by local councils increased by 9.0 per cent,<sup>1</sup> 1.9 per cent more than the assumption in the local government finance settlement. This added £1.3 billion to the amount that had to be collected from council tax – equivalent, at a national level, to an average of £77 on a Band D council tax bill.
- 11 In addition, councils reduced support for spending from balances by £221 million. This added the equivalent of £13 to the average Band D council tax bill.

### The gearing effect

- 12 The percentage increase in spending translates into a significantly higher percentage increase in council tax. This is because council tax meets around 25 per cent of spending by councils. This means that, for each 1 per cent added to spending, there is an average increase of around 4 per cent in council tax. It also means that for each 1 per cent reduction in spending, there is an average 4 per cent reduction in council tax.
- 13 The 1.9 per cent increase in spending above assumptions in the local government finance settlement therefore added around 7.9 per cent to the increase in council tax. In addition, the 0.4 per cent added to spending as a result of reduced use of balances increased council tax by a further 1.3 per cent.
- 14 **Table 1** above shows how the different elements of the council tax increase, which when translated into percentage terms become magnified because of the gearing effect, contributed to the 12.9 per cent average increase in Band D council tax from £976 in 2002/03 to £1,102 in 2003/04.

<sup>1</sup> There is no generally accepted way of calculating increases in local government spending. The calculation depends on the treatment of specific grants, balances, and changes in functions and responsibilities. The approach we have taken – to include specific grants and adjust for changes in functions and responsibilities – allows comparison with assumptions in the local government finance settlement.

## Causes of the spending increases

- 15 The analysis of components of council tax increases shows that the most significant element was increases in local government spending compared with the assumptions in the local government finance settlement. The impact of additional spending on council tax was reinforced by the gearing factor.
- 16 Why did councils increase spending by more than the amount allowed for in the local government finance settlement? After all, the local government finance settlement already assumed an increase in spending of 7.1 per cent, well above the target inflation rate of 2.5 per cent.
- 17 One of the difficulties in carrying out this analysis is that the government itself does not set out the basis on which it comes to its decisions on what to allow for in the local government finance settlement. Does it allow for new pressures on local government spending as a result of its own policies? What allowance does it make for external factors affecting councils such as the increase in employers' national insurance? And to what extent are assumptions about achievement of cost effectiveness targets included?
- 18 In the absence of information on the basis for the settlement, we have looked at cost pressures that underlay increases in spending in local government, including pay and price inflation and increases in employers' national insurance contributions.<sup>1,11</sup> We have also considered factors that may have led to increased demand, including general increases in population and pupil numbers.
- 19 These national cost pressures taken together account for about £2.3 billion of the total increase in councils' spending of £4.3 billion. In other words slightly more than half the total increase is due to national pay and price inflation, increased national insurance and general population growth.
- 20 Evidence gathered by auditors from those councils that increased their spending most showed that a range of other factors were putting pressure on spending at a local level. These included:
- local cost pressures – such as local demographic changes, increased (non-teaching) pension fund contributions, and loss of income from investments due to falling interest rates;
  - impact of national policy decisions – such as passporting of schools' funding and spending on recycling to meet national targets; and
  - impact of local policy decisions – such as additional spending on highways.
- 21 **Table 2**, overleaf, shows spending increases at a national level compared to the assumptions used for grant allocation purposes in the local government finance settlement. The increases exclude spending funded from specific grants. The table demonstrates that increases in spending above increases in formula spending shares occurred across services. The largest differences were in police and highways. But

I It has not been possible to analyse in detail councils' planned spending between pay and goods and services because those figures will not be available until councils have closed their accounts for 2003/04. However, it is possible to estimate costs on the basis of past patterns of spending and the estimated impact of each of the increases.

II This does not include increases in contributions to teachers' pensions – they are accounted for in adjustments to functions and responsibilities in 2002/03 base figures.

education accounts for almost half of total spending in local government and therefore has the largest overall increase in spending – albeit that it was only marginally above the provision in the local government finance settlement.

**Table 2**  
**Spending increases compared to government assumptions**  
**– 2002/03 to 2003/04**

	Formula spending shares			Local government spending plans			Difference between increase in FSS and local government spending plans £bn
	2002/03 adjusted £bn	2003/04 £bn	Increase £bn	2002/03 adjusted £bn	2003/04 £bn	Increase £bn	
Education	23.5	25.0	1.5	23.9	25.6	1.7	0.2
Social services	10.6	11.2	0.6	10.7	11.3	0.6	0.0
Police	4.1	4.1	0.0	4.2	4.7	0.5	0.5
Fire	1.7	1.8	0.1	1.7	1.9	0.2	0.1
Highways	1.9	1.9	0.0	1.9	2.3	0.4	0.4
EPCS <sup>I</sup>	11.1	11.6	0.5	11.3	12.0	0.7	0.2
Capital financing	2.0	2.3	0.3	1.2	1.4	0.2	-0.1
<b>Total (before use of balances)</b>	<b>54.9</b>	<b>57.9</b>	<b>3.0</b>	<b>54.9</b>	<b>59.2</b>	<b>4.3</b>	<b>1.3</b>
Use of balances	–	–	–	-0.5	-0.3	0.2	0.2
<b>Total (after use of balances)</b>	<b>54.9</b>	<b>57.9</b>	<b>3.0</b>	<b>54.4</b>	<b>58.9</b>	<b>4.5</b>	<b>1.5</b>

Source: Audit Commission<sup>II</sup>

<sup>I</sup> EPCS is environmental, protective and cultural services.

<sup>II</sup> Primary sources of information in Table 2 are as follows:

- 2002/03 and 2003/04 government spending assumptions (excluding specific grants) – ODPM Local Government Finance Settlement Papers 2003/04.
- 2002/03 and 2003/04 budgeted spending and use of balances – ODPM Local Government Financial Statistics England No.14 2003.
- Adjustments to 2002/03 spending assumptions and budgeted spending based on adjustments in ODPM Local Government Finance Settlement Papers 2003/04.

## Education spending

**22** The Audit Commission is currently carrying out a study into education funding that we plan to publish in the spring / early summer of 2004. The study is focused on addressing two key questions:

- how far do the changes in the arrangements for funding local education departments and schools for 2004/05 and 2005/06 announced by the Secretary of State go towards addressing the problems experienced earlier this year?
- what are the practical steps local education departments and schools can take and are taking to plan and manage their finances better under the new arrangements?

- 23 There are a number of factors that form the backdrop to this study including the impact of the requirement that councils increase spending on schools at a local level in line with government assumptions made nationally (passporting); the effect on different councils and schools of the transfer of money previously paid through the Standards Fund (to meet specific educational needs) into mainstream funding; and the changes to the basis for allocating the education element of formula grant to local councils.
- 24 Analysis by the Chartered Institute of Public Finance and Accountancy (CIPFA) shows that the total amount that was provided in the local government finance settlement for education was sufficient to meet increased education costs at an aggregate level, with a real 'uncommitted' increase in spending of £225 million (although, as CIPFA point out, this was equivalent to under 1 per cent of local government spending on education).<sup>1</sup> However, the combined effect of the passporting requirement, designed to ensure that all councils increased spending in line with government requirements, and local choice to spend above the passported amount, led to spending in aggregate increasing by £0.2 billion more than the government had allowed for.

### Spending on other services

- 25 There is less direct government pressure to increase spending on other services, although government targets and expectations have played a part in the increases.
- 26 Councils have also been responding to local spending pressures. There is evidence of real improvements in services, some of which could be accounted for by budget increases. For example, star ratings for social services announced in November 2003 showed an increase from 42 per cent to 60 per cent in the proportion of councils that received 2 or 3 star ratings compared to a year before.
- 27 The additional spending on highways reflects councils' response to local public pressure. Councils have historically underspent on highways – with spending squeezed out by other higher profile national services. In 2003/04, highways spending went up by almost 20 per cent, more than any other service.
- 28 Another area where spending increases were significantly in excess of government spending assumptions was police. The formula funding share and planned local government spending for police shown in Table 2 above does not include police formula grant or other specific grants, which fund over 50 per cent of police spending. Police formula grant went up from £3.8 billion to £4.1 billion, an increase of 7.1 per cent. In addition there were increases in other specific grants, such as the Crime Fighting Fund grant. However, police spending increased by £0.5 billion more than this. Chapter 2 sets out some of the reasons for this increase and also shows that there were considerable differences between police authorities.

<sup>1</sup> From *An introductory guide to education finance* published by CIPFA, available at [cipfa.org.uk](http://cipfa.org.uk).

## What made 2003/04 different from earlier years?

- 29 One of the issues we investigated is whether there is a significant difference between the pressures councils faced when setting council taxes in 2003/04 and setting council taxes in 2002/03 to see if this explained the increase from average council tax increases in 2002/03 of 8.2 per cent to the average increase of 12.9 per cent in 2003/04.
- 30 We compared the components of the council tax increase in 2003/04 with the components in 2002/03. This shows that the principal factor causing the difference in average council tax increases between the two years was the significantly higher variation in 2003/04 between increases in council spending and the assumptions in the local government finance settlement.

**Table 3**  
**Components of the council tax increase in 2002/03 and 2003/04**

	2002/03		2003/04	
<b>Increase due to:</b>				
– assumptions used to distribute grant in the local government finance settlement	£38	4.1%	£36	3.7%
– impact of increases in local government spending above assumptions in the finance settlement	£33	3.7%	£77	7.9%
– reduced use of balances	£4	0.4%	£13	1.3%
<b>Total increase</b>	<b>£75</b>	<b>8.2%</b>	<b>£126</b>	<b>12.9%</b>

*Source: Audit Commission<sup>1</sup>*

I Primary sources of information in Table 3 are as follows:

- Average council tax in 2001/02, 2002/03 and 2003/04 – CIPFA Finance and General Statistics.
- Assumed national council tax increase – ODPM Local Government Finance Settlement Papers 2002/03 and 2003/04.
- Impact of local government spending increase above assumed levels – derived from ODPM Local Government Financial Statistics England No. 13 2002 and No. 14 2003.
- Impact of reduced use of balances – derived from ODPM Local Government Financial Statistics England No 13 2002 and No. 14 2003.

II Increases in pension fund contributions in 2003/04 were generally lower than in 2002/03, although some councils made interim adjustments or had to fund phased increases resulting from the 2001 pension fund valuation.

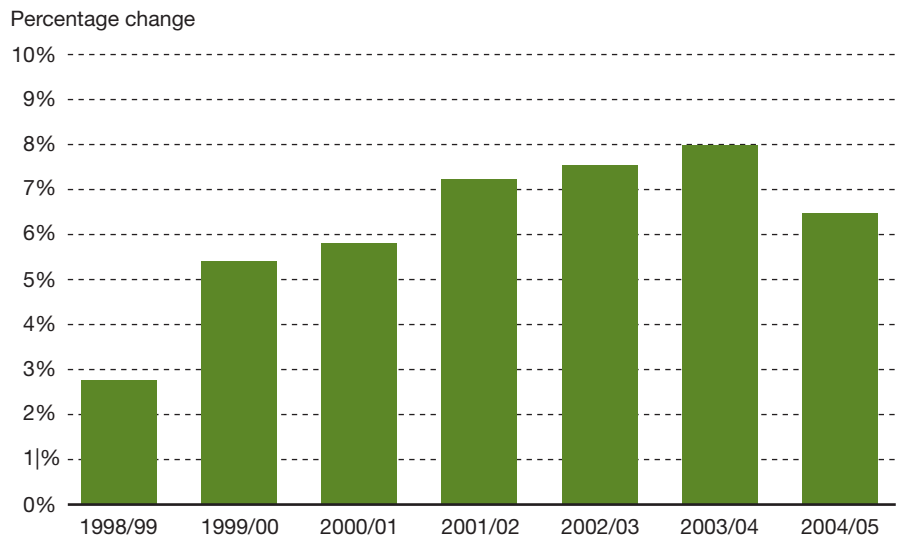
- 31 There were a number of factors that led to greater pressure to increase spending in 2003/04 than in 2002/03. Employers' national insurance contributions increased by 1 per cent; employers' contributions to the teachers' pension fund increased by 5 per cent; and the pay award for local government staff was around 0.5 per cent above what it had been in the previous year. Together these factors contributed to more than half the total increase in local government budgeted spending in 2003/04.
- 32 But there were also factors that would have led to higher increases in 2002/03 than 2003/04 – for example, in 2002/03 councils had to budget on average for an additional 1 per cent for an increase in employers' contributions to their own pension funds following the triennial valuation of pension funds in 2001.<sup>II</sup>

33 The significant issue is whether the government allowed for these increases in the local government finance settlement. While we have noted above that the government is not explicit about what it has allowed for, the increase in government funding – at 8 per cent – was higher in 2003/04 than in previous years (**Exhibit 2**). Without knowing the underlying assumptions, we cannot know whether this was sufficient to meet the additional spending pressures.

**Exhibit 2**

**Increase in central government funding for local government 1998/99-2004/05**

Central government funding increased more in 2003/04 than previous years.



Source: ODPM Local Government Finance (LGF) Settlement papers

## What conclusions do we draw?

- 34 The conclusion (confirmed by the work of our auditors set out in Chapter 2) is that budget increases were justifiable. Authorities faced a combination of pressures: national and local cost increases, increased demand for services, and government requirements. They also had their own local priorities to meet.
- 35 There is however a difference between increases being justifiable and increases being unavoidable. Authorities have choices about which priority growth areas they fund, what budget reductions they agree, and the charges they raise for services. They also can feel under more or less pressure to deliver efficiencies.
- 36 In 2003/04, authorities appeared collectively (although not necessarily individually) to feel less pressure to keep down spending increases than they had in previous years. The impact of spending increases on council tax rises was magnified by the effect of the 'gearing' factor.
- 37 Chapter 2 looks in more detail at what was happening in individual authorities, including reasons for variations in spending and council tax increases. The following section (Chapter 3) then considers what factors might have led to authorities collectively increasing spending – and therefore council tax levels – more in 2003/04 than in previous years.

# 2

## Why did the increases vary so much?

- 38 While the national council tax increase in 2003/04 was, on average, 12.9 per cent, increases around the country varied significantly. Figures varied from a 57.3 per cent increase for the London borough of Wandsworth down to council tax decreases of around 3 per cent for the district councils of Harlow and Swale.<sup>1</sup>
- 39 2003/04 saw a much wider variation in council tax and precept increases than in previous years. The highest increase for metropolitan councils was 19.9 per cent and the lowest was 2.3 per cent, a range of 17.6 per cent. In 2002/03 the highest increase was 9.1 per cent and the lowest was a decrease of 3.0 per cent, a range of 12.1 per cent.
- 40 This Chapter summarises the reasons for the wide variations in council tax increases between local authorities across England. The major factors that we have identified are:
- the local government finance system; and
  - the impact of local spending and financing decisions.
- 41 The Chapter also covers the relationship between council tax increases and the timing of elections, comprehensive performance assessment (CPA) category and party political control.

## The local government finance system

- 42 Three features of the local government finance system appear to have contributed to the wide variation in council tax increase in 2003/04. These are:
- the effect of 'gearing';
  - the redistribution of grant funding; and
  - the effect of differing service responsibilities.

### Gearing

- 43 Differences in gearing levels lead to wide variations in council tax or precept increases between authorities which have similar increases in budgeted spending. There are three reasons why gearing might be higher in one place than another, which are as follows:
- high needs;
  - low resources; and/or
  - historically low levels of council tax.

<sup>1</sup> Figures quoted here are the council tax rises of individual councils. In the cases quoted, they do not include the effect of increases in precepts by precepting authorities.

- 44 Across England in 2002/03 the percentage of local government spending met by the council tax varied from just over 60 per cent in the case of some district councils, down to just under 11 per cent. This large variation is most obvious in the case of London boroughs. Wandsworth, which combines a historically low tax with relatively high needs, has a gearing ratio of approximately 9:1 (meaning just 11 per cent of its expenditure is met by council tax), while Richmond has a gearing of approximately 2:1.
- 45 This variation has a large impact on the scale of the council tax increase. The following theoretical example demonstrates the effect of gearing at individual council level (**Table 4**).

**Table 4**  
The effect of gearing on two otherwise similar local authorities

	Authority X	Authority Y
Spend on services 2002/03 (£m)	100	100
Met from: council tax	60	10
Gearing ratio	1.7:1	10:1
Spend on services 2003/04 after 'real' increase of 2 %	102	102
Met from: council tax	62	12
<b>Percentage increase in council tax</b>	<b>3.33%</b>	<b>20%</b>

### Box A

#### Changes in grant distribution in 2003/04

The main reasons for the changes in grant were:

- changes to the way additional costs in London and the south east are allowed for;
- the use of population figures based on the 2001 population census;
- increased weight given to deprivation in the calculations; and
- resource equalisation, aimed at bringing government aggregate spending assumptions on services into line with what local government was spending in aggregate.

There were other formula changes affecting individual services.

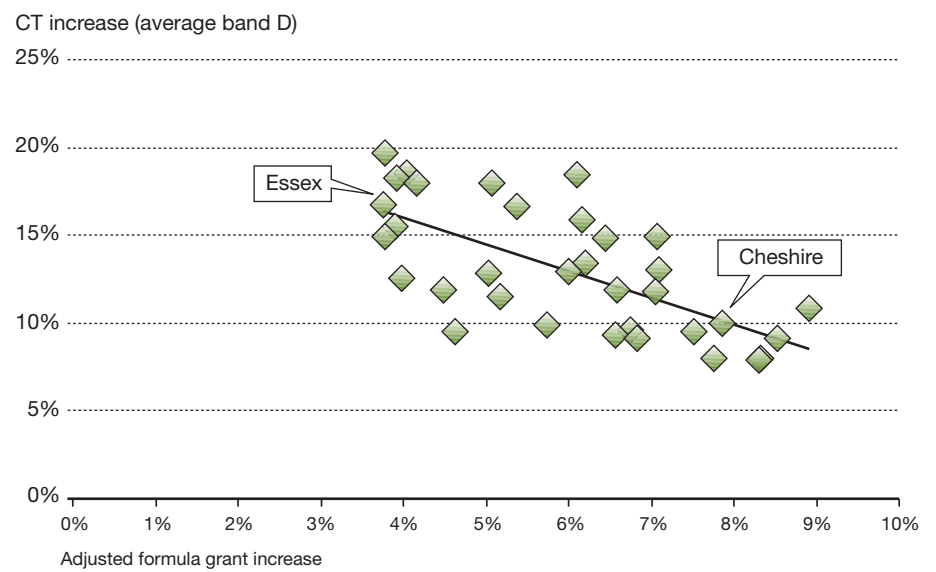
#### Redistribution of grant funding

- 46 The 2003/04 local government finance settlement included the outcome of the review of grant distribution which introduced formula changes following a four-year moratorium. The new system resulted in redistribution of grant between authorities. The government continued to use a system of floors and ceilings to moderate this, involving restricting the maximum and minimum possible grant increases. There were still, however, wide variations in how much grant increase councils received.
- 47 In the case of district councils, the majority received grant increases either at the floor (3 per cent) or the ceiling (12.5 per cent). In the main, districts appear to have been able to absorb this variation by tailoring their budget increases to the grant increases (those with low grant increases have tended to set lower budgets and vice versa). Consequently, council tax increases for districts at the floor are only slightly higher than for those at the ceiling.
- 48 In contrast, single tier and county councils, which are responsible for the vast majority of local government expenditure, have been less able to change budgets in response to formula grant variation. Grant increases ranged from 3.5 per cent to 8.5 per cent for these councils and there is clear evidence that this variation has been reflected in council tax increases. **Exhibit 3** demonstrates this relationship for one type of authority – county councils.

**Exhibit 3**

**The relationship between grants and council tax in county councils**

There is a clear link between formula grant increase and council tax increase.



Source: Audit Commission

- 49 A similar relationship to that shown above exists for single tier authorities, though the degree of scatter is greater.
- 50 Essex and Cheshire received very different increases in grant yet they both increased budgets by 12.1 per cent and are a useful comparison. **Table 5** below demonstrates the consequent impact of formula grant on council tax in each.

**Table 5**

**Example of county council tax increases**

	Essex	Cheshire	Difference
Grant increase (adjusted for service transfers)	3.8 %	7.9 %	4.1 %
Budget increase (including impact of service transfers)	12.1 %	12.1 %	nil
Council tax increase (average band D)	16.7 %	9.9 %	6.8 %

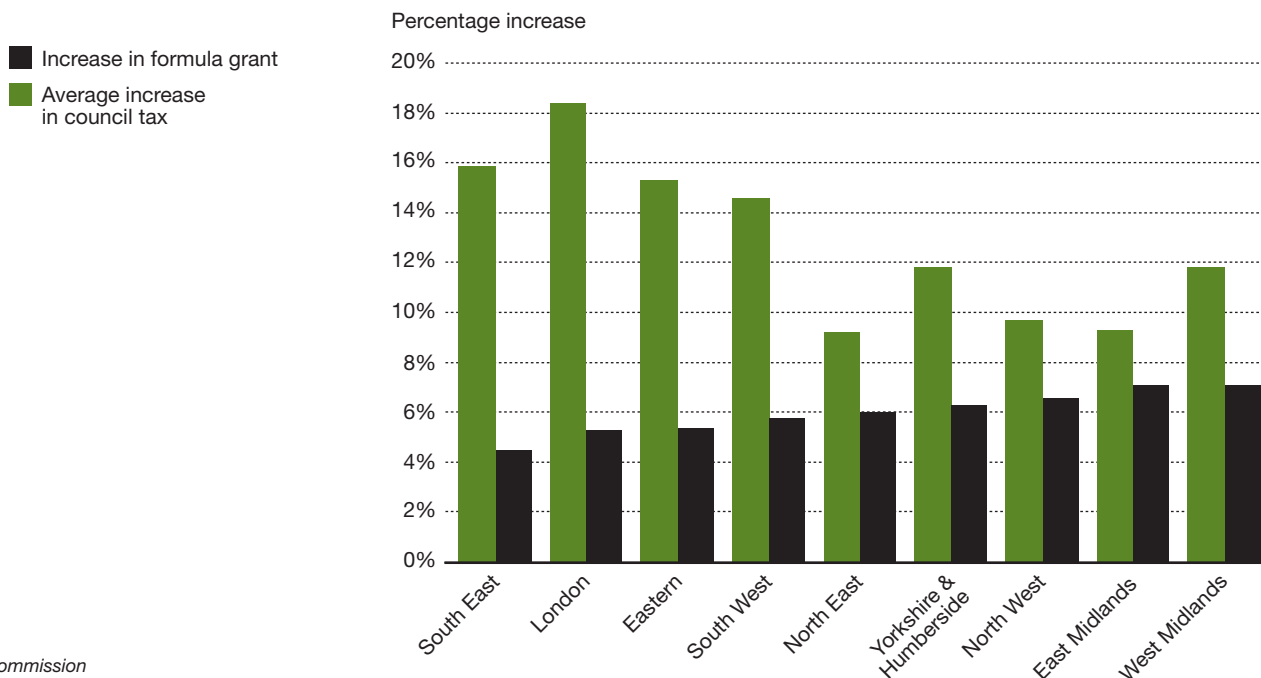
51 One of the reasons for the difference in the levels of council tax increase between the two authorities was different levels of grant increase received. In order to achieve Cheshire’s lower council tax increase, Essex would have had to reduce its spending expectations by some £26 million, bringing its budget increase to 9.7 per cent – lower than all but one county council.

52 There are also regional differences. Some regions of the country did worse as a result of grant distribution and some did better and this was reflected in relative council tax rises. **Exhibit 4** compares regional increases in funding with average increases in council tax. A general pattern emerges which shows that regions in the south with lower grant increases had higher average council tax increases and those in the midlands and north with higher grant increases had lower council tax increases – although there are exceptions where regions which appeared to do relatively well from the grant changes had relatively high average council tax increases.

### Exhibit 4

#### Regional funding increases, compared with council tax increases

There are regional disparities in grant and council tax increases.



Source: Audit Commission

#### Differing service responsibilities

53 Different local authority services face very different financing problems that, when combined with the differing structures of each body, can cause significant variations in council tax increases. For example, the pressures on the provision of environmental services, with new regulations relating to recycling in recent years, are very different

from those on a police authority facing the need to recruit additional officers to meet policing targets and to pay for an unfunded pension scheme.

- 54 These different service pressures, combined with the fact that different types of local authorities across England provide different combinations of services (**Box B**), can lead to a wide range of spending increases. This does not have an impact at individual taxpayer level – all services are provided in all areas – but it can affect the council tax/precept increase for different types of authority.

### Box B

#### Selection of services provided by different types of local authority

Type of authority	Typical services provided
Metropolitan councils, London boroughs, unitary authorities	Education, social services, highways, housing, environment, library and leisure services, benefits, council tax collection.
County councils	Education, social services, highways, library services, fire and rescue (some).
District councils	Housing, environment, leisure services, benefits, council tax collection.
Police authorities	Police.
Fire authorities (metropolitan and some county areas)	Fire and rescue.

#### Police authorities – a special case?

- 55 Of the top 20 highest increases in precept/council tax,<sup>1</sup> 13 are police authorities. The particular issues that police authorities face include the following:
- police authorities provide a single service. In multi-function authorities, service pressures in one area are more able to be offset against savings elsewhere. This does not however rule out reallocation of resources within a service or the achievement of efficiency savings.
  - service pressures range from those outside the control of the authority (such as unfunded pension schemes) to costs that are within authority control, but driven in part by national demands and public pressure (for example, recruiting additional police officers to meet public expectations).
  - police authorities have a relatively high gearing ratio (typically between 4:1 and 5:1), which causes small budget increases to have a disproportionate effect on the precept increase.

<sup>1</sup> Precepts are raised by authorities that do not directly bill for council tax, such as police authorities. The precepts are added to the billing authority's council tax to produce total local council tax bills.

- 56 In addition, police authorities are not directly elected which may make them less susceptible to public pressure to keep down their precept. They also, as precepting authorities, do not have responsibility for collecting the tax so are less directly affected by direct pressure from council taxpayers.
- 57 There were significant differences in spending and precept increases in police authorities. North Yorkshire police authority increased its budget by 22.7 per cent and precept by 76.1 per cent; Merseyside police authority increased its budget by 5.3 per cent and its precept by 7.2 per cent.<sup>1</sup>

## The impact of local decisions

### Local spending decisions

- 58 It is for each individual local authority to decide how much to spend on its services. These decisions will be influenced by a number of national and local factors. The different approaches taken and decisions made can make a significant difference to local council tax. These different approaches are magnified by the effect of gearing. A decision to spend 1 per cent more adds 4 per cent on average to the council tax/precept that has to be raised; conversely, a decision to spend 1 per cent less reduces the council tax/precept that has to be raised by 4 per cent on average.
- 59 The local decisions made by each authority are influenced by a wide range of factors. Local spending pressures in a particular area, for example the costly renegotiation of a waste management contract to deal with recycling targets in one district council area, might lead to widely varying council tax increases between neighbouring, apparently similar authorities.

### Local financing decisions

- 60 Every authority has a different approach to budget setting and the way in which it plans to finance the budget pressures it faces. Our research has shown a wide variation in the way in which authorities have financed the expenditure pressures they are facing locally. Three specific examples of differing budget decisions are:
- the use of balances;
  - identification of savings; and
  - changes to income and charges.

### Use of balances

- 61 Every local authority has balances of some description. Authorities hold these to protect against unforeseen circumstances, and many also use them to smooth the effects of budget and grant changes from one year to another. In difficult years they may choose to use up some of their balances to support their budgets and keep local council tax increases down, in easier years they may contribute to balances to

<sup>1</sup> Police authorities cover more than one council area. There can be differential impact on different councils within the police authority's area depending on how high overall council tax is in the area and the tax base of the area.

replenish what has been used or to build them up for future years. Maintaining adequate balances is prudent for authorities; and the criteria used in auditor judgements in CPA and legislative changes in the 2003 Local Government Act have reinforced this. So in practice councils reduced their use of balances in 2003/04 in a year when they might have been expected to increase use of balances to limit council tax increases.

### Identification of savings

- 62 Councils are required under the 1999 Local Government Act to deliver continuous improvement through the application of best value, including the identification of savings through more economic, efficient and effective ways of delivering services. Savings can also be achieved by reducing the level of non-priority services.
- 63 The extent to which savings are available will depend on a number of factors including:
- the scale of savings identified and achieved in earlier years. Are there further efficiencies available?
  - the type of service. It is difficult to make reductions in service provision in high profile and highly regulated services such as police and education, although this does not rule out budget reductions as a result of efficiency savings.
  - the relative priority that the council attaches to limiting the council tax increase as compared to the impact of potential services reductions.
  - the political and managerial will to drive through changes.
- 64 Central government controls over service spending can limit the incentives for councils to redirect spending if resources cannot be used for other purposes. One of the advantages of reducing ring-fencing is that it will allow councils to look more critically at spending across the board – although passporting in education continues to limit this.

### Raising money from fees and charges

- 65 The funds available to local authorities from charging for services are small compared to grant funding and council tax. However, changes to fees and charges can have a significant effect on council tax levels due to the gearing effect (**Case study 1**).
- 66 The ability of local authorities to raise additional money from fees and charges is influenced by a number of key factors, including:
- their legal ability to charge for the services they provide;
  - the incidence of 'chargeable' services; for example, authorities in the centre of London, other population centres, and tourist areas have greater ability to raise charges than other areas;
  - the extent to which charges fit in with corporate strategies and policies such as town centre regeneration or anti-poverty policies; and
  - the impact on demand for services.

#### Case study 1

One northern metropolitan authority budgeted to generate additional income from charges and fees equivalent to 1 per cent of its net revenue budget overall. This represented a 4 per cent reduction in council tax.

- 67 A new power for Best Value authorities to charge for discretionary services was contained within the Local Government Act 2003. This increases the flexibility available to authorities for future years' budgets.

### Local choice

- 68 Councils make local choices. Some increases in spending are unavoidable but the choice about whether those are to be met by reducing spending on other services, increasing charges or increasing council tax are ones councils make. Our auditors found that spending increases – and consequential council tax increases – were justifiable. But the fact that different councils reacted in different ways means that they were not unavoidable.
- 69 The following example (**Box C**) demonstrates the effect of differing spending and financing decisions on the tax increase at two similar single tier authorities.

## Box C

### Local spending decisions

#### Introduction

Authority A increased its council tax by 5 per cent in 2003/04, while Authority B increased its council tax by 13 per cent. They spent similar amounts in 2002/03 and both received similar percentage increases in formula grant.

#### Key facts

Authority A limited its council tax increase by restricting its budget increase to only £4 million more than the uplift in government funding (**Table C1**). Authority B's budget increase was much higher than the government provided funding for, and consequently it required an additional £9 million from council taxpayers.

### Table C1

#### Some key facts<sup>i</sup>

	Authority A	Authority B
Budget 2002/03	£280 m	£280 m
Budget 2003/04	£305 m	£315 m
Budget increase	£25 m	£35 m
Budget increase (%)	9%	13%
Government funding increase	£21 m	£26 m
Government funding increase (%)	8%	8%
Council tax income 2002/03	£87m	£65 m
Council tax income 2003/04	£91 m	£74 m
Increase in council tax income	£4 m	£9 m
Increase in council tax income (%) <sup>ii</sup>	5%	13%

<sup>i</sup> The figures in Table C1 have been rounded.

<sup>ii</sup> The figures for increases in council tax income represent the total amount raised from council tax payers in the two authorities. These translated into increases in Band D council tax at broadly the same level, ie, 5 per cent at Authority A and 13 per cent at Authority B

### Factors influencing the 2003/04 budgets, and analysis of the increases

The electorate's response to the previous year's council tax rise acted to limit Authority A's increase in 2003/04. Members attributed the loss of a seat by a senior member in May 2002 to a large council tax increase in 2002/03. Consequently, members were reluctant to sanction a further significant rise in 2003/04. The budget for the year was finalised after each political party submitted its proposals and a compromise was reached.

Part of a substantial change agenda at Authority B involved the introduction of a more rational approach to budgeting. This process was designed to facilitate better targeting of resources towards priorities. A decision to invest substantially in local priorities was made after conducting budget seminars for members and wider consultation with the authority's partners, its employees and the public.

National factors accounted for a substantial proportion of the additional needs of both authorities. Both passported large amounts to schools, substantially increased social services funding, and provided for other amounts such as the employer's 1 per cent national insurance increase, pay awards and levies (**Table C2**).

**Table C2**

### Analysis of the 2003/04 budget increases:

	Authority A £m	Authority B £m
Schools passporting	11.1	14.9
Teachers' pensions	3.6	4.3
Social services increases	3.2	4.4
Inflation and 1% NI increase	3.8	4.9
Increased levies	1.9	0.9
Local priorities	1.6	6.2
Other	(0.2)	(0.6)
Budget increase	25.0	35.0

However, even after those amounts there was a significant variation in growth allowed for local priorities. Within its £1.6 million growth, Authority A provided extra funds for area committees' spending, libraries, and maintenance of property and the environment. It also forced services to secure improvements by not providing price inflation increases in their budgets. Authority B's priorities to be met from its £6.2 million growth included improving the environment, funding education above the government-calculated indicative need level, and measures to improve community safety.

### Conclusion

Authorities A and B have different approaches to budget setting, influenced by their local circumstances. In 2003/04, the authorities made significantly different demands on their council taxpayers. Both can reasonably claim to be representing their electorate's wishes. One did this partly by restricting the level of council tax increase, and the other by more substantially investing in local priorities.

## Contextual factors

- 70 The debate around the level of council tax increase in England for 2003/04 has suggested a number of other potential influences on the variation in increases between authorities. The most regularly quoted are:
- the effect of election timing;
  - the effect of the CPA category given by the Audit Commission; and
  - the effect of political control.

### Election timing

- 71 One view is that an authority facing an election in the near future is less likely to increase council tax significantly than one that is not. We carried out statistical tests to see if this was supported by evidence we had. We could find no evidence of a statistically significant relationship between either budget or council tax increase and the length of time until the next council election because most councils faced elections in 2003.
- 72 However, unitary and district councils facing whole council elections in 2003 tended to set significantly lower council tax increases (8.4 per cent and 6.6 per cent respectively) than those who faced elections for only part of the council (12.4 per cent and 9.9 per cent respectively).

### The effect of the CPA score

- 73 The government's decision not to 'cap' authorities which had been scored 'good' or 'excellent' under the Audit Commission's CPA regime led to the suggestion that the CPA categories announced in December 2002 might be a factor influencing the council tax increases.
- 74 Average Band D council tax increases for single tier and county councils in different CPA categories were as follows:
- |           |               |
|-----------|---------------|
| Excellent | 14.3 per cent |
| Good      | 10.7 per cent |
| Fair      | 11.2 per cent |
| Weak      | 9.6 per cent  |
| Poor      | 13.0 per cent |
- 75 While there were differences, tests show these were not statistically significant – indicating no causal relationship.

## Political control

- 76 We also looked at the relationship between political control and budget and council tax increases.
- 77 Our tests do not show a statistically significant link between budget requirement increase and political control in 2003/04.
- 78 But the tests did show that there were statistically significant differences in increases in council tax between councils under different political control in 2003/04. However, further research indicated that the differences were to do with the differential impact of grant redistribution and not political party. In other words, councils that received lower grant increases tended to put council tax up more than councils with higher grant increases, regardless of political party in control.

## What conclusions do we draw?

- 79 Council tax increases varied significantly across the country. There were many factors which contributed to this variation. The different gearing that individual authorities face was a key factor, as was the redistribution of grant funding in the 2003/04 settlement.
- 80 For each type of authority, the variation was magnified depending on the type of services provided together with the different funding arrangements and budget pressures involved.
- 81 It is also clear that authorities reacted to budget pressures differently and made different decisions about the extent to which pressures should be funded by budget reductions or council tax increases.
- 82 There is no evidence that CPA scores had a significant influence on the council tax increase 2003/04. There is also no evidence of a causal link between council tax rises and party political control. However, there is evidence that councils facing whole council elections tended to moderate council tax rises more than those facing partial elections.
- 83 Chapter 3 asks 'Why did we see such high increases in 2003/04?'. It examines the change in a balance of factors influencing council tax setting and explains why levels increased more in 2003/04 than in earlier years.

# 3

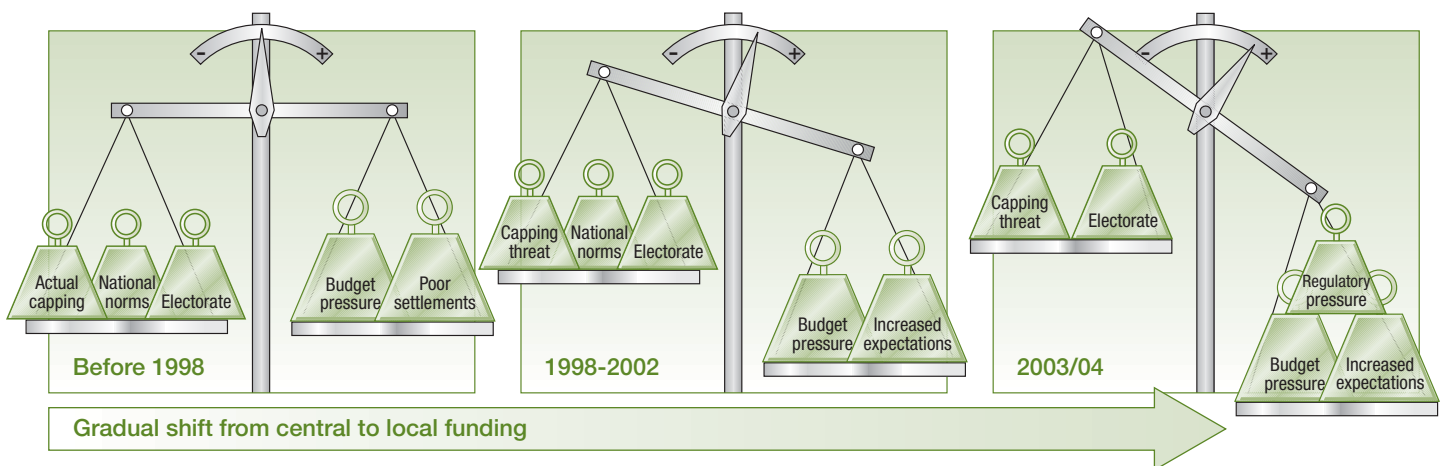
## Why did we see such high increases in 2003/04?

84 In setting the level of council tax, councils have a difficult balancing act to perform. On the one hand, they have a duty to carry out statutory functions coupled with a desire to respond to local demand for more and better services. On the other hand they are constrained by the availability of resources. Moreover, the sensitivity of council tax levels to the balance between budget pressure and service demands is magnified three or four times by the impact of gearing – sometimes much more (see the Wandsworth case in Chapter 2). Consequently, council tax levels are very sensitive to any change in the balance of pressures on services and budgets (**Exhibit 5**).

### Exhibit 5

#### Pressures on council tax

Council tax levels are very sensitive to any change in the balance of pressures on services and budgets.



## Increasing upward pressure on budgets

85 Demands for more services are nothing new. However, over the past few years demands have increased, in particular as a result of:

- public expectations;
- government expectations; and
- regulator expectations.

## Case study 2

A district council with, hitherto, one of the lowest per capita costs of waste collection faced a £1.6m increase in the contract cost upon renewal, mainly to pay for recycling arrangements.

The council's expiring refuse collection and street cleansing contract had been let in 1995. The contract was based on a back door/black bag collection and was priced at a low value. In order to achieve government targets, a new contract was required incorporating modern methods of collection (wheelie bins) and recycling schemes. This was let under a competitive tendering exercise and following guidance on Procurement issued by the Treasury Task Force.

The increase in cost accounted for over 90 per cent of the budget increase which in turn led to one of the highest council tax rises nationally.

## Public expectations

- 86 The public constantly demand more and better services and councils have to decide how they meet these demands and manage expectations. Work by MORI for the Commission has stressed the need for councils to improve communication as a way of managing expectations.

*...public expectations have risen over time; people expect more from organisations and the individuals representing them. This demonstrates the need to manage public expectations. However, it is important to know that it is very difficult to manage expectations downwards; rather than making expectations easier to meet, this can actually lead to a loss of confidence in the service itself. In this sense there is a clear need for more considered communications.<sup>I</sup>*

## Government expectation

- 87 Government puts direct pressure on councils to spend more on particular services. One example is passporting of schools' budgets. Passporting requires councils to spend the additional amounts allocated at a national level on schools and limits councils' flexibility to respond to local circumstances and needs. It means that any efficiency savings required to fund growth in other areas have to be found outside the schools' sector.
- 88 In addition, councils are under pressure to spend more to meet government targets, for example, on waste recycling. Evidence from auditors indicates additional spending on waste collection as a major additional spending pressure for some district councils (**Case study 2**).
- 89 The government also continues to ring-fence grants for particular purposes – thus limiting local flexibility – although it is committed to reducing the amount of ring-fencing. The government proposes to reduce ring-fencing of grant as a proportion of total government funding from 13.3 per cent in 2003/04 to 11.1 per cent in 2004/05, and to below 10 per cent by 2005/06.<sup>II</sup>
- 90 Reductions in ring-fencing can be achieved with little turbulence if the grants are rolled into mainstream funding. However, turbulence can be caused if, as happened with some Standards Fund grants in education in 2003/04, grants are simply ended.

## Regulator expectations

- 91 Regulators have also contributed to upward pressure on budgets. Inspectorates (including the Audit Commission) often make recommendations to improve services without setting out the cost implications. A quarter of auditors feeding back on the reason for budget increases in 2003/04 mentioned regulators as a contributory pressure. This was reinforced by the perception that greater weight was given in the CPA process to outcomes than cost effectiveness.

<sup>I</sup> From *Trust in Public Institutions 2003*, MORI.

<sup>II</sup> Taken from the statement to the House of Commons by the Minister for Local Government, Nick Raynsford, on the 2004/05 provisional local government finance settlement (19 November 2003).

92 Each year, auditors examine the adequacy of balances as part of the overall judgment on the financial stability of authorities, and this forms part of the judgement by auditors of financial standing as part of CPA.<sup>1</sup> Use of balances to support spending reduced from around £0.5 billion in 2002/03 to £0.3 billion in 2003/04. Councils' response to examination of balances as part of CPA was prudent, but it also added to the pressures to put up council taxes in a year when planned council tax increases were already high.

## Decreasing downward pressure on council tax

93 The introduction of revised council tax capping powers in the Local Government Act 1999, together with the fact that these powers have not been exercised, may have reduced the extent to which councils felt constrained by capping. The decision to exempt 'good' and 'excellent' councils from the reserve power to cap council tax has been seen as a possible cause of higher council tax increases in 2003/04. However, as we have set out in Chapter 2 above, there is no evidence of a statistically significant link between CPA category and council tax rises in 2003/04.

94 It is also clear that councils continued to be concerned about capping in setting their budgets for 2003/04. In **Case study 3**, the council went ahead with a proposed budget increase but only after considering the threat of capping.

95 Despite the reduced threat of capping, most councils limited council tax increases to single figures up until 2002/03. Very few appeared willing to go for increases which were out of line with what other councils were doing.

96 This changed in 2003/04. A number of councils announced early on in the council tax setting process that they would be increasing council tax by significant amounts to compensate for loss of grant. The result was that increases in double figures were no longer seen as exceptional. In 2003/04, 54 out of 116 single tier councils, 23 out of 34 county councils, and 49 out of 238 district councils increased council tax by 10 per cent or more.

### Case study 3

A district council faced increased costs due to waste recycling and a one-off redundancy cost from the removal of a layer of management. Members took the decision to increase council tax by £1 per week per Band D taxpayer (amounting to over 30 per cent on council tax bills). Minutes record that there was a discussion of the possibility that the government might invoke capping powers, but the council went ahead.

<sup>1</sup> Auditors look at the adequacy of the financial risk management process to justify balances; in the absence of adequate financial risk management processes, the criteria for judgement in CPA expect councils to hold balances equivalent to at least 5 per cent of their overall budget.

## What conclusions do we draw?

- 97 There has been increasing pressure from the public, government and regulators to increase spending.
- 98 At the same time, there has been a reduction in downward pressure on council tax. This has come in part from the perceived reduction in the threat of capping, but the main reason was that in 2003/04 double-figure increases in council tax were no longer seen as exceptional.
- 99 In Chapter 4 we draw out overall messages and suggestions for councils, the government, and regulators.

# 4

## Messages

- 100 In producing this report, the Commission wishes to move the council tax debate on in a constructive way. Council tax levels have become a matter of public concern, with implications for the long-term sustainability of the existing local government finance system. Individual council taxpayers, particularly those on low or fixed incomes, have expressed criticism of the total bill and its unpredictability.
- 101 There are short to medium term measures that can be taken which would increase stability and predictability of council taxes. We set out our recommendations to help achieve this below.
- 102 But there are underlying problems that cannot easily be addressed by making changes to the existing system. The system is too complex for citizens – and many involved in the decision-making processes – to understand, and there is no direct relationship between decisions to spend and increases in local taxation. The consequences are lack of accountability.
- 103 The balance of funding review is examining potential solutions. On 24 September 2003, Nick Raynsford said:
- ...One concern is that this balance of funding undermines local accountability. Another is about the 'gearing' effect.... The review is examining how far there really is a problem with the current balance. We will then move on to looking at possible options for change...*
- 104 There are no easy solutions to this. For example, altering the balance of funding between national and local sources of finance cannot be achieved by simply transferring costs from national taxation to council tax. This would only serve to increase the council tax even further, and thus increase public discontent.
- 105 So other options need to be looked at including supplementing council tax with other sources of income – for example, charging for services, return of the business rate to local control, and local income tax – or changing funding responsibilities of local government. Alternatives such as these are being considered as part of the balance of funding review. The aim needs to be a sustainable local government taxation system which provides accountability to local citizens.

## Recommendations

- 106 The Commission believes that government should:
- give councils more certainty about future allocations of resources and potential changes to them;
  - provide greater transparency about the factors which are included (and which are not) in formula grant increases;

- reduce the amount of direct control over councils through national targets and continue to reduce ring-fenced grants so as to maximise local choice and financial flexibility;
- recognise that public engagement is more likely to achieve a balance between council tax rises and service provision which is acceptable to local citizens than use of capping powers; and
- as part of the balance of funding review, come forward with proposals for addressing systemic problems with the existing local government funding arrangements.

**107** Councils are accountable through democratically elected councillors to the public. That process should ensure that there is an appropriate local balance between council tax levels and spending decisions. In order that this is as effective as possible, we suggest that all local authorities:

- improve processes for:
  - delivering efficiencies in service delivery; and
  - carrying out longer-term financial and service planning which anticipates known pressures and helps them respond to unanticipated events;
- ensure that council appointees to non-elected precepting bodies, including police authorities, exercise their duty to protect taxpayers' interests effectively; and
- communicate and consult effectively with the public so that the reasons for spending and tax decisions are better understood and there is more public acceptance of the final outcome.

**108** In making recommendations to local authorities, it is important that all regulators recognise the overall framework within which local government operates. In particular, they should:

- increase the focus on efficiency when carrying out audits and inspections;
- balance recommendations for service improvements with the requirements to keep spending within levels that are acceptable to the public; and
- indicate clearly the cost implications of recommendations.

**109** In addition, in planning their audits for 2004/05, all auditors will consider the risks relating to councils' financial management arrangements and, in particular, their budget-setting processes. The Commission has developed an audit tool to help them do this.

**110** In developing proposals for CPA in 2005/06 and beyond, the Commission intends to increase focus on cost effectiveness and value for money delivered by councils as part of the overall CPA assessment.

## Postscript – will this happen again?

- 111** It is too early to say whether what happened in 2003/04 will happen again.
- 112** The recent announcement of the provisional finance settlement for 2004/05 included a lower level of additional grant funding than in 2003/04; but cost pressures are lower too. In addition the narrowing of the gap between floors and ceilings means there will be less redistribution in 2004/05 than there was in 2003/04, and reduced ring-fencing of grant gives more flexibility to councils to respond to local circumstances without putting up council tax.
- 113** However, gearing continues to be a factor that will lead to any variations (up or down) from government spending assumptions having an exaggerated effect on council tax increases. In addition, the requirement for councils to passport schools funding will continue to limit local flexibility.

**Table 6**

### Factors influencing council tax rises in 2004/05 (compared to 2003/04)

Factors pushing council tax increases higher	Factor dampening council tax increases
lower increase in grant – grant funding nationally up 6.5 % in 2004/05 compared to 8 % in 2003/04	cost pressures reduced – national insurance and teachers’ pension fund contributions stable, teachers’ pay award down, interest rates going up (increasing interest on investments)
new statutory requirements to ensure adequacy of reserves	councils adjusted use of balances in 2003/04 to take account of auditor expectations
passporting of school budgets	reduction in ring-fencing in non-school budgets
gearing factor	less redistribution of grant
increased public awareness of the impact of spending decisions	increased public awareness of council tax increases
	threatened use of reserve capping power

- 114** The intense debate about council tax rises in 2003/04 has increased public awareness of the issues. Councils therefore have the opportunity to engage more fully with local citizens about the choices they have to make between increasing local taxes and limiting spending increases. While reserve capping powers are available – and Nick Raynsford, Minister for Local Government, has threatened to use these if necessary – public engagement is more likely to achieve a balance between council tax rises and service provision which is acceptable to local citizens than use of capping powers.

# Appendix 1

## Local government finance settlement calculation of assumed Band D council tax increase in 2003/04

	2002/03 (adjusted) (£m)	2003/04 (£m)	Change between 2002/03 (adjusted) and 2003/04 (%)
<b>Total assumed spending (including specific grants)</b>	<b>64,945</b>	<b>69,586</b>	<b>7.1%</b>
Specific grants	-10,047	-11,677	16.2%
<b>Total formula spending shares (excluding specific grants)<sup>I</sup></b>	<b>54,897</b>	<b>57,908</b>	<b>5.5%</b>
Formula grant	-37,563	-39,815	6.0%
<b>Assumed council tax yield</b>	<b>17,335</b>	<b>18,094</b>	<b>4.4%</b>
Taxbase (million band D equivalents)	17.320	17.440	0.7%
<b>Assumed Band D council tax (£)</b>	<b>1,001<sup>I</sup></b>	<b>1,037</b>	<b>3.7%</b>

Source: ODPM Local Government Finance (LGF) Settlement Papers 2003/04

<sup>I</sup> The actual council tax in 2002/03 was £976, compared to the £1,001 assumed in the settlement.

# Appendix 2

## Reference documents

### Spending and council tax

- Office of the Deputy Prime Minister, *Local Government Finance Settlement data*, available at [odpm.gov.uk](http://odpm.gov.uk)
- Office of the Deputy Prime Minister, *Local Government Financial Statistics*, available at [odpm.gov.uk](http://odpm.gov.uk)
- IPF, *Statistical Information Service (SIS)*, available at [ipf.co.uk](http://ipf.co.uk)
- Local Government Association, briefings on the local government finance settlement, available at [lga.gov.uk](http://lga.gov.uk)
- Chartered Institute of Public Finance and Accountancy, *An Introductory Guide to Education Finance in England*, 2003, available at [CIPFA.org.uk](http://CIPFA.org.uk)

### Relevant Audit Commission publications

(all available at [audit-commission.gov.uk](http://audit-commission.gov.uk))

- *Planning to Succeed, Service and Financial Planning in Local Government*, 1999
- *The Price is Right, Charges for Council Services*, 1999
- *Connecting with Users and Citizens*, 2002
- *User Focus and Citizen Engagement – Learning from Comprehensive Performance Assessment – Briefing 4*, 2003
- *Setting Priorities and Maintaining Focus – Learning from Comprehensive Performance Assessment – Briefing 2*, 2003
- *Trust in the Public Sector*, 2003
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- *Strategic Regulation: Minimising the Burden, Maximising the Impact*, 2003



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