# LOCAL GOVERNMENT COMMITTEE

Tuesday 27 March 2001
(*Afternoon*)

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## Tuesday 27 March 2001



## LOCAL GOVERNMENT COMMITTEE
**10th Meeting 2001, Session 1**

**CONVENER**

*Trish Godman (West Renfrewshire) (Lab)

**DEPUTY CONVENER**

*Dr Sylvia Jackson (Stirling) (Lab)

**COMMITTEE MEMBERS**

*Mr Kenneth Gibson (Glasgow) (SNP)
*Mr Keith Harding (Mid Scotland and Fife) (Con)
*Mr Michael McMahon (Hamilton North and Bellshill) (Lab)
*Mr Gil Paterson (Central Scotland) (SNP)
*Iain Smith (North-East Fife) (LD)

*attended

**WITNESSES**

Charles Armstrong (Aberdeenshire Council)
John Campbell (Chartered Institute of Public Finance and Accountancy)
Councillor Paul Coleshill (Argyll and Bute Council)
Bill Hughes (Chartered Institute of Public Finance and Accountancy)
John Lindsay (Society of Local Authority Chief Executives and Senior Managers)
Alex Linkston (Society of Local Authority Chief Executives and Senior Managers)
Stewart McGregor (Argyll and Bute Council)

**CLERK TO THE COMMITTEE**

Eugene Windsor

**SENIOR ASSISTANT CLERK**

Irene Fleming

**ASSISTANT CLERKS**

Craig Harper
Neil Stewart

**LOCATION**

The Hub

# Scottish Parliament

## Local Government Committee

*Tuesday 27 March 2001*

(*Afternoon*)

[THE CONVENER *opened the meeting in private at 13:46*]

13:57

*Meeting continued in public.*

**The Convener (Trish Godman):** Okay, comrades, we can begin. I begin by asking whether members agree to items 5 and 6 being discussed in private—item 5 because we will be considering our conclusion and drafting a report on a consultation; and item 6 because we will be considering expenses for witnesses, whom we will be naming. Do members agree to take those two items in private?

**Members** *indicated agreement.*

## Local Government Finance Inquiry

**The Convener:** We now move on to the next part of our inquiry into local government finance. I welcome Alex Linkston, who is the chief executive of West Lothian Council, and John Lindsay, who is the chief executive of East Lothian Council.

I invite the witnesses to say a few words by way of introduction, before I allow committee members to ask questions.

**Alex Linkston (Society of Local Authority Chief Executives and Senior Managers):** Although we are chief executives from individual councils, John Lindsay and I are here representing all the chief executives in Scotland, in our capacity as members of the Society of Local Authority Chief Executives and Senior Managers.

SOLACE very much welcomes the committee's carrying out of a review of local government finance and we are grateful for the opportunity to give evidence. SOLACE has been concerned for some time about local government finance. Last year we produced three documents in conjunction with the other local government associations. I shall leave copies of the documents for members to read. The first is entitled "Proposals for a future planning system in Scottish Local Government Finance". The second is called "Strategic analysis of Local Government spending needs in Scotland 2001/02–2003/04", which is the period that is covered by the current three-year spending review. The third, "Best value: The next steps", completed that compendium of reports and acted as a response to the consultation paper that had been sent out.

We have been keen to influence the agenda. We welcome the steps that the Executive has taken, particularly the move to three-year budgets. That is a huge cultural step, which should not be underestimated. Previously, local government received its grant allocation in December and was required to set a budget by February. With local government funding having been downsized in the way that it has over the past few years, the challenge was getting more and more difficult. We very much welcome that move.

There are many demands on local government resources. Demands come from the Parliament and the Executive because local government spends nearly 40 per cent of the Parliament's budget. There are demographic factors—the aging population is the cause of a large part of the spending pressures on local government. Community planning requires that we work closely as partners with other public sector players in our areas—again, cash needs to be put on the table for joint initiatives. Public and particular interest groups in our areas also make demands. Everybody wants more, expanded services; people do not want higher taxation, but fewer services.

14:00

We in local government accept that local government must deliver on the national priorities. We welcome that challenge; we are not scared of it and we are not against it. We recognise the reality of the situation, but the system is too rigid with hypothecation and ring-fencing of moneys. Little room exists for local discretion. Local needs are squeezed at the expense of national priorities without proper analysis of what is best for the local communities. Local initiatives should determine how a thing is to be done—rather than national objectives being interpreted against local needs.

We advocate a joint planning system, which is mentioned in our first document. We have suggested to the Executive that there should be a joint planning system between local government and the Executive for common themes—such as children and families—which the Executive should control through public service agreements, rather than by hypothecation. That is my main message.

SOLACE also recognises that local government must be seen to be delivering best value and value for money on its resources. We are heavily involved with the Executive and with Audit Scotland in developing best value and in developing measures of the effectiveness of local government. We are up for that agenda and we accept fully that we cannot go back to the old days when the Government sent the cheque and we spent the money. There must be accountability and complete transparency on how money is spent.

John Lindsay and I will be happy to answer questions.

**The Convener:** Does John Lindsay want to say anything?

**John Lindsay (Society of Local Authority Chief Executives and Senior Managers):** I will say just a few words about capital. We consider that there has been a massive underinvestment in public sector infrastructure over the past 20 years—perhaps for the past generation. For local government, that means underinvestment in public buildings, roads, schools, hospitals, railways, sewers and all the rest of it. We need a substantial capital investment just to catch up in the short term.

We know that capital allocations have increased during the past year or so—in the last spending round—but they still fall well short of what is required. That capital investment cannot be delivered under the present tight Government rules on local government capital expenditure—the section 94 system. We advocate the abandonment of section 94 controls and their replacement with a prudential system, as has been proposed for England and Wales. The headlines in last week's *Municipal Journal* were about abandoning those controls with effect from 1 April 2004. The committee should bring to the attention of the Scottish Executive the fact that we in Scotland need to abandon section 94 controls to start to get the capital investment in local government that we need.

We know that some sort of prudential controls system is needed to replace section 94 controls. I understand that the Chartered Institute of Public Finance and Accountancy is working on that in England and Wales. I know that the capital planning committee on the local government finance working party has also started to look at that.

One of our problems with the controls that are in place is that there are two sets of them. Capital expenditure is controlled by consent that is granted under section 94 of the Local Government (Scotland) Act 1973, while our revenue is controlled by reserve capping powers. The impact of capital expenditure is felt through loan charges. I wanted merely to stress the importance of trying to do something in relation to capital and to leave it at that.

We know that public-private partnerships and private finance initiatives are important. However, East Lothian Council is working on such a scheme, which is bureaucratic and time consuming from start to finish because we must convince the Treasury, the Government and the European Union that we are complying with the rules, that the project is being done off balance sheet and so on. PFI is just one chapter in the book, but the main step would be the abandonment of section 94 controls. The problems can be multiplied in relation to housing. As members know, there is a 75 per cent clawback of housing capital receipts, and if that clawback were removed, local authorities would get a bit of breathing space. I make a plea for a reduction in controls on capital.

**The Convener:** I suspect that you will not be surprised to learn that you are not the first person to have made that plea.

**Dr Sylvia Jackson (Stirling) (Lab):** Could you explain your views of the difference between local government and the local administration of services?

**Alex Linkston:** Local government has a mandate and is accountable to the electorate, but local administration means that everything is handed down to us by central Government—by the Executive—and we account for what we spend to central Government.

**Dr Jackson:** Do you think that local government, as distinct from local administration, is important and, if so, why?

**Alex Linkston:** I think that local government is very important. It is right that the Scottish Parliament and the Scottish Executive have national priorities, but those priorities do not all apply equally to every community in Scotland. Local government must be able to take national priorities and apply them to local needs and circumstances. The strength of local democracy is that the people who are elected on the ground are close to their communities because they are elected from among them and can interpret local needs.

**Dr Jackson:** Is it possible to maintain a system of local government, as opposed to a system of local administration, when the Scottish Executive controls 80 per cent of council funding? What do you think about the balance in local government finances?

**John Lindsay:** If I may, I will say first that I am in favour of local democracy, but there is no doubt that it costs money and that local administration would be cheaper to administer. However, if people want a system of local democracy, they must pay for it. Local councils are elected on local manifestos, on which they must deliver within the overall national priorities that are laid down by the Scottish Executive.

There are problems and concerns in relation to the balance of funding between central and local government. We believe that, over the past five years or so, central Government has not paid its fair share of new burdens and inflation. If it does not pay its fair share, the balance must be picked up through council tax. Because of the gearing effect, council tax increases are far higher than they would otherwise be. If we had a system in place in which the Government paid its fair share of new burdens and inflation, perhaps that risk would be obviated or reduced.

**Dr Jackson:** In your introduction, you mentioned a joint planning system between the Scottish Executive and local government, and your submission refers to a

"joined up approach to expenditure".

Could you elaborate a little on those issues?

**Alex Linkston:** In local government and certainly in SOLACE, people feel that the Executive is managing at the margins. It is concentrating on new initiatives or on particular services in which it wants improvements to be made, rather than looking at the needs of the whole service. For example, most of the resources that have gone into education over the past few years have been directed through the excellence fund and have been earmarked for specific spending in schools. There has been no discretion to take account of other spending pressures, which councils must absorb by making economies elsewhere.

We have had more money in the past couple of years, but we have had to make real-terms cuts as more burdens were attached to that money. When new burdens and increases in funding are discounted we have, in the past seven years, had less money to fund services than was previously the case. For seven years, we have been making cuts. That cannot go on for ever; communities are starting to squeal. We are getting an adverse reaction to the cuts that we are imposing. A proper evaluation has to be made of the value of the services that we are currently providing and of new initiatives.

I do not think that anyone would disagree with the desirability of the new statutory travel scheme. However, the Executive reckons that, by year three, that will cost £0.75 million in my area. If I consulted my community on that, I doubt that they would put it in their top 10 priorities. Other areas may be different, but that is the value of local democracy. We are being directed about how to spend money. That means that we must cut services that the community finds more valuable.

**Dr Jackson:** Is there anything more that you can say about how the Scottish Executive and local government could come to an agreement on that? What you are saying is that we have come some way, but that we need more communication. You mentioned the need for an evaluation. Whom do you envisage doing that?

**Alex Linkston:** Two of our three documents make that clear. The first is the report "Proposals for a future planning system in Scottish Local Government Finance", in which we suggest that evaluation should be conducted in about six groupings: children and families; community safety; support for vulnerable people and community care; economic development and employment; sustaining and enhancing the built and natural environments; and public transport and infrastructure. Those are our suggestions. We should sit down with the Executive and agree jointly on the spending pressures on new initiatives and maintaining current services.

The second document was prepared specifically to inform the spending round that we are about to move into. SOLACE and other local government professional associations costed all the spending pressures, including existing services, demographics and new initiatives. It was meant to offer a menu of actual choice. That is how I see us taking forward a process, which needs openness and transparency. The mechanism is in place and evaluation will not therefore be difficult to do.

**John Lindsay:** We need something to replace hypothecation and ring-fencing. They are symptomatic of there being insufficient money in the system to deliver on expectations, and they allow ministers and civil servants to impose priorities from the centre. As Alex Linkston said, we need to have more discussion in a joint planning forum. To all intents and purposes, the current spending round is over and we should start to talk together now about the next spending round. That would give us a longer lead-in time to agree national priorities. Local democracy means local priorities, and cognisance needs to be taken of both local and national priorities in any talks that take place in a joint planning forum.

**Dr Jackson:** It would be helpful to have a summary of how you see the joint planning group going forward. I am aware that we have a copy of the documents, but a copy of such a summary would be useful. The committee might want to contact you again on that issue.

**Mr Michael McMahon (Hamilton North and Bellshill) (Lab):** I was pleased to hear John Lindsay refer to section 94 consents in his opening remarks, because views on that issue were not made clear in the written submission.

You said in your submission that

"proposals to replace the Section 94 regime with a jointly planned and agreed revenue-based system"

would be appropriate. Can you say what you mean by that?

**John Lindsay:** That refers to a system of prudential controls. I understand that, under the English system, the bottom line would involve first having a balanced budget. The budget could not be overspent. In other words, it would not be possible to budget for a deficit. As for the overall controls on revenue expenditure, members will know that loan charges represent the way in which capital expenditure impacts on revenue. The Government controls the overall totals and has reserve capping powers. There may also be other transitional arrangements, whereby authorities cannot borrow more than a certain percentage of their debt. They cannot over-commit by more than a certain percentage of their debt for their forward commitments. Some sort of prudential controls need to be brought into place—I think that we are quite capable of doing that.

14:15

**Mr McMahon:** I take it then, that you think that councils should secure the Scottish Executive's approval for their capital improvement programme.

**John Lindsay:** No, I do not think that they need that approval. The controls are through the revenue system and the way in which the Government controls the overall revenue total—total expenditure—and a system of prudential controls along the lines of, "Do not borrow more than 1 per cent of your outstanding debt in any one year." Apart from that system, councils spend what they need to.

**Mr McMahon:** You spoke about a longer lead-in and discussion time. Is that the type of thing that you would want to discuss in order to arrive at a position where everybody is agreed on what each council should allocate?

**John Lindsay:** Absolutely.

**Mr McMahon:** Is that the basis of everything else that you are talking about in relation to the systems and the mechanisms?

**John Lindsay:** Yes.

**Mr Gil Paterson (Central Scotland) (SNP):** In your written evidence, you suggest that there is no benefit for local government from the return to local control of the non-domestic rate. Can you explain why SOLACE takes that view?

**Alex Linkston:** That view is held by SOLACE, rather than by individual local authorities. Individual authorities would respond depending on how each was affected. From an all-Scotland perspective, it will be a matter of winners and losers. If one council gets more—given that the sums that are involved are previously determined—other councils will get less. We want even allocation of resources, and to secure more certainty. A system that brought more uncertainty would set council against council for allocation.

We also want to move away from the current distribution system, which is far too detailed.

**Mr Paterson:** Can you explain why a nationally set non-domestic rate is better able to cushion areas from any temporary local decline in the tax base, compared to a locally set non-domestic rate? Would an equalising grant system provide such protection, even if the tax were set locally?

**John Lindsay:** There has always been an equalisation process for non-domestic rates. Even when it was under local control, there was an equalisation process, which was known as the standard penny rate product. If a business found itself under the level of the standard penny rate product, the difference was made up through the grant system.

If the non-domestic rate is to be returned to local control, there must be some sort of equalisation process. Some areas are richer than others, for whatever reason. East Lothian produces about half the electricity for the whole country. We therefore have a high non-domestic rate value. The situation is similar in other areas, for example Fife, where the Mossmorran petrochemical works is located.

There has to be an equalisation process in any case. Whether that is done nationally or locally, we cannot envisage a situation in which a local authority could keep all its non-domestic rates.

**Mr Paterson:** Why does SOLACE believe that a single non-domestic rate poundage for the whole of Scotland is necessary for a successful enterprise economy? Why would local competition over tax rates not stimulate inward investment?

**John Lindsay:** I would prefer to turn that question around. SOLACE is a bit ambivalent about the return of the non-domestic rate, because we think that that would give the appearance of more local control without actually giving more local control. We have had many years—I cannot remember how many—of national control over non-domestic rates. Therein lies the problem; if local authorities are seen ostensibly to be given back control over the non-domestic rate, and if limitations are put on us on how much we can put up the rate, nothing much will have changed, to all intents and purposes. That is our dilemma and problem with regard to a return to local control of the non-domestic rate.

**Mr Paterson:** Following on from that, if non-domestic rates were passed back to the control of local authorities with a degree of flexibility, such as a 3 per cent margin, would that change your view?

**John Lindsay:** It would help, but the difference would be at the margin. At present, 22 per cent of expenditure is raised by council tax and 23 per cent is raised by non-domestic rates. The amount that could be added as a supplementary tax that would be payable by businesses would be only about 2 per cent or 3 per cent.

**Mr Paterson:** The difference would be that the balance that sees 80 per cent of local authorities' funding being provided by the Executive and 20 per cent being raised by the councils would change. The argument is that only the balance would be different. If the Government allowed more flexibility, there might be a 50/50 split of the true responsibility for the collection and dispensation of the non-domestic rates. If the council had the authority to raise or lower non-domestic rates—

**John Lindsay:** That would help, obviously. It would mean that there was less addition to council tax, because the increases could be spread more widely.

**Alex Linkston:** If that were the only change, there would be little benefit to local government. The problem that we face is that too many initiatives come from the centre and we do not have the capacity to fund them and to provide services that are relevant to our local community. The main thrust of our submission is to try to get a better joint planning system. All the small initiatives will help, but local government is haemorrhaging because of the top-down pressure that is being placed upon us.

**Mr McMahon:** When we took evidence from representatives of Glasgow City Council, I was a bit concerned about their arguments in relation to retaining non-domestic rates because of the impact that that would have on neighbouring authorities. In reply to my concerns, the councillors said that they wanted to retain the additional growth that was generated from an investment that had attracted an increase in non-domestic rates. Do you sympathise with that point of view? Is that what you understand that Glasgow City Council is saying?

**John Lindsay:** There has to be an equalisation system. If the non-domestic rate is returned to local control, the benefits must be equalised throughout the country. We have always had such a system and I do not think that we could do other than have an equalisation system that takes account of growth and reduction in growth.

**Alex Linkston:** I read the *Official Report* that contained Glasgow City Council's evidence and I must say that SOLACE supports that council's position in principle, in the circumstances that it described. The problem will come from having to identify what additional rate income derives from an investment that Glasgow City Council specifically led, as opposed to an investment that would have been made anyway or had been delivered by Scottish Enterprise. West Lothian is an expanding area at the moment, for example, but it is hard to say how much of that is because of the council and how much is because of the area's location or because of what previous Governments, the development corporation and so on did a number of years ago. There are no easy answers in this complex situation.

**Iain Smith (North-East Fife) (LD):** Talk about equalisation in relation to non-domestic rates takes me neatly on to the question that I was going to ask. SOLACE seems to reject the concept of local income tax on two grounds, which are fairness, and administration cost and complexity. On the issue of fairness, you mention in your submission that

"deprived areas with lower average incomes would have to levy more tax to achieve an equivalent increase in revenue than in wealthier areas."

Is not that the case with any form of taxation? It is currently the case with the council tax. Glasgow City Council complains bitterly because it now has a smaller council tax base, which means that council tax is higher.

**John Lindsay:** Again, there is equalisation within the grant distribution system to increase the funding of authorities that are not as wealthy as others.

There are two arguments about local income tax—one is political and the other is administrative. If you have 32 different rates of local income tax in the country, you have an administrative problem on your hands. Some people will live in one area but work in another, so there will be problems collecting the tax. That leads to the question, "Why have 32 different local income taxes; why not just have one?" The next question would be, "Why have a local income tax, when it is now national rather than local?" Other than that, I do not think that we have a great deal more to say. We will leave it at that.

**Iain Smith:** I presume that you could still have equalisation within a local income tax regime. As for administration, do not you accept that payroll systems ought to be able to cope with a local income tax system? In Scotland, payroll systems are already set up to cope with the tax-varying powers of the Scottish Parliament—which have yet to be used. However, I am sure that it is not impossible to set up payroll systems to cope with different tax rates. After all, it is done in other countries where there is local income tax.

**Alex Linkston:** You may have to take that up with the Federation of Small Businesses, which is a substantial employer across the land. If there were 32 different rates of income tax, my council might, given its catchment, have to handle about 10 of those on its payroll. It would be a nightmare for a big employer and impossible for a small one. It would lead to distortion in employment, with employers considering where potential recruits came from.

Our biggest fear is that no Parliament is likely to agree to a system of 32 different tax rates competing with a national tax. The local taxation element would very quickly be lost. We feel strongly that, if we are to have local democracy, local government must have a distinctive income policy. Even if locally raised income amounts to only 20 per cent of the total, that at least gives some flexibility. Without that, there would not be local government but local administration, in which councils would become simply the agents of central Government. I do not think that that would be a good thing for national or local democracy.

**Mr Kenneth Gibson (Glasgow) (SNP):** I am intrigued by what you say about 32 different levels of taxation. I understood that there were 32 different levels of taxation anyway, through the council tax. Is not it the case that every authority has a different level of council tax?

**Alex Linkston:** That is a property tax, not an income tax.

**Mr Gibson:** Yes, I am aware of that—but why would having different levels of local income tax create any more difficulties than having different levels of property tax?

**Alex Linkston:** The local income tax would be deducted by the employer whereas, at the moment, each local authority sends out a bill to every property in its area. The answer to your question lies in the complexity of administration. Third parties would have to be brought in to administer a local income tax.

**Mr Gibson:** If it is so difficult, how do they manage to administer such taxes in places such as Scandinavia, which is certainly more advanced than we are in the delivery of social justice objectives.

**Alex Linkston:** I am afraid that I have not studied those systems, so I cannot answer your question.

**Mr Gibson:** Has SOLACE considered the systems in other countries? The difficulty that we have is that theories are being considered, as opposed to the practical things that are actually happening in other countries. I do not think that anybody around the table wants to reinvent the wheel. If other small nations are successfully implementing taxation systems, is not it the duty of organisations such as SOLACE—and this committee and the Scottish Executive—to consider those systems and say either that they are better or that they would not apply in Scotland?

**Alex Linkston:** Before you could say whether a system was workable, you would need to do detailed research. SOLACE does not have the capacity to do that. In our submission, we have concentrated on what we think is achievable and we have addressed what we think are the key issues. I am not saying that another form of local tax is not a proper issue for the committee to consider, but you would need to commission some detailed research to ensure that you had quality information on which to base decisions. I am afraid that SOLACE has neither that capacity nor that information at present.

**Mr Gibson:** How much does it cost to collect and administer the council tax throughout Scotland?

**Alex Linkston:** I do not have the detailed figures with me, but the council tax is relatively cheap to collect compared to other forms of taxation.

**Mr Gibson:** So you are saying, although you have not done any research into alternative systems such as local income tax, that your gut instinct is that council tax is less expensive to collect. However, employers may be faced with the administrative costs of one tax and local authorities with the administrative costs of the other.

14:30

**Alex Linkston:** Local authorities would be faced with the administrative costs under both systems, but in addition the local income tax would impose a big cost on employers.

**Mr Gibson:** I have a question on capital. On page 4 of your submission you state:

> "The Invest to Save and Modernising Government Funds are good examples of these kind of funds but are ultimately inadequate in size and scope. Higher mainstream capital funding is essential to achieve real change and the modernisation of public services."

What would be a realistic level of capital funding for Scotland?

**John Lindsay:** It would frighten everyone if we started to consider what we need to spend to get our infrastructure back up to what it should be. We are talking huge sums of money. We need only consider the roads network, schools and public buildings—they need a lot of investment. I think that it has never been calculated. We have considered it tentatively in the capital planning committee without getting to the bottom of it. The huge sums of money required are above and beyond what the system—as it stands—can deliver.

**Mr Gibson:** Is there any year in which capital funding peaked? Was there a golden year—for example in the 1970s, 1980s or 1990s—for the funding of capital services?

**John Lindsay:** Capital funding peaked about 20 years ago and has been sliding ever since. For central Government it is an easy cut to make—easier than revenue costs, which means jobs. However, capital funding is indirectly an investment in jobs and so on.

**Mr Gibson:** How long would it take to bring things back up? Should the Scottish Executive prepare a plan to restore Scotland's infrastructure over, for example, 10 years or 20 years?

**John Lindsay:** Ten years is a reasonable period in which to make a huge inroad into restoring levels of funding—that is feasible. It takes time to plan systems and to get them, the processes and people in place to undertake that.

**Mr Gibson:** Should the Scottish Executive consider the cost of restoring funding levels over a ten-year period? Should it consider funding that?

**John Lindsay:** From a local government perspective, yes.

**The Convener:** I apologise—I thought that Kenny Gibson was going to ask one question. I should have known.

**Mr Gibson:** As if.

**Mr Keith Harding (Mid Scotland and Fife) (Con):** I am delighted that you told Mr Gibson that funding peaked under a Conservative Government. Thank you.

**John Lindsay:** Was it a Conservative Government?

**Mr Harding:** Twenty years ago, yes.

To return to Sylvia Jackson's question, in its written evidence, SOLACE appears to reject every option for significantly broadening the local tax base and changing the balance between central and local funding from the current 80:20 split to something closer to 50:50. The society could be seen to be rejecting the conventional wisdom—including the opinion of your finance directors and the Council of Europe—that local autonomy requires local authorities to raise at least 50 per cent of what they spend. Why does SOLACE take a different view?

**Alex Linkston:** Like everything, those responses were prepared by a committee. Individual authorities have clear views on how the system should be reorganised. There are 32 good reasons why councils need more money. We all need more cash. In the submission we tried to pick up the key problems throughout Scotland. The 80:20 split is not good, but while the Executive continues to impose new burdens upon us, annually or every three years, without having regard to their effect, it is wrong to consider only the non-domestic rates issue and other minor sources of income.

We must address the biggest problem in the system, which is how the Executive determines the spending pressures on the council and how we relate those to our local communities—which is not to say that there are not other things that could be addressed. I speak as a chief executive who has to persuade a council of the need for a particular strategy, stand up in front of public audiences and deal with pressure groups, when I say that the biggest problem that we face, although there may be enough money in the system, is the prioritisation of that money.

Even in education, where in real terms a lot of additional money has been invested, head teachers tell me that they do not feel that they have much additional money. They get pockets of money for certain initiatives, but they do not feel that they have ownership of that money. There cannot be a proper management system without ownership. The top-down management approach has never worked in history and will never work here. We need a system in which people buy into output targets and are encouraged to deliver them. That is what we would like to move to. The lack of such a system is one of the biggest problems confronting local government finance at present.

**Mr Harding:** So you are saying that it would be desirable to move toward a 50:50 split.

**Alex Linkston:** I would love to move to a 50:50 split, if we had a meaningful 50 per cent and real discretion.

For years, Government has considered alternative ways. In the mid seventies, the Layfield Committee of Enquiry into Local Government Finance carried out a detailed analysis. It concluded that the Government had to determine whether we would have a centrally or a locally controlled system. By default, we have opted for a centrally controlled system. The Layfield committee's analysis still stands.

**Mr Harding:** You identify hypothecation as a problem, particularly in education. I am a radical, so I ask about removing education and social services from local government. That would lead to a 50:50 split.

**Alex Linkston:** It would, but we would then have national services and there would be prescription. As well as educating children, schools have a big role to play in the agendas for social inclusion, improving Scotland's health, and safer communities. If a head teacher is made accountable to, say, a committee of the Parliament, their objectives will become very narrow.

We have a project in West Lothian, called West Lothian connected, which is a multi-agency one-stop shop, on which we work with the Employment Service, the Benefits Agency, the Inland Revenue and the health service. It has taken a wee while to get those organisations to move from their narrow focus to joined-up services for the customer. If social work and education were taken out of local government, we would end up with a silo effect in services. The services might be efficient, but it would become very difficult to implement the cross-cutting agenda that the Executive is pursuing. Social inclusion and justice would be pushed on to the back burner. All those matters have cultural aspects. We are finding from community planning and working with the health service and Scottish Enterprise that if we can join up around the customer, using our experience and resources, we can start to make a difference.

**Mr Harding:** I was not suggesting moving education to the control of a parliamentary committee or even the Executive. I was suggesting that funding could go directly to schools under the control of school boards. We will leave that matter.

**The Convener:** I should think so, too.

**Mr Harding:** Your submission says that council tax has a good collection rate. Do you consider the rate good when it is 10 per cent below that of England and Wales?

**Alex Linkston:** You must compare like with like. A culture of non-payment developed with the community charge, which has taken a while to turn round. Local authorities are getting on top of that and collection rates are improving year-on-year. My council budgeted for 95 per cent collection for the past five years. This year, we increased the figure to 96 per cent. I hope that we will progress to 97 per cent or 97.5 per cent in the next couple of years. The collection rate is rising.

When we had the old rates system, a large proportion of houses were local-authority owned, and rates were collected with rent. We had a 99 per cent collection rate then because the debts were collected together, weekly. That link has been severed. We would like to return to that system. Collection rates are improving. In a few years' time the council tax collection rate will be as good as that for any other tax.

**Iain Smith:** If we moved towards a prudential system for capital, what would the society recommend should be done with councils' inherited debts?

**John Lindsay:** That is a question of detail for a working party. The grant system is based on the level of debt and additional capital expenditure, so a system would have to be worked out that took into account existing debt and the amount of grant received in relation to existing debt. I do not think that we have gone far enough to be able to sit down and work something out about that, although East Lothian Council's capital planning committee has provisionally considered that, without reaching any conclusions.

**Alex Linkston:** I will give a relevant example. At present, capital and revenue are in different compartments. In the world in which we work, money flows between the two. If an official in my council approached me and said, "I could save us £50,000 by replacing a boiler that costs us £250,000 in one of our premises," we could do that under John Lindsay's prudential rules, because capital expenditure would be incurred and the revenue saving would be made on fuel costs, which would cover the additional loan charges. However, to do that under the present system, I would need to persuade my council to cut out a capital project, which would invariably involve traffic management improvement or school improvement or modernisation. Energy conservation is a poor relation of primary school improvement.

**Iain Smith:** I understand the concept, which has many attractions, but I am worried that councils do not have a level playing field. Some have higher debt burdens than others, which may be a problem.

**Alex Linkston:** The grant system adjusts that and would continue to do so.

**Iain Smith:** The system does that—at present.

**Alex Linkston:** We hope that we will continue to have grant after the review.

**The Convener:** I have two quick questions. I wonder whether I have misinterpreted your comments a bit. First, am I right to think that your written evidence suggests that the Scottish Executive should be more involved in the planning of every council's capital and revenue budget? Secondly, if you could change one aspect of local government finance to make a difference, what would it be?

**John Lindsay:** I would change the section 94 rules. If I could get anything out of the committee and the review, it would be the abandonment of section 94. That would make an immediate difference to Scottish society.

**Alex Linkston:** I would like output-based agreements rather than hypothecation.

**The Convener:** What about the suggestion that the Scottish Executive be involved in the planning of every council's revenue and capital budget?

**Alex Linkston:** Did we say that? [*Laughter.*]

**The Convener:** That is what I think you said.

**John Lindsay:** We are talking not about every council's budget, but about a joint planning forum, whereby Scottish local government would come together with the Scottish Executive and plan in a longer-term arrangement. That would provide joint outcome agreements to replace hypothecation and other initiatives.

**The Convener:** So, it links in to what you said at the end. Okay. Thank you for attending the committee and for your presentation. It would be helpful if you could leave the documents or if we could have copies of them.

14:45

We now welcome Charles Armstrong, who is the director of finance for Aberdeenshire Council. I invite you to say a few words, after which we will ask questions.

**Charles Armstrong (Aberdeenshire Council):** Thank you, convener. Good afternoon, ladies and gentlemen. You will have received a submission from Aberdeenshire Council.

**The Convener:** Yes, we have received that paper.

**Charles Armstrong:** That paper is only a finance officer's view—it has not been formally endorsed by the council. Nonetheless, by and large it is in line with the council's thinking as expressed on various occasions over the past few months and years. Views have been expressed on 12 of the 13 issues that are contained in the committee's remit, which was submitted to us. I will highlight two of those issues in my introductory statement: the first is non-domestic rates and the second is revenue finance.

It has been suggested that the control of non-domestic rates should be transferred back to councils, to achieve a perceived double benefit of increasing the local tax base and removing an apparent discrepancy between the sums that are paid by businesses in a council's area and that council's share of the non-domestic rate pool. However, that argument is misguided. Councils will only really regain control of NDR if they also have the power to vary the charge. That would strike at the heart of the current arrangements, which were set up in 1993 to level the playing field for businesses in different areas of Scotland and the UK.

When the pooling and redistribution arrangements for non-domestic rates were established in 1993, the Government grant to councils was—as it still is—based on an overall figure of aggregate external finance, which is formally referred to as the AEF envelope. That was, and remains, a predetermined sum for each council. Each council's share of the NDR pool is included in that envelope, as are specific grants and revenue support grant. Movement in one is compensated for by movement in the other, so if the non-domestic rate income were to be changed for any reason, that would be compensated for by an equal and opposite adjustment in the revenue support grant.

On paper, some councils are winners and some are losers as a result of the NDR pool. Businesses in the Aberdeenshire Council area pay around £53 million into the NDR pool, but the council's distribution from the NDR pool is approximately £73 million in the current financial year. However, that does not mean that we win. If the proportions were to change within the total envelope, I would expect the revenue support grant to move accordingly to compensate for the discrepancy. Returning the control of NDR to councils would mean no overall change in the financing arrangements but it would lose the level playing field for businesses in the north and south and within Scotland.

The second issue relates to the recent announcement of grant figures for the three-year period to March 2004. Along with other councils, we have been pushing for a three-year grant for a long time and it is most welcome. Nevertheless, I am concerned that the figures that have been announced do not seem to include any firm plans for rolling forward annually. We seem to have replaced the issuing of one-year lumps of money with the issuing of three-year lumps, without saying what will happen to the figure at the end of those three years. As I have set out in my submission, that means that, in 2004—if nothing happens before then—we might fall off the edge of a cliff, as we do not know where we are going at the end of that three-year period. The process must be moved on, and we must look ahead to issuing three-year figures on an annual rolling basis, which would truly allow local authorities to plan ahead with some certainty.

That concludes my opening statement. I will be happy to assist the committee in any way that I can.

**Mr Paterson:** You say that you have concerns about the three-year budgeting process. You have answered the question that I was going to ask. You are looking for a rolling programme in which year 3 would drop out and year 4 would come into play. You are saying that you would like a progressive, rolling programme, as you state on page 3 of your submission.

What changes does Aberdeenshire Council believe should be made to the grant distribution system?

**Charles Armstrong:** I confirm that such a rolling programme is exactly what I am suggesting.

In my submission, I state that we have concerns over the way in which the grant distribution system has turned out, as it seems to preserve the status quo in distributing GAE between local authorities, based on 100 or so different factors. Having had experience of that system, my concern is that it is not perfect. It is obscure and some of the factors work against each other—some of them are illogical. I could cite examples, but you probably would not want me to, as we would be here all afternoon.

Some work has been undertaken to produce a simplified distribution mechanism based on six or eight factors. I would like us to move away from the 100 or so factors, which are frozen in the system at the moment, towards a simplified system. Such a system might take a broad-brush approach, but it would at least be more comprehensible to the public than the present one.

**Mr Paterson:** Would it save money if the system used only six indicators, rather than the present number?

**Charles Armstrong:** I do not think that it would save money directly, but it would save a lot of effort by the Scottish Executive and councils, and it would stop a lot of time-consuming lobbying. Indirectly, it would release staff resources for other work.

**Mr Paterson:** So, indirectly it would save money by releasing staff resources.

**Charles Armstrong:** Theoretically, yes.

**Mr Gibson:** I am intrigued. I understand that, among Aberdeenshire Council's 68 members there are 28 Liberal Democrats and 24 SNP members. Both those parties have a policy on local income tax, yet there seems to be no mention of local income tax in your submission. Why is that?

**Charles Armstrong:** As I said at the outset, my submission is an officer-prepared paper and has had no political input. My view is that a local income tax would not really work. It would have to be based on an individual's place of employment, which would cause difficulties for local authorities. For example, many residents of Aberdeenshire work in Aberdeen, therefore Aberdeen City Council would gain by a local income tax and Aberdeenshire Council would lose out. [*Interruption.*] Sorry. I had a French meal at lunchtime, and I seem to have a frog in my throat.

**Mr Gibson:** So your understanding is that revenue from a local income tax would go to the local authority where an individual worked. Has the council examined systems in other countries where there is a local income tax? Do you accept that, if there were a local income tax in this country, an element of equalisation would be involved?

**Charles Armstrong:** We have not examined any other systems in any other countries. I suspect that an equalisation system could be brought into play, but I question whether the effort involved in that would be worth while. I question whether such a system would be any better than the council tax that we have at the moment.

**Mr Gibson:** How do you know until you look? If you have not looked, how can you possibly ascertain whether what you say is the case? Equalisation seems to work perfectly well in other societies.

**Charles Armstrong:** If a concrete suggestion were made, we would certainly consider it.

**Mr Gibson:** You talked at some length about non-domestic rates and said that you were unhappy at the idea of such rates going back to local control. If an equalisation method was in place—you have touched on that—surely the return of the non-domestic rate to local control would reduce the gearing of the local tax and give local authorities greater freedom to determine local spending needs, given that your local authority would not be a penny worse off than it is at present.

**Charles Armstrong:** That would be the case if local authorities had the power to vary the rate of non-domestic tax. Failing that, it would not expand the local tax base at all. It would simply be equivalent to the system that exists at the moment.

**Mr Gibson:** Would that method not allow local authorities to be more sensitive to business needs and therefore develop more business-friendly policies? Even if they might not be seen to be getting any additional resources—unless, as Glasgow City Council suggested, there was a slight increase over the margins—might it not be more sensitive to local business needs and interests?

**Charles Armstrong:** Businesses might perceive it as better that the local authority would be receiving their income. However, that would be a perception only; there would be no real benefit.

**Mr Harding:** You support the imposition of full council tax on second homes. Has the council estimated its potential extra income if that happened?

**Charles Armstrong:** We have not gone through that exercise as yet.

**Mr Harding:** Can you explain further why you consider that the council tax base and the yield from a council tax levied on second homes should be treated differently for revenue support grant purposes from the existing council tax base and yield?

**Charles Armstrong:** I am not quite sure that I follow the point of the question.

**Mr Harding:** You say in your submission:

> "This change is supported, subject to adjustments to the grant distribution arrangements to ensure that any increased yield from Council Tax revenue does not simply result in an equivalent reduction in RSG."

**Charles Armstrong:** I meant that there is little point in expanding the council tax base to include second homes if the revenue support grant is simply reduced accordingly. However, I accept the point that that would mean a small increase in the local tax base at the expense of the Government grants.

**Mr Harding:** I will go on. What implications do you believe that the special treatment of the yield from the full council tax on second homes would be likely to have for the future of an equalising grant system in Scotland? Do you feel that it would reduce the RSG? RSG is not reduced when you build new homes, is it?

**Charles Armstrong:** I was thinking of council tax on second homes as an additional source of income for the local authority. If we are given an additional source of income—

**Mr Harding:** It should be additional.

**Charles Armstrong:** Yes. It should be allowed to be put into services rather than clawed back by central Government, which, in effect, it would be if the RSG were to be adjusted downwards.

**Iain Smith:** I want to ask about capital. Your submission suggests that you agree with the approach of other organisations to the move towards a prudential system for capital finance. Is that a reasonable interpretation of your remarks?

**Charles Armstrong:** What we are saying is broader than that. I think that section 94 controls should be abolished altogether and that control should simply be through revenue.

**Iain Smith:** That is essentially similar to the prudential approach. The submission states that you have had some difficulties with public-private partnership schemes and private finance initiatives. Can you give us some examples of the types of difficulties that have arisen?

**Charles Armstrong:** We have started to build a new school complex. That has taken something like two years of preparation, which is much longer than it would have taken normally. We have had to spend a significant amount on consultants, specialists, legal advisers and financial advisers. We would not have had to do that if we had been involved in a conventional capital project.

At the end of the day, however, we are getting nothing out of this deal that we would not have got out of the deal had we been able to finance it conventionally. I accept that the use of PFI and PPP schemes reduces the public sector borrowing requirement as funding is off balance sheet. I also accept that that helps the national economy, but it comes at a significant cost in terms of time delay and consultants' fees. It is a more expensive way of reaching the same end.

15:00

**Mr McMahon:** Many of the submissions from councils that we have received say that the council tax base should be revalued and that the banding structures should be changed. Your written evidence says nothing about any revaluation but says that the tax system should remain structurally unchanged. Why have you adopted that position?

**Charles Armstrong:** I am aware of the views of other councils. When I say that the tax system should remain structurally unchanged, I mean that the basic system is satisfactory and is working quite nicely. Revaluation is a sensible thing to do—it is so obvious that it should happen from time to time that I do not think that it has to be highlighted as being a potentially major change to the council tax system.

Since sending my submission, I have given much thought to increasing the number of bands. There would be a marginal advantage to increasing the bands at the higher level as that would bring in some additional money. I do not know whether it is worth extending or refining the bands at the lower level. I would like work to be done to determine whether that would cause any difference or whether the existing council tax benefits scheme takes care of people in the band A and band B houses, who tend to be the people who receive housing benefit.

**Mr McMahon:** Is there an argument for allowing a degree of flexibility in the level of bands between one local authority and another, or should the structure remain the same in the interests of uniformity? If the number of bands is increased, should that increase be uniform across Scotland or should account be taken of the number of houses in each band in any given area?

**Charles Armstrong:** Any change in the number of bands should take effect across Scotland. I do not think that there would be any advantage in having differences between local authorities.

**Mr McMahon:** I wondered whether there might be a difference between the number of houses in a particular band in a rural area compared with an urban area or in a deprived area compared with a prosperous area. Does that have implications?

**Charles Armstrong:** What you say is true. For example, Aberdeenshire has fewer houses in band A than Glasgow has. However, I am not sure that the problem of deprivation could be addressed by changing the council tax banding. Again, the issue that you raise would probably have to be investigated in more depth, but my gut feeling is that such a change would not be beneficial.

**Dr Sylvia Jackson:** When you spoke about the distribution formula earlier, you said that simplifying the formula would make the situation easier, although it was a broad-brush approach. After considering some of the complexities, we agree with you to an extent. However, bearing in mind the section in your paper on hypothecation and challenge funding—and I accept that it is an officer-led paper—surely the attempt to dovetail more closely national priorities with local outcomes that will meet local needs is important. Nearly every council that I can think of has talked about infrastructure needs. Do you think that the section on hypothecation and challenge funding is useful in the attempt to come to some agreement between national priorities and local needs?

**Charles Armstrong:** The problem with hypothecation and challenge funding is that they concentrate too much on inputs—money—and do not concentrate on outputs, which is the difficult bit. Something should be done to develop more output controls. I accept that the Scottish Parliament has priorities that must filter down to local authorities, but the best approach that can be taken is to filter money down or, although this is more off beam, to assist through grant-aided expenditure figures. It would be worth researching ways of setting output targets for those priorities and allowing local authorities to determine how best to meet those output targets.

**Dr Jackson:** Could you give us examples of situations in which the cost that the council has incurred in preparing unsuccessful bids has been unhelpful and of any schemes that the council has introduced only because you have obtained challenge funding, not because the schemes were particularly high priorities for the council?

**Charles Armstrong:** I am pleased that I do not have any elected members with me and am therefore able to give an example. I know that a park-and-ride scheme was introduced only because it was almost entirely funded by the Scottish Executive, which made available about £300,000 of additional borrowing consent for the scheme. There had to be a leap of faith with the park-and-ride scheme, which is not an initiative on which we would have placed a high priority if we had had to fund it from our own resources.

**Dr Jackson:** Are there any examples of situations in which an enormous amount of time was taken to prepare an unsuccessful challenge funding bid?

**Mr Gibson:** All of Aberdeenshire Council's bids are first-class.

**Charles Armstrong:** There are examples, but I am having difficulty coming up with a suitable one. I will inform the committee of some examples at a later date.

**The Convener:** I want to ask a couple of questions to clear up some loose ends from earlier questions.

Gil Paterson asked about grant distribution. What did you mean by the six indicators or six elements that you think should be in the grant distribution process? By indicators, I mean factors such as population or pupils and by elements, I mean roads and social security spending and so on.

**Charles Armstrong:** I was talking about indicators, for example, population, school pupils and road miles.

**The Convener:** My question leads on from something pursued by Sylvia Jackson. Iain Smith talked about this. What was the extra cost of the

PFI scheme and the capital cost of the school that you talked about? If you do not have figures, you can perhaps give us information later, as you promised Sylvia Jackson.

**Charles Armstrong:** The capital cost is around £20 million. The advisers' fees total just over £1 million so far. Had the school been procured through normal means, those advisers' fees would not have been required. The work required would have been done in-house. In the end, it still consumed a lot of our in-house time plus advisers' time.

**The Convener:** If the council could change one thing in local government finance to make a difference, what would that be?

**Charles Armstrong:** Section 94 controls should be abolished. At the moment, there is a double control. There is control through section 94 over capital spending. The revenue costs that that generates through loan charges are then effectively controlled through the revenue side. One control would be sufficient on the revenue side rather than the capital side.

**The Convener:** Thank you for coming.

Have we lost Gil Paterson, comrades?

**Mr Gibson:** He is on a secret mission.

**The Convener:** I welcome representatives from Argyll and Bute Council. Councillor Paul Coleshill is the chair of the policy and resources committee, which is an important council committee. Stewart McGregor is the director of finance.

Both representatives know the procedures because they have been sitting at the back. I therefore hand over to them. The committee will ask questions afterwards.

**Councillor Paul Coleshill (Argyll and Bute Council):** To correct you, convener, the council reorganised last Thursday and I am no longer chair of the policy and resources committee. That committee no longer exists, however important it was, but I was the chair of the committee and that is why I am here.

**Stewart McGregor (Argyll and Bute Council):** Councillor Paul Coleshill and I appreciate the opportunity to give evidence to the committee and we welcome the committee's proactive approach to the complicated issue of local government finance. I want to say a few words in support of the submission. Paul Coleshill also has some remarks.

I wish simply to highlight revenue grant distribution among councils. I will use the review of the special islands needs allowance as an example. That review identified particular factors that caused the cost of service delivery to be higher than normal. The current grant distribution system is mainly formula-based and does not adequately reflect real-cost pressures that affect the delivery of services. The review of the special islands needs allowance identified such pressures and recognised that they were over and above pressures that are reflected in the current formula-based system that is used to distribute grant.

As a result, any future formula-based system for grant distribution should be augmented by an independent study of service delivery where there is evidence of specific local circumstances within a council that materially affect the cost of delivering a particular service. Our council believes that the rigidity of the formula-based grant distribution system has failed Argyll and Bute Council in the past in some respects. We believe that a commonsense, pragmatic approach to augmentation is required in the future.

**Councillor Coleshill:** Thank you for allowing us to give evidence. In my day job, I am an economist. Being simple-minded, as economists are, I cannot understand why some form of gross domestic product is not used in the funding formula. Some sort of GDP, calculated per head for council areas, would seem to be a useful alteration to the funding formulation. It would enable councils such as Glasgow City Council and our own to put forward a case that we are poor or we are rich. People could see how much income people have, either per household or per head. The difficulty at the moment is that data are not fully available. I will return to that point if members' questioning suggests that that is appropriate.

15:15

During the time that I was sitting at the back of the committee room, I was interested to hear other councillors report how expensive they found PFI to be. Our council has two PFI/PPP projects on the stocks. One is a PFI waste management project that has taken four years, cost £0.75 million in advisers' fees and is only just coming on stream.

The PPP project, which I distinguish quite carefully from PFI, relates to school funding. We have identified a backlog of between £70 million and £80 million required maintenance on our school buildings. There is absolutely no way that we can fund that work, and Argyll and Bute does not have marketable land that a private company would like to take as part of a PFI arrangement. We are trying therefore to set up a distributing, non-profit-making organisation. We hope that that will be allowed under the PPP rules, although it is a side step. I heard one person say earlier that the reason for taking on PFI was to get borrowing out of the PSBR. That is precisely not the reason that the Treasury gives for using PFI. However, my own belief is that that is precisely why it exists. I will stop on that last remark.

**The Convener:** No one has signalled that they want to start the questioning and, as I have not written anyone's name down yet, I will start with a quick first question. Now that I have said that, they will all start putting their pens up.

**Mr Gibson:** The convener winked at me.

**The Convener:** I winked at Kenny Gibson for another reason. It was nothing to do with calling members.

Councillor Coleshill's comment on GDP was interesting. Does GDP measure the cost of the delivery of services and, if not, does not the benefit system cope with low incomes?

**Councillor Coleshill:** Is the convener asking me why we should switch to either an individual or a household-based gross domestic product measure?

**The Convener:** Yes.

**Councillor Coleshill:** The grant distribution system that we have had, and that we have moved to, leaves most councils dissatisfied, including Glasgow City Council and Argyll and Bute Council. There is no system that would not leave some councils dissatisfied, and that does not mean that the system is not working. The fact that those two councils are dissatisfied should lead members to believe that the current system is working appallingly badly. My suggestion is to introduce a relatively simple structural change, which would not be statistically impossible—indeed, in relative terms, it would be simplifying. It would address some of the issues that people have come here to tell the committee about.

Glasgow City Council and Argyll and Bute Council do not feel that they are getting a fair crack of the whip. For example, data from a household income survey by the Public Health Institute for Scotland show that the Inverclyde area has an average family income of £16,690 per annum and that the West Dunbartonshire area has an average family income of £19,090, whereas the average family income in seven areas of Glasgow—which is divided into 10 areas for the survey—is well below that figure, at around £13,000, and the figure for Argyll and Bute is £16,300. The current mechanism does not address such disparities between those council areas. Argyll and Clyde Health Board says that Argyll and Bute is the only council out of the five that it covers that is not deprived; however, on those results, it certainly is.

**Mr Gibson:** I looked at those figures, which show that the average household income is about £23,000 in West Aberdeenshire, whereas in Pollok, in Glasgow, the average is £13,250—24.1 per cent below the Scottish average. What kind of weighting should be given to that kind of information? The Scottish average household income is £18,200. If the average in Argyll and Bute is 10 per cent below that, should Argyll and Bute receive a grant of 10 per cent above the Scottish average, or should it receive a grant of 20 per cent above the average?

**Councillor Coleshill:** With respect, that is not the way in which I shaped the question.

**Mr Gibson:** Indeed. Other factors must be taken into account, such as islandness and rurality. There are also issues of urban deprivation. How would the mix work?

**Councillor Coleshill:** Data have not been compiled to a sufficient level, therefore we do not have a result. If we had a result, we could compare the pattern that emerged with the pattern that has emerged from the current indicators. This may sound fanciful, but it is a bit like the difference between the Copernican system, whereby the earth orbits the sun, and the system that existed before, in which spheres were continually added to make the apparent motion of the planets fit what people actually saw. The present grant distribution system is complex, because so many spheres have been added by way of adjustments.

What I am suggesting is not a perfect system, which will give a definitive answer, but some sort of mixture. I am a simple person, and I believe that, if we have a measurement of how rich individuals are, it would be most useful if we could use it. That is not the only answer or the only measure, as deprivation can be intensified by other factors that might also be measured. However, it would be a useful measurement to begin with. I am not sure how the average household income in an area would affect grant distribution—whether it would lead to increases of 10, 20 or 50 per cent—but at the moment it does not affect it at all, and that cannot be right.

**Mr Gibson:** I am fascinated by your argument, which we will have to consider further. From your submission and from what you have just said, you seem to support the idea of a local income tax. You may have heard previous witnesses reject that idea without having taken evidence on the matter. What is the view of Argyll and Bute Council on the issue of a local income tax?

**Stewart McGregor:** We also state in our submission that council tax collection has been improving over the years. A lot of councils had to replace their council tax systems, which had an effect on council tax collection. However, the rate of collection is improving and the system is settling down, and we must recognise that.

We also have a fairly effective means of collecting council tax, and collection costs are about 2.3 per cent of the amount to be collected. The Inland Revenue recently published statistics that show that its collection costs vary from 1.1 per cent to 2.1 per cent. Of course, the Inland Revenue does not include all the employers' costs of collecting tax. Although we acknowledge that a system of local income tax could be effective and might be seen as more progressive, we have not undertaken any further detailed studies into it and, as a result, cannot make any comparisons with other countries.

**Councillor Coleshill:** The point that you made about the political balance of Aberdeenshire Council applies very much to Argyll and Bute Council, which I represent.

**Mr Gibson:** I am also intrigued by something on page 2 of your submission. You say:

"In Scotland, uniquely, water and sewerage is collected alongside council tax. The high increases in these charges have affected perceptions of increases in council tax."

We would all accept that. Should we therefore separate out the collection of various charges? For example, it has been suggested that tenants' rent should be added into the mix to make it easier to collect the whole package. How would such separating out work in practice?

**Stewart McGregor:** We think that the charges should be separated out, as it would help councils. It has become more difficult to collect arrears for water and sewerage charges. We do not get a very good return from the water authority, and the recognition of the costs that we incur in collecting those arrears could be improved. As the charges appear on one bill, people think that the council sets all of them.

**Mr Gibson:** You talked at some length about your belief that Argyll and Bute Council does not get a good deal from the distribution of grants and so on. On the last page of your submission, you say that

"the current grant distribution system has failed Argyll and Bute since local government reorganisation and reliance on COSLA and the Distribution Committee system has also proved to be ineffective in resolving inequities. There is clearly a role for some form of independent intervention in the future to address the anomalies in the grant distribution system."

What form should such intervention take?

**Stewart McGregor:** I tried to expand on that point in my opening remarks.

**Mr Gibson:** I know, but I was not quite sure what you were getting at.

**Stewart McGregor:** Using the special islands needs allowance review as an example, we have shown how the distribution system could be improved and simplified through recognising other factors in areas where the formula-based system was failing. In late 1995 and early 1996, Argyll and Bute Council put forward the case that the current system did not adequately reflect the spending need in the area. No doubt many other councils will express the same view.

**Mr Harding:** I asked the previous witnesses about council tax on second homes, which is a proposal that you support, but with reservations. Approximately how many second homes are there in Argyll and Bute, and what proportion of the housing stock do they represent?

**Stewart McGregor:** You have put the question very carefully by referring to second homes, not holiday homes, about which there has been much comment. We cannot yet distinguish between holiday homes and second homes that receive a discount. However, we will have that information in a few months' time after the review that we are carrying out.

Approximately 3,600 houses in Argyll and Bute receive a discount as a second home, which translates to about 1,800 houses at equivalent band D. If a distinction were made and a higher level of council tax were levied on holiday homes, some owners might change to a non-domestic rates system, which would mean that we would lose that council tax income. We roughly estimate that we would earn a further £1 million in council tax income by levying a full charge on holiday homes. However, the grant distribution system contains another complication. If the number of band D homes increases, a council loses some of its revenue support grant.

15:30

**Mr Harding:** Have you any idea how the proportion compares with the average for Scotland?

**Stewart McGregor:** No, I have not carried out that work or obtained any other information.

**Mr Harding:** But it is relatively substantial, is it not?

**Iain Smith:** I want to come back to the distribution formula. I am only half of an economist, so I get more confused than Paul Coleshill does, and I need simpler information. I am unclear whether you are arguing for a more complex distribution formula—because you seem to be arguing that certain other factors should be taken into account that currently are not—or for a simpler formula. Could you clarify that for someone who is as simple as I am?

**Councillor Coleshill:** We are conscious of the fact that a formula exists. What could we recommend that you might accept? Altering the current formula to include an extra element, and advising you to take out a number of spare elements, seems to be the best idea, so I advocate that you take into account GDP averaged for council area or households, which is information that is calculable now.

I should be content to see half a dozen minor indicators and one or two major indicators crossed off, because the remaining information would do the job, but I would not want that to be done without comparing the results. So to start with, the process would be more complex because people would be doing two jobs. It is no use asking individual councils to give a view of what the result would be across Scotland. Councils are aware that many of them are unhappy with the distribution system. Relating an element of the formula to income per head would be an improvement, and would solve some of the problems that councils as disparate as ourselves and Glasgow have. That does not answer your question, does it?

**Iain Smith:** Not really, no.

**Councillor Coleshill:** I did all right, then.

**Iain Smith:** At the end of the day, whatever changes are made, there will be winners and losers. Argyll and Bute Council and Glasgow City Council are asking for changes because they think that they are losers under the system. The change that you are advocating obviously is one that you think would benefit Argyll and Bute, but somebody else would lose.

**Councillor Coleshill:** I am suggesting a change that would be fairer and imply a socially inclusive programme, which I believe the Executive wishes to see. Because Argyll and Bute is poor, it would benefit, and because its social exclusion is not adequately measured at the moment, it would benefit. That is not an incidental effect of my recommendation.

**Mr McMahon:** Kenny Gibson indicated earlier that he did not have a particular line of questioning on this issue, and then proceeded to ask the question that I was going to ask. One issue is independent intervention with regard to grant distribution. Are you advocating a commission as an independent arbiter?

**Stewart McGregor:** We are not being as specific as that. We have simply used the SINA review as an example of what could be done with some form of independent analysis. That analysis would be fair where the local policy choices could be separately identified, leaving real spending needs exposed. That would have to be done with some form of academic independence, with professional expertise in the area being employed. Certain areas of service delivery in particular councils would be investigated and reported on. I believe that such analysis would improve the distribution system.

**Mr McMahon:** I was going to ask for some examples. Obviously, Argyll and Bute receives SINA because of its rural nature and because of the disparity between one part of Argyll and Bute and another. Do you have specific examples of the impact of lack of economies of scale, sparsity and so on? Why would that need to be taken into account?

**Councillor Coleshill:** We have a large body of data.

**Mr McMahon:** Could you give us one example for the record today and send the rest?

**Stewart McGregor:** The review of the special islands needs allowance identified that super-sparsity had a big impact on the cost of delivering services. Super-sparsity affects not only Argyll and Bute but other rural councils. Our council has done further research on that and has submitted a paper to Angus MacKay. Super-sparsity is where services have to be delivered to small pockets of communities beyond, say, the 25-mile distance. Super-sparsity drives costs up and is worthy of another study.

Lack of economies of scale probably applies to 10 or 11 smaller councils. One of the Lothian councils has already done a lot of work with the Scottish Executive. A good bank of work is already available, which could be explored further.

I could probably give one or two other examples that are particular to Argyll and Bute, but I will mention only the support of public transport. Of the 12 councils in the west of Scotland that came out of the Strathclyde grouping, all except Argyll and Bute, I understand, spend at or just below their GAE level in support of public transport. Argyll and Bute has to spend three to four times more than its GAE in that area. I welcome the opportunity to mention such examples. Councils can give many more.

Some councils merit further special scrutiny. It would be a benefit to the grant distribution system to add that to the methodology.

**Mr McMahon:** On a slightly different area, your authority seems to assume that a locally set non-domestic rate would discourage inward investment in some areas. Perhaps that is because of sparsity. Does Argyll and Bute Council believe that all local authorities would fail to take account of the likely impact of a local non-domestic rate poundage on the business community?

**Stewart McGregor:** We have answered for Argyll and Bute in that respect. It may be of interest for the committee to know that of our total non-domestic rate—the contributable amount is £25 million to £26 million—between £7 million and £8 million relates to Faslane and Coulport, which are not actually businesses. If Faslane and Coulport are taken out, Argyll and Bute has a low non-domestic rate base. As a council, we are looking for all the support that we can get to attract inward investment and help to improve the economy of the area.

**Mr McMahon:** I am not trying to be difficult, but it seems that you argue that in some cases Argyll and Bute needs to be treated separately, but that in other cases it needs to be seen within the broader spectrum, which must be taken into account. Would not that lead you towards a national council tax, which would take such problems into account?

**Councillor Coleshill:** The submission is equivocal because the council is equivocal. In its thinking on non-domestic rates, the council has taken into account the fact that there is only a limited number of things that can be done to increase the percentage of council expenditure that is raised locally. Returning control of non-domestic rates to councils would be one of them, but you would have to give us full flexibility—or at least as much flexibility as is currently given with the council tax—in order for it to make a difference. If control were to be returned, we would ask whether there was an economic disadvantage for Argyll and Bute Council. To put it crudely, we would wonder whether our neighbouring councils would pinch stuff from us. Because of such considerations, our submission is equivocal on certain issues. I am sorry, but that is how it is.

**Mr McMahon:** If the grant distribution system took into account the specific spending needs and resources of your council, would that alter your views on the localisation of decisions on the tax rate?

**Councillor Coleshill:** Personal views have been given by other witnesses today, so I feel okay giving my personal view, which is that I want control of non-domestic rates returned to local authorities. I cannot see how that would be harmful. It would mean that decisions were taken at the level at which they should be taken. However, that is my personal view; it is not the view of Argyll and Bute Council. The council is equivocal.

**Dr Sylvia Jackson:** Having an economist daughter, I share your thoughts about economists taking a simplistic view of the world.

**Councillor Coleshill:** I sympathise.

**Dr Jackson:** Several months ago, or perhaps even longer ago, the European Committee discussed rural deprivation indicators. At the time, the Scottish Executive was doing research into the whole issue, which, obviously, is complex. You have spoken about data that were collected to do with the islands allowances, and I think that you mentioned the Lothians as well. Was that data collection part of the research exercise, or was it separate from it? Are you considering issues that are wider than the issue of deprivation indicators? Are you considering particular needs in your area?

**Councillor Coleshill:** The special islands needs allowance is a special case. Argyll and Bute Council has been fighting for it for ever. In the past, all Scotland subsidised the Western Isles and half of Scotland subsidised about 30 islands. After the 1996 reorganisation that created 32 councils, only Argyll and Bute Council subsidised 26 of those islands. Because of the extra costs that islands entail, it seemed to us that we had a straightforward and overwhelming technical case. That case was ignored for years. We have fought bitterly about that. Because our case was ignored, we felt that something was wrong with the distribution system.

However, the special islands needs allowance case is quite separate from the general case, which I have presented today, on GDP. Consideration of GDP would assist Argyll and Bute Council. However, in Aberdeenshire, there might be a specific local problem that has to be taken into account, in the same way as the 26 inhabited islands have to be taken into account in Argyll and Bute. Two points arise. First, the current distribution system has failed Argyll and Bute, as our submission suggests. Secondly, if we are being asked what changes we would make to the system, we can argue that you should give us a special islands needs allowance—which of course you should—but we must also recommend specific changes that we think will benefit the whole of Scotland.

**Dr Jackson:** I think that you suggested earlier that not many data were available to help you to consider the wider issues.

**Councillor Coleshill:** Data on gross domestic product?

**Dr Jackson:** Yes—but I think that you were also talking about your particular case.

**Councillor Coleshill:** We have been working on the special islands needs allowance for five years and we have volumes of data–whole libraries. We could supply those data if necessary. I suspect that each council has volumes of data on its specific problem. All those data should be taken into account in a distribution system that made sense. The current distribution system does not make sense, because those data are not properly weighed. The data that are not there—on GDP—should be gathered. As a simplistic economist, it seems to me that GDP is a very useful piece of information, which could be particularised to council level and used as an information tool to make decisions on distribution.

**Dr Jackson:** If you take average values of gross domestic product, does that cause difficulties with regard to spread or degrees of deprivation? I am trying to link this with the bigger issue of rural deprivation indicators and so on.

15:45

**Councillor Coleshill:** Deprivation is a construct of the devices that people use to measure it. At the moment, the only devices that are readily available—they are not very readily available, but they are used—are urban. Under the Carstairs index of deprivation, which is not used for distribution—and which would terribly disadvantage Argyll and Bute—if someone owns a car, they are not deprived. Argyll and Bute is 120 miles by 120 miles of land and sea, with only 90,000 people, including people who are desperately poor but must struggle to own a car. The measure of deprivation, under the Carstairs index, would relate to the concentration of certain indices, including those covering various sorts of claimants. There is no concentration of population in Argyll and Bute bigger than Helensburgh, which has about 15,000 people. It is like Australia. We cannot use urban deprivation indices. It is nonsense to say that we do not have deprivation.

We have five social inclusion partnerships. It is excellent and marvellous that we have them—we have got some money—but they are for five tiny little areas in five tiny little places, which have just enough people for us to have been able to argue that there should be a SIP. What does not count, however, in the measurement of deprivation is six people here, seven people here and 20 people there, who are in dire need. We have no money nor a mechanism to help them.

I know that committee members know that—I am just making the point that we do not have measures of rural deprivation; we have measures of urban deprivation, and they are not good and not perfect. So far, the Scottish Executive has not produced any measures of rural deprivation that I have seen. Believe me, I have pushed to hear that the Executive is working on them. We would love to work with the Executive to establish such measurements.

**Dr Jackson:** Could I recommend that we perhaps take the issue up later, when we see representatives of the Scottish Executive to find out a bit more about it?

I will come to the question that I was supposed to put to you. I ask that you answer it very quickly, as I am aware that time is running out. It is about PFIs and PPPs. There are obviously difficulties with the length of run-in time, the level of consultancy fees and so on. How can there be improvements to make those aspects of the system better? You say that the system also has advantages.

**Councillor Coleshill:** This is a composite submission. I would say that the system has no advantages. However, that is not Argyll and Bute Council's view. As far as I am able to tell it to you, the council's view is that we are desperate for capital, will do anything necessary and will jump through any hoop. The pressure of European directives has led us to go for the waste management PFI. There was no other way. That has cost us £750,000 in external fees. It is an absolutely essential service, delivered by the public sector with public sector capital—but, okay, we have privatised it. However, nobody wants to do the islands, so we have to do them ourselves. As for the rest of the money, the Scottish Executive is putting in millions.

I have absolutely no objection to working constructively with the private sector. I am in favour of it; I think that it is a good thing. We have to consider the fact that opportunities are different for different council areas. One proxy for consideration of whether PFI could work in different council areas could be the non-domestic rateable value in each council area. Our non-domestic rateable value is not particularly high. That gives us a proxy both for PFI-ability—that is a horrible word—and for the capital receipts that could reasonably be expected from councils. Not much in the way of capital receipts can reasonably be expected from us, because we have no property that is worth selling. In that case, the distribution system would have to be adjusted to take account of very rich areas.

**Mr Paterson:** I remember seeing kangaroos on Loch Lomondside—did they come up to Argyll? I do not expect you to answer that, because you will not know the answer.

**Councillor Coleshill:** See the pink elephants out there.

**Mr Paterson:** It is true—I saw kangaroos on Loch Lomondside.

**Mr McMahon:** Were you at the bar earlier?

**Mr Paterson:** You folk do not know a lot about Scotland.

On page 4 of your submission, Councillor Coleshill, you dismiss a local sales tax because of differentials across boundaries. Would it be more acceptable to you if a national sales tax were implemented, from which local councils could take a bite? Would that solve some of your problems?

**Councillor Coleshill:** No.

**Mr Paterson:** Why is that?

**Councillor Coleshill:** Argyll and Bute is isolated, so it is not as badly placed as are other councils to deal with a local sales tax. The problem would be at the boundary; for example, people might buy their washing machines in

Dumbarton and not in Argyll and Bute. In the majority of councils in Scotland, people would go 200yd, across the boundary, to buy their washing machines somewhere else. I cannot see how that would work.

**Mr Paterson:** Would it help if a national rate were set?

**Councillor Coleshill:** Do you mean a national sales tax that is handed generously to local government?

**Mr Paterson:** The point is this—

**Councillor Coleshill:** We would be happy with any tax that is handed generously to local government.

**Mr Paterson:** The point I am trying to make is that you do not have any levers at present. Governments can bring in all sorts of taxes and tell us that we are getting better treatment.

**Councillor Coleshill:** I am entirely in favour of taxes being handed entirely to local government.

**Mr Paterson:** Thanks—that will do.

**The Convener:** In your written evidence, you say:

"Any move to an outcome based approach to delivery of services is inconsistent with the need to have hypothecated funding."

Will you expand on that?

I know that you have been waiting to answer my next question. What one thing would you do to change local government finance?

**Councillor Coleshill:** We have two answers.

**Stewart McGregor:** The view was that the ring-fenced moneys were acting against other initiatives and the on-going delivery of services. One example comes from our education department. We have made a succession of cuts in recent years in education. Teachers' posts were cut as part of the general need to cut expenditure. However, at the same time, classroom assistants were coming in. The belief within the education department is that if we had been given more flexibility, we could have concentrated on outcomes.

In answer to your second question, I will stick to what I said at the outset about a simplified grant distribution system that takes into account special local circumstances and evidence of particular difficulties in a council.

**Councillor Coleshill:** To do the politician's trick of not quite answering the question, in capital terms, I would get rid of PFI. Secondly, in revenue terms, I know that it sounds odd, but I would get rid of the section 94 capital consent because it has an impact in revenue terms as well as capital terms.

**The Convener:** Thank you.

As you have probably noticed, it is freezing in here. I have asked for extra heating, but there is none. We will have a short break. I have another meeting to go to, so I will hand over to Sylvia Jackson. I apologise to the next witnesses, who will be on in a short time.

15:53

*Meeting adjourned.*

16:04

*On resuming—*

**The Deputy Convener (Dr Sylvia Jackson):** I call the meeting to order. It is still quite cold, but we will press on.

I welcome the Scottish branch of the Chartered Institute of Public Finance and Accountancy directors of finance section. We have with us John Campbell, who is chairman of the CIPFA directors of finance section and director of financial services for Scottish Borders Council, and Bill Hughes, who is vice-chair of the section and director of finance and information technology at Renfrewshire Council.

Would you like to say a few words?

**John Campbell (Chartered Institute of Public Finance and Accountancy):** The CIPFA directors of finance section very much welcomes the opportunity to give evidence to the committee.

Local government finance is a challenge for us all. We start by acknowledging the progress that has been made in the past year—the position is certainly better than it was 12 months ago. We appreciate first hand how complex a subject local government finance is. We do not envy the committee's task. If the CIPFA directors of finance section can offer any professional assistance as the committee reaches the conclusion of its inquiry, we will be happy to do so.

I turn now to our submission. I apologise for its lateness. I listened with interest to our colleagues from Argyll and Bute Council as they tried to reach an agreed position. The committee can imagine what doing that has been like with 32 directors of finance; we have had a little bit of fun trying to achieve what we think is a general submission for the committee.

I will start by picking out one or two key issues and then we will be happy to answer the committee's questions.

Our first point is the balance between central and local funding, which we ask the committee to consider carefully. There is an imbalance at the moment. An easy way to put right part of that imbalance would be to let local authorities set non-domestic rates.

On council tax, we have made representations that the bandings should be the subject of a review. We have a number of examples from various local authorities in whose areas there is wide variation in the values of the houses in band A and at the other end of the banding system. We ask the committee to examine that, along with the valuation process.

On the grant system, hypothecation has been a problem for all directors of finance for a number of years. Even in the latest, three-year agreement, to which I referred obliquely at the beginning of my remarks, what we would call hypothecation by the back door arrived soon after the formal circular was issued. That gives local authorities a great number of problems in trying to match local needs to the Scottish Executive's needs.

The CIPFA directors of finance section asks the committee to consider a more formal joint planning framework between the Scottish Executive and local authorities so that both achieve what they want to achieve. The Scottish Executive and local authorities often come across as competitors, although they have a single aim: to provide the best public service to the public in their respective areas. If we worked together on that and on the funding for it, we would all provide a better service.

We have touched on the distribution mechanism. Bill Hughes and I found it interesting to be in the audience this afternoon and to note how much time was spent on distribution. We recognise that scenario easily. As directors of finance, we seem to spend a great deal of our time, if not most of it, arguing about splitting up the cake when we believe that the real problem is the size of that cake. If we had a joint planning framework between the Scottish Executive and local authorities, we would all spend our energies much better than we do.

On the intelligibility of the distribution system, we noted the comments about having a simple system. We are not advocating a simpler system; we are trying to put forward a more intelligible and transparent system. In particular, as officers, we make the point that we believe that the distribution system should be professional, not political, as some of us have encountered it being in recent times.

My final point is about capital expenditure. We agree with the abolition of section 94 controls and the adoption of a prudential framework. We consider public-private partnerships to be another tool, but not the only one.

Those are the highlights. We are happy to take questions.

**Mr McMahon:** Thank you for clarifying whether the setting of non-domestic rates should return to local control. What would be the main effects of that?

**John Campbell:** The main effect would be on accountability. It is difficult for us to be accountable for only some of the people in our area. Throughout the country, there have been different rates of increase in non-domestic rates compared with council tax. Explaining those differences involves challenges for us all. If local authorities are to be held accountable, they must have a level of funding that allows them to meet the requirements of accountability and decide on the level of expenditure.

The position depends on whether inflation is high or low—we may be protected a little at the moment. If inflation were high and non-domestic rates were increased at levels similar to recent levels, we would have more problems.

**Bill Hughes (Chartered Institute of Public Finance and Accountancy):** The business community needs some reassurance that, if the setting of non-domestic rates was returned to local control, businesses would not suffer the difficulties that they experienced when local authorities had control before. Local authorities would need to show by their prudence that that would not be a concern.

The present system involves a perverse disincentive. Local authorities issue rates notices and collect a national tax. They have no incentive to maximise the collection of that tax, because it is subject to a pooling arrangement. Therefore, local councils' collection efforts have no direct benefit to them. I am not suggesting that any local authority is not doing its best to maximise collection, but I find it strange that a local tax collection system has no incentive to maximise the tax.

Returning local rate setting to councils would allow decisions to be taken locally. Authorities would then be able to consider the gamut of rating legislation and develop the different reliefs that are available to them to suit local circumstances. I was interested to hear the comment from colleagues from Argyll and Bute Council about a mechanism that they were considering for developing a public-private partnership that would be a trust. One attraction of that is that it would take the council outwith the liability for non-domestic rates. In other words, the other 31 councils in Scotland would help to pay for the trust. That applies across all councils, for which several trusts have been devised. Returning rates to local control would improve the transparency that John Campbell emphasised and allow decisions to be taken locally to meet local community needs.

**Mr McMahon:** If you had your ideal world and it was agreed that local authorities should set their own NDR, how much time would local authorities need to adjust to the new system? What practical difficulties do you envisage?

**John Campbell:** We must take account of the fact that we are in the first year of a three-year settlement. I would not envisage great difficulty in adjusting to the new system, because we would just take it into the funding mechanism. We already do the billing.

**Bill Hughes:** I agree. There would be no practical difficulties. However, the distributional effects of returning the setting of non-domestic rates to local councils would have to be considered carefully, because issues about disparities between councils must be thought through.

**Mr McMahon:** Have you given any thought to how local authorities would run the NDR system? Have you identified any difficulties in achieving uniformity in how the new system is employed?

**John Campbell:** I envisage no problem with the system of billing for or collecting non-domestic rates, because we are used to those and other functions. However, we would need to scrutinise any grant redistribution that would be required. If urban authorities could keep all the income from non-domestic rates to themselves, they would gain much more, to the detriment of some rural authorities that did not have similar opportunities. That would need to be part of a wider debate about available Government support.

**Mr McMahon:** Do you envisage any difficulty in adjusting the link between council tax and non-domestic rates? Should they be brought together? Should they be revalued at certain times? Should they overlap? What difficulties would be involved in doing that?

**John Campbell:** Our submission talks about council tax revaluation. We accept that non-domestic rates would also have to be revalued. We have touched on whether the valuation method for council tax should remain the capital value and whether the rental value should remain the basis of the non-domestic rates system.

**Bill Hughes:** The point is well made. I remember the effects of previous revaluations, when we collected domestic and non-domestic rates. Shifting the balance between the two sectors created distortions. We need to recognise the fact that if local authorities are once more to be given the ability to determine the business rate, the balance between the business sector and the domestic sector has to be thought through. Personally, I would prefer the balance to remain fixed over time so that there is no distortion between the two tax groups.

16:15

**Iain Smith:** Your submission talks about the relationship between council tax and non-domestic rates, but I am not sure what your thinking is. I do not know whether you are suggesting that there should be a maximum amount of income that can be taken from non-domestic rates or whether you are saying that the increase has to be the same for both sectors, so that councils cannot lump all the increases on the non-domestic rate payer, in an election year, for example—not that politicians would dream of doing such a thing, of course.

**John Campbell:** If local authorities were given the opportunity to get non-domestic rate setting back, they would, in the main, take a prudential view. I do not think that the election-year scenario that you suggest would arise.

Those who are old enough to remember the consultation on non-domestic rate payers about 12 years ago might agree with me that the process did not really get off the ground. It may be that it was a good idea that was implemented before its time and, as we are now in an age of consultation, it might be time to conduct the process again. However, it is difficult to justify to council tax payers in many areas the fact that the increase in their council tax is in some cases 2 or 3 per cent more than the increase in non-domestic rates. Many councillors think that there should be a link between the two sectors and that if one goes up by 5 per cent, the other should as well.

**Mr Gibson:** Paragraph 2.4 of your submission says that you believe that the council tax system is "relatively straightforward". Do you think that it is sustainable in the long term? Yearly, council tax seems to increase above the rate of inflation because of the gearing effect. If you believe that the system is not sustainable, have you given any thought to alternatives? There appears to be an attempt to tinker with the present system rather than to analyse alternative systems, such as the local income tax system, which was recommended by Layfield 25 years ago.

**John Campbell:** We are sitting here as officials, not as politicians. Your question should perhaps be directed towards those in the political arena. We will put in place the mechanisms by which local sales tax, local income tax or whatever can be collected. That is what local government officers do—usually to tight schedules.

Your point about the council tax could be made about any system. Your comments on the gearing effect and the above-inflation increases were accurate but, as officers, we would argue that there were other causes for that increase, such as new burdens, hypothecation and the lack of reasonable funding. As I said earlier, we need a bigger cake if we are to avoid the large increases in council tax that sometimes occur.

**Mr Gibson:** Although I absolutely agree with your comments, given the world we are in, council tax increases below the rate of inflation might not be the norm. Despite what you say about politicians making decisions, which you follow, are not finance directors responsible for recommending options for systems? At the end of the day, we are lay people and you are the experts; it seems quite insular that no one has considered systems in other countries that might be more effective. As I said to Jack McConnell in September 1999 when this issue first arose, it might well be the case that the current system is the best and that it just needs some adjustments. However, should not we consider other systems first? Why has that not been done?

**John Campbell:** I agree that we should consider other systems. We have not been able to because of the pressure of work on council officials.

**Bill Hughes:** This is a difficult question for the directors of finance section of CIPFA to answer. Certainly we have not been encouraged by the Executive or others to pursue that initiative, but the submission from the Convention of Scottish Local Authorities makes clear the organisation's interest in exploring approaches in other countries. We feel that the current balance is wrong. We need to have a debate about how we can correct it. We are not hooked to the single solution of returning rates to local authority control and achieving a 50:50 balance.

We must not forget the third player in this situation, which is central Government and its funding. Some of our difficulties arise because of changes in the Government's share of spending, which are considerably exaggerated by the gearing effect. Even a more balanced approach would have an impact. For example, there were similar concerns about the previous system of domestic and non-domestic rates, because reductions in the Government's share of funding caused burdens that affected the relatively good balance between domestic and non-domestic rate payers. At the time, Renfrew District Council consulted non-domestic rate payers and convinced them that the problem was not the council, but the bad Government of the day. Consultation can have a number of benefits.

We must keep recognising that the Government has an important role in funding local government adequately. Ideally, local government should not be dependent on central Government for any funding; instead, councils should control local taxes that would fund all their services.

**Mr Gibson:** We have fought quite hard for this independent review, which is why we hope people will look outside the ballpark. If people consider the issue from only a very narrow perspective, it makes the whole exercise not worthless, but less valuable than it should be.

Which untapped sources of income, if any, could councils dip into?

**John Campbell:** That is a difficult question, because many councils are trying to maximise their income through direct charges, a number of which have been introduced and indeed increased. I am not aware of any other innovative ideas, if that is what you are asking about.

**Bill Hughes:** Given the financial constraints that we have been under for some years, an easily collected and locally imposed charge could be introduced. The question is more about a system of national taxation that could be administered locally. Perhaps the most effective system would be a slice of value added tax; some kind of local sales tax might be relatively acceptable, although councils would have to resolve some cross-boundary issues. However, there would be no such issues if there were a national tax with national standards. Such a system might achieve a better balance.

**Mr Harding:** I was interested in your comments about the collection of non-domestic rates. You said that transferring the responsibility for non-domestic rates back to councils would give them an incentive for collection. When I asked about the amount of non-domestic rates that are uncollected, I was amazed to find that the figures are not available. Does either of you know the figures for your councils?

**Bill Hughes:** Our collection rate for non-domestic rates is generally between 98 and 99 per cent.

**Mr Harding:** So there is no great incentive to improve your collection rate, as only 1 per cent is outstanding.

**Bill Hughes:** That 1 to 2 per cent is a lot of money.

**Mr Harding:** There is a much greater incentive to collect council tax, which, as you said, you are not doing. Your collection rate is 10 per cent below that in England.

**Bill Hughes:** I must take issue with you—

**Mr Harding:** The collection rate for council tax is 10 per cent below the figure for England. Where is the incentive to recover outstanding non-domestic rates?

**Bill Hughes:** The challenge in collecting tax lies at the margins, where tax is difficult to collect. Most businesses pay their rates, although some have to be pushed to do so. Resources must be devoted to maximising that collection. I am not encouraged to put that effort into the collection of non-domestic rates because I receive no direct benefit from it. The public sector generally receives a direct benefit from the collection of council tax, which is partly why improvements have been made in all council areas in the in-year collection of council tax over the past few years. There is still some way to go, but the legislation that the Executive has introduced is helping considerably.

**Mr Harding:** I share the concerns of the Executive—that may seem strange—over the idea of returning control of non-domestic rates to councils. The uniform business rate was introduced to create a level playing field and to address the huge difference in rates between Scotland and England, which resulted from the large increases that were imposed over the years by mainly Labour-controlled councils.

You say that councils will have to demonstrate prudence, but I have fears over that. I recall Michael Forsyth being persuaded to stop ring-fencing housing grants in 1994-95. The end result is that less than half the amount is now spent on housing grants than was spent then, as the councils have moved the money to other areas. What guarantees can the Executive expect that the councils will show prudence and will not increase non-domestic rates out of all proportion? The only reason for returning control over UBR to councils—apart from the gearing effect, which does not work unless councils set the rate—would be for them to raise revenue and increase the tax base.

**John Campbell:** We are advocating a true partnership between the Executive and local government. For any partnership to work, there must be trust, and the Scottish Executive must trust that local politicians will act prudently. If they do not, who will be the losers? As an official looking at politicians, I see a sea change—politicians are now much more responsive to what is happening than they were. I recognise the picture of the past that Mr Harding is painting, but I think that we are entering a different era in which we must work together with the single aim of improving public services. We should not argue over whether councils can be trusted to keep increases reasonable.

**Mr Harding:** You mentioned hypothecation and ring-fenced moneys. Has the group considered under which circumstances it would be reasonable for the Executive to introduce or continue to use specific grants?

**John Campbell:** The section is generally against specific grants. First, they reduce the flexibility of local councils. Secondly, we are concerned about situations in the past—especially when we were receiving no inflation allowance in the central Government settlement—in which many specific grants were spent on manpower and there was no exit strategy for specific grant projects. After three years, what happens to that specific grant? Is it put back into the GAE pot as the total amount or as a lesser amount? We have had disagreements about what a new burden is and what the amount of a new burden is.

That takes us back to whether there is a need for hypothecation and specific grants. Why cannot the two sides sit down together and agree on a plan for the next three years? Local government should recognise that that is what ministers want to do. Local government should try to accommodate ministers' wishes, but equally ministers should listen to local government's wishes. Local government has the local knowledge to say, "If we put those two things together and get a funding package to cover it, that will improve local services."

**Mr Harding:** How do you think challenge funding should be managed? Who should be responsible for the appraisal and allocation of the process?

**Bill Hughes:** Our section does not have a view on challenge funding. It is a useful device if used sparingly but, when it is used to address issues that affect all councils and the outcomes are not spread fairly across all councils, it is not helpful. We have to be careful about which service areas and needs are selected for challenge funding.

**Mr Harding:** Would you prefer an independent appraisal?

**Bill Hughes:** By that, do you mean an assessment of who should receive funding?

**Mr Harding:** Yes.

**Bill Hughes:** Happily, I live in a political world where politicians have the good sense to come to the right decisions, having taken on board all the advice that they have been given.

16:30

**Mr Paterson:** Do you think that there should be a revaluation of the banding system and an increase in the number of bands? Should that occur at the same time as rates revaluation?

**Bill Hughes:** Our mailbags do not tell us that council tax bandings are a problem. However, as John Campbell said, we are clear that the banding levels need to be expanded; band A needs to be reduced and band H needs to be increased. It is increasingly problematic to explain to our council tax payers, when giving them their council tax notices, that their banding level is set not on the price that they would pay for their house today, but on the April 1991 price. Greater transparency and simplicity would result from a revaluation. It is not essential to revalue domestic properties at the same time as non-domestic rates are revalued; it would be important to undertake revaluation at the same time only if control of non-domestic rates were returned to local government.

**Mr Paterson:** Should revaluation be annual or biannual? Would that be helpful for people whose houses had deteriorated?

**Bill Hughes:** One of the clear advantages of the council tax system is that it is operated in bands. Changes seldom lead to a revision of the property banding level. However, there should be provision in the system to deal with any inadequacies.

An annual review would worry me, as council tax bills have to mean something to the council tax payer. A bill that changes because of alterations in council tax levels, banding levels and water and sewerage levels—the other complication in the bill—becomes unclear to the council tax payer.

**Mr Paterson:** Has the group considered what, if any, changes should be made to the capital financing system? Has the group considered the future role of public-private partnerships and private finance initiatives?

**John Campbell:** As I said in our introduction, we see PFI-PPP as a tool, but not the only tool, in the capital financing system. Our section is very much against the retention of section 94 controls. We also want to look in greater detail at the safeguards that could be introduced, as we expect that the Scottish Executive will want to have safeguards in the system.

We will look at any method of capital financing and funding. Over recent years, we have seen some welcome flexibility creeping into the system in relation to what is black and white for revenue and capital. However—and this is the officer in me coming out again—we have accounting principles to abide by.

**Iain Smith:** How would you introduce safeguards to the prudential system and how would that operate? How would councils' existing debt be dealt with? The current system is not necessarily equitable. At reorganisation, a lot of councils inherited debt, which was not of their choosing but which has to be paid off. How do you balance those different factors?

**Bill Hughes:** Work is being done by the Executive, COSLA and the directors of finance section to develop suitable prudential indicators. A lot of work has been done in England and Wales through the Department of the Environment, Transport and the Regions to identify the relevant indicators.

The indicators are a safeguard; they are not, in themselves, control mechanisms. There has to be basic trust—I use the word again—between the centre and local government. Why should central Government believe that local government would all of a sudden throw prudence to the wind? We all understand what capital expenditure costs and the options that exist to fund it and we all understand that ultimately the burden has to be picked up by the council tax payer. Financial decisions need to be taken in the context of their effect on council tax payers. That is where the prudential safeguards will come in.

The prudential safeguards would allow councils to compare with others the bargains that they are entering into for debt-management arrangements and to take some reassurance from what they learn.

We have a stringent accounting standard that we must follow. If any council was to enter into financial transactions that had significant burdens in later years, our accounts would be heavily qualified to indicate the problem. It is my belief that, because of the existing accounting standards regime, councils would not go down that road.

**John Campbell:** A great amount of energy is spent trying to get round controls. Imagine what we could do if we were working just to improve the service rather than to beat a section 94 control. That is the key issue that we would like to leave in committee members' minds. We want to turn the situation around—rather than trying to find loopholes in order to achieve an objective, we could work together to achieve it.

**The Deputy Convener:** SOLACE gave us some information on how we could move forward with a joint planning framework, which is one of your main suggestions. Do you have any other information about that? Would you be willing to provide us with more information on how the mechanism would work?

**Bill Hughes:** I am happy to take that away and to provide some further evidence to the committee on the lead that has been given this afternoon.

**The Deputy Convener:** The joint planning framework seems to be an important issue, which we should pursue.

What changes should be made to the spending assessment or the grant distribution system? For example, your submission mentions the grant distribution system and how the current GAE might be altered.

**John Campbell:** Let me start by commenting on something that we touched on earlier. There is far too much focus and time spent on grant distribution; in some cases, energies are almost wasted. Our submission referred to the need for a system that is transparent and intelligible, although not simplistic.

Discussions are on-going from which we may end up being party to a recommendation that there should be only six indicators, for example, instead of the current raft of primary and secondary indicators, which has created an industry to test and vary them.

Our main concern is to secure a fair financial settlement rather than to concentrate our time on the distribution system, although, if there were 32 directors of finance here this afternoon, they might not agree with that—when we left the meeting, we would all be working for our individual councils. However, if we were being objective, that is probably how we would all go forward.

**Bill Hughes:** The distribution process has struggled to get through reorganisation and several years of severe reductions in support for local authorities. During that time, councils have been trying to make the best use of their share and to maximise their needs in terms of the grant distribution process. Had the political or economic circumstances of the past four years been different, I am sure that we would not be talking about the distribution process in the way that we are.

Unfortunately, I have been able to listen to only a couple of the submissions today, but I am sure that you have picked up the differences between councils in Scotland. I do not think that we can have a simple system that adequately deals with those differences. We will all have to wrestle with the issue of whether the distribution process should be technically fair. That is why we said that the system should be driven by professionals rather than politicians, because we have concerns about political input into the distribution process. There is an issue around what the distribution process should be designed to achieve.

I cannot foresee a system that could deal with island, urban and rural councils and be less complex than the current system. Perhaps there are too many indicators and we can refine them. Although we are apparently down to six indicators, the number is not really six. If you look at the way in which the three-year settlement has been developed, you will see that the 126 factors have not been updated. Is the concern about the transparency of the process? I think that the concern is about the size of the cake, and not about distribution. If the cake is big enough, the distribution process will deal adequately with the needs of all councils.

**The Deputy Convener:** Thank you. I wish you a safe journey home.

# Item in Private

**The Deputy Convener:** I seek the committee's agreement to take another item in private next week. I suggest that we hear the evidence from Audit Scotland on the financial performance of councils in private, because the material will not be publicly available until two days after we discuss it.

**Mr Gibson:** I am not happy about that. That is the kind of issue that we should discuss in public. If the information is going to be published anyway two days later, Audit Scotland should publish it on the day of our meeting or earlier. I do not see why we should have to go into private session to suit Audit Scotland's publication timetable.

**Mr McMahon:** Can we not wait a week and discuss the report after it is published, rather than get Audit Scotland to change its whole schedule to suit the committee?

**The Deputy Convener:** Unfortunately, the timetable is so tight that we cannot do that. Please do not say that, once again when I have taken the chair, we will have to have another vote. Are there any other comments, or do members agree with Kenny Gibson's view?

**Iain Smith:** I do not understand why Audit Scotland's report cannot be published earlier. What is its reason for not publishing it earlier?

**The Deputy Convener:** I assume that the timetable is set. We are trying to fit into the timetable.

**Iain Smith:** Does the report legally have to be published on a certain date, or will it simply not be back from the printers?

**The Deputy Convener:** I think that it is just that there is a publication timetable, which we were not involved with and which could not fit into what we are doing. If we had known how busy we would be the following week, we could have followed Michael McMahon's suggestion.

**Mr Paterson:** May I ask a silly question? What is the material difference if we look at the evidence?

**The Deputy Convener:** If we consider it next week in public, it will be in the public domain before the councils have seen it.

**Mr Gibson:** It is unfortunate that this has happened. We do enough of our work in private and, although much of that is essential, we should not send out the wrong signal on this issue. I propose that we take the evidence in public; it will be up to Audit Scotland to decide whether to publish it.

**Mr McMahon:** We would be sending out the wrong signal. If Audit Scotland is geared to a publication date, local authorities will be looking to that date. If they discover that the publication date has been altered because this committee does not want to fit in with the timetable of Audit Scotland, we would be sending out the wrong signal to local authorities; we will be saying that we should supersede their right to have the information before we do.

**Mr Harding:** May I ask a question? I assume that, if we refuse to hold the session in private, Audit Scotland's representatives will refuse to come.

**Mr McMahon:** That is the danger.

**The Deputy Convener:** Most likely, that would be the outcome.

**Mr Harding:** In that case, I would prefer to see the evidence two days before the councils do.

**The Deputy Convener:** Do you wish to proceed, Kenny?

**Mr Gibson:** The evidence should be taken in public.

**The Deputy Convener:** The question is, that we hold next week's evidence session from Audit Scotland, on the financial performance of councils, in public. Are we agreed?

**Members:** No.

**The Deputy Convener:** There will be a division.

**FOR**

Gibson, Mr Kenneth (Glasgow) (SNP)
Paterson, Mr Gil (Central Scotland) (SNP)

**AGAINST**

Harding, Mr Keith (Mid Scotland and Fife) (Con)
Jackson, Dr Sylvia (Stirling) (Lab)
McMahon, Mr Michael (Hamilton North and Bellshill) (Lab)
Iain Smith (North East Fife) (LD)

**The Deputy Convener:** The result of the division is : For 2, Against 4, Abstentions 0.

It is agreed that the evidence will be taken in private.

## Subordinate Legislation

**The Deputy Convener:** We have before us a negative instrument, the Non-Domestic Rate (Scotland) Order 2001 (SSI 2001/44). The instrument sets the non-domestic rate poundage for the financial year beginning 1 April. It was sent to committee members some time ago and no comments have been received on it. The Subordinate Legislation Committee has considered the order; an extract of its report is included in the attached papers. The Subordinate Legislation Committee did not consider that the attention of the Parliament needed to be drawn to the instrument. No motions to annul have been lodged, and no other action can be taken on the instrument. I suggest that we agree that the Local Government Committee has no recommendation to make on the Non-Domestic Rate (Scotland) Order 2001. Does the committee agree?

**Members** *indicated agreement.*

16:47

*Meeting continued in private until 17:04.*

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