Economic Reform

Studies in Economics by
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1980 - 1994

L E C T U R E   N O T E S

Rate Reform

20th January 1986

Published by the Economic Study Association, London, 2016

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The financing of local government from local revenues has been a topical political issue for a hundred years or more. There have been Royal Commissions, Committees of Enquiry, White Papers, Green Papers, and so on and so forth, but never a solution. Whenever central government has been goaded into action, the result is that it has made things worse. Mostly central governments have attempted to bribe ratepayers by handing over to local government ever increasing amounts of the moneys collected from national taxpayers. This process has eroded both local financial responsibility and local independence.

In 1912 Professor Cannan, himself a local councillor, wrote in his History of Local Rates in England: “A few months ago a distinguished continental professor, who had been commissioned by his government to enquire into local taxation abroad, assured me that he, like others, had been brought up in the belief that England was the home of local self-government, but that he found we enjoyed less of it than any other country he knew.”

This judgement was confirmed by reports for a Congress of the International Union of Local Authorities held in Rome during 1955. These reports showed that local government in this country had a far greater financial dependence upon central government and enjoyed far less freedom and autonomy than did local government in other comparable countries. Today, some thirty years on, the freedom and autonomy of local government together with its financial responsibility are near vanishing point - using the national taxpayers’ money to pay the piper, the men from central ministries call the tune and the localities must dance to that tune. Is there then an alternative to the present drift?

If, in this modern world, it is not possible for a country with a geographical area as small as that of the United Kingdom to sustain local government by providing an independent local revenue sufficient to ensure an acceptable measure of freedom and autonomy with local financial responsibility, then should we not give up the struggle against centralisation and accept that local government must be, and must be seen to be, no more than a local agency financed wholly from central funds? Indeed the point has been reached where if it is not possible to move towards the one goal then we must move towards the other.

Is it possible to provide a local revenue sufficient to sustain a truly local government responsible to its local electors? The answer to this question turns on the possibility of reforming the present rating system. In this country the term 'rates' has come to signify a form of property tax used exclusively for local purposes, and when we look around the world at comparable countries we find that all their local authorities rely largely on some similar form of property tax. It is possible to raise additional local revenue by a variety of methods and many localities in other countries do just this but always some form of tax on real estate is the major source of income. In the United States, for example, property tax revenues account for 90% of total local government tax revenue and form a larger proportion of total general tax and revenue - Federal, State, and Local - than does the revenue from rates in this country.

It is not surprising that a property tax revenue should be so important in the nature of things. The income we receive may be generated anywhere in the world, the goods we buy with that income may be bought and produced anywhere in the world, but a freehold property is truly local and cannot be moved from its given locality. A freehold is the natural base for a local revenue. So let us consider the main objections to our present rating system and whether these objections can be met by reforming the system.

The first objection, and one of major concern to politicians, is the fact that the electorate seem to consider rates to be the most obnoxious of all methods of taxation. With their eye on collecting votes as well as revenue politicians quietly prefer what Professor Taussig called “the cynical principle of taxation.” He explained this, being a Harvard man with a homely turn of phrase, as “plucking the goose with the least squawking possible.”

Maybe a majority of the electorate would prefer taxes to be extracted under a complete anaesthetic but be wary of the ‘cynical principle’ - it obscures a slippery slope. In this country our democratic freedoms rest on the foundation that many centuries ago our forefathers objected to taxation and successfully demanded a forum in which they could give assent to the raising of any extra-ordinary revenue of this kind. Having obtained this, they then went on to gain control over the spending of that extra-ordinary revenue. Let us not trade our birthright for an anaesthetic. There is no such thing as a good tax and so it is good that rates are considered newsworthy; it is good that any increase in rates usually calls forth vociferous objections from ratepayers. All this keeps politicians on their toes and helps to sustain our democratic freedoms.

A second objection is that rates are a regressive tax and that the twice yearly rate demand presents difficulties for ratepayers, especially those from lower income groups. Admittedly the Allen Committee[1] showed conclusively that when related to household incomes rates are a regressive tax, but even so they found it hard to find actual cases of hardship directly attributable to rate demands. In any case, that a particular tax is regressive does not mean that it has no place in a general tax system that is either proportional or progressive in its incidence. Moreover, the regressive incidence of domestic rates is greatly accentuated by the current method of valuation which results in domestic rateable values being far

1 Report of the Committee of Inquiry into the Impact of Rates on Households (Chairman: Professor R. G. D. Allen). London, H.M.S.O. Cmd. 2582, 1965.

higher than they should be relative to non-domestic valuations. This is admitted by central government and since 1967 central government has spent an ever increasing amount of the national taxpayers' money by way of grants and subsidies specifically directed towards reducing the rates of householders. A case of robbing Peter with one hand to pay that same Peter with the other. These are cosmetic measures by which successive central governments have avoided implementing the solution - a change in the basis of valuation.

A further factor which results in rates bearing relatively more heavily on domestic ratepayers than on others is that private households must pay their rates from taxed income, whereas for others in the case rates are a tax deductible expense. The Chancellor could attend to this in his next Budget - but he won't.

The shock of the twice yearly rate demand is a matter of administration and some progress has been made to reduce the shock. More could be done. Those who advocate replacing domestic rates with a local income tax intend to collect by way of withholding the tax from employees' pay. Where the ratepayer is agreeable the same could be done with rates. One figure may be fed into a computer just as easily as any other figure.

A third objection to the present system is that its base is too narrow but this is not something inherent in the system. The narrowness of the base is the result of successive central governments reacting to powerful pressure groups by granting the privilege of either not paying rates or of paying less than is due. When central government create privileged groups in respect of the payment of rates then automatically they create also under-privileged groups. If some pay less than is due then others must pay that much more than is due. To meet this objection it is not the rating system that needs to be abolished but the legislation creating privileged groups.

Some press this objection further, claiming that in any event rates are levied only on the owner or a tenant of a property. While this is so it is true also that any tax on expenditure affects only a proportion of the population so far as its formal incidence is concerned. That the duty on beer is levied only on the brewers of beer does not mean that the beer drinker is unaffected by the tax. Further the price of beer affects wage demands and so in turn the prices which most of us have to pay, beer drinkers or not, for all the things we buy. In the case of rates we all occupy space in a particular locality, some in more than one locality, and the charge we have to meet in respect of any space we occupy takes into account rates along with many other taxes, for when we buy goods or services the seller will have included the rate demand when fixing the price in the same way as VAT or a local sales tax, and any other tax.

A fourth main objection to the present rating system was clearly put in a White Paper, "Local Government Finance - England and Wales" published in 1966. The White paper stated: "Moreover rates lack a natural buoyancy; the yield of income tax or purchase tax grows automatically as incomes or sales increase, but rating assessments do not adjust themselves to rising values. Between re-valuations the rate in the pound at which rates are levied has to be increased almost every year to keep pace with rising expenditure, and when re-valuation does take place the resulting shifts of burden are resented by the ratepayers who find themselves paying more."

This objection amounts to no more than central government expressing a preference for the cynical principle of taxation and attempting at the same time to cover up its own failures. Before the Second World War the job of re-valuation was carried out at regular intervals by local government. The result was that until 1939 rating assessments in total kept in step with local spending and changes in the value of money. After the war the central government took the job away from local government and gave it to a central government department - the Inland Revenue. During the past forty years there have been only two full re-valuations in

England and Wales; one in 1963 and the last in 1973. Nonetheless, both these full re-valuations showed that in total, rating assessments did keep in step with both rising prices and rising local government spending. This need be no cause for surprise. It is common knowledge that freehold property is a good hedge against inflation and to the extent local governments spend responsibly then the resulting improvements in local services will be reflected automatically in the assessments for rates. If central government did its job of re-valuing at regular intervals and made an annual adjustment for inflation, a matter of pressing a few buttons in this computer age, then all the evidence suggests that rating assessments would have a buoyancy greater than unity. This means that over the years the local rate poundage would tend to fall.

A fifth objection is that rates as at present assessed are a tax on development. This is a valid objection but it can be remedied easily enough by excluding development from the valuation. At the time of the 1963 re-valuation the Rating and Valuation Association, a professional body, carried out a pilot survey which excluded development from assessments for rates. They found that not only did their results give a more equitable spread but also, by either route, the total assessments in a locality were of the same order of magnitude.

Sixth and finally is the objection that there is today insufficient evidence to carry out a full re-valuation on a rental basis as at present required by Act of Parliament. Again this is a valid objection but again it is one that can be remedied easily and with advantage by enacting a change in the basis of valuation. What Parliament enacts Parliament can change. There may be little evidence today of open market rents for domestic property but there is ample evidence of open market capital values and it is a matter of simple arithmetic to translate these capital values into an annual income.

I trust I have said enough about the main objections to the present rating system to show that some of these objections are on closer inspection misguided or wholly invalid, others result from the failure of central government to fulfil its statutory obligations, and of the remainder some could be resolved by administrative changes whilst the most fundamental could be resolved by changing the basis of valuation. Let us then consider the reform of the present system.

At the turn of the century Alfred Marshall, then the Professor of Economics at Cambridge and acknowledged today as one of the chief founders of the neo-classical school of economic thought, argued that the market price of a freehold property was the sum of two distinct parts.

One part can be traced to the work and outlay of the actual individual holders or occupiers of the property and this part he called “private value.” For example, if a farmer is a good cultivator, erects good farm buildings, puts in an efficient drainage system and so on, then the market price of that farm will be that much more than it would have been otherwise. Similarly if a developer builds a good and pleasing building on a site then that property will sell for a higher price than if he had jerry-built. If a landlord keeps his property in a good state of repair then his property will be worth that much more than if he allowed it to fall into decay. Again if a householder improves his home, installs central heating, creates a pleasing garden, then the market price of his property will be that much more than if he had not carried out the improvements. All such enhancements of the market price of freehold property resulting from the work and outlay of the individual Marshall included within private value, and this private value, he argued, is not different in kind from what in business is commonly considered as private profit. From an income point of view private value gives rise to what is properly private income - the return to the work and outlay of private individuals or firms.

The other part making up the market price of a freehold property is, according to Marshall, largely or entirely the result of the work and outlay of people other than those holding or occupying the property. This part he called "public value." He instanced the case of a barren heath land that becomes valuable from the growth of an industrial population nearby even though, as he wrote, "its owners have left it untouched as it was made by nature."

This public value, argued Marshall, depends upon the situation of the property. Again he wrote: "If in any industry, whether agricultural or not, two producers have equal facilities in all respects, except that one has a more convenient situation than the other, and can buy or sell in the same market with less cost of carriage, the differential advantage which his situation gives him is the aggregate of the excess charges for cost of carriage to which his rival is put." Marshall went on to give many other instances all of which when added together and translated into money values give the money value of the advantage of one situation over another. Mostly these advantages of situation flow from the availability of what today we call public goods and services.

From this Marshall concluded the public value, or site value, of a freehold to be beyond the control of the owner or occupier of that freehold. It is not the use or development of a particular site that determines its public value, but it is its public value that determines the margin of profitable private expenditure at any particular site.

As private value gives rise to private profit or private income then so public value must give rise to what is properly public revenue. If local rates were to be levied on public value then the local authority would be collecting a revenue generated by the locality for which it is the public authority. In this case local rates would not be a tax in the strict economic usage of that term for there would be a direct 'quid pro quo'. The amount paid by a ratepayer to the local authority would bear a direct relationship to the advantages received by that ratepayer in return. In effect the ratepayer would pay to the local authority the current market price of the advantages being made available to him by the locality. This solution to the levying of rates should appeal to the present government who are forever extolling the benefits to be derived from the free play of market forces.

The question to be answered now is whether it is a practical proposition to assess public value for the purposes of levying a local rate? The people to answer this question are the professionals who would be required to do the job. Their answer is: Yes, it is a practical proposition for we do that job every day for private clients. The pilot survey in 1963 conducted by our professional body, the Rating and Valuation Association, was in effect the assessment of what Alfred Marshall called public value. Not only is it possible, but it is easier to assess public value than to assess rental values as required by the present rating system. Further, it is a simple matter to keep a register of public value up-to-date, annually if needs be. So speak the professionals.

How would such a reformed rating system answer the main objections to the present system that were outlined earlier?

As regards the first objection ratepayers might not like paying their rates any more than they do now but who can honestly and justly object to paying the current market price for the benefits and advantages received? Local councillors would be kept on their toes for they would need to adjust their spending to their revenue and this revenue would be determined in turn by the extent local government spending met the needs of their localities. Local councillors would be subject to the same financial disciplines as the rest of us, and this can be no bad thing.

The second objection is met also, for the regressive nature of the present system would be greatly reduced, if not eradicated, by a more equitable spread of the assessments and by the same token the excessive burden on householders would vanish. Central government would not need to spend national taxpayers' money on grants and subsidies to reduce domestic rates. This should appeal to national taxpayers, as well as to the Chancellor, and the would-be Chancellors.

Providing central government abolished all the legislation creating privileged groups of non-ratepayers when the new valuation lists were enacted then the base of the new rating system would be as wide as possible. Thus the third objection is met.

The proposed system would meet the objections put forward in the White Paper of 1966 for rates would have a natural buoyancy. Public value moves in step with public expenditure and freeholders over the past forty years know as a matter of experience that public value keeps pace and more with the rate of inflation.

Again the new rate would not be a tax on development since all developments carried out and paid for privately would automatically be excluded from public value.

Finally, the professionals assure us there is sufficient evidence for them to assess public value for rating purposes and it is a much easier task than that demanded by the present system.

So it is possible to reform the present rating system in a way that will not only meet the objections to the present system but result also in a just and equitable method of financing local government in these small islands, and doing so in a way that should appeal to the present government who pay much lip service to the free market and its financial responsibility.

In these days of unemployment, especially amongst young people lacking work experience, a by-product of a countrywide assessment of public value is well worth noting. When making their assessments in a local area the professional assessors can with advantage make use of a relatively large number of numerate but otherwise inexperienced field-workers. Thus many young people could be offered work experience in their own localities. In addition such a scheme would reduce the net cost to the central government of preparing the new valuation lists for one way or another taxpayers' money has to be used in support for these youngsters.

We have been warned; the government have stated that the introduction of additional new local taxes is to be an issue at the next general election - if not earlier. We have been promised that the Government's proposals will be made well in advance of any legislation - a further Green Paper possibly before the end of this month - and no doubt the Opposition parties will follow the Government's lead by publishing their own proposals.

Already party spokesmen have been, as it is said, flying flags. It would seem there is some agreement amongst politicians on the promise to abolish domestic rates and replace them with other methods of taxation. In particular flags have been flown for a local income tax and for a poll tax on every person over the age of eighteen. In other words the party politicians are not seeking, it seems, a solution to a public issue that has been the subject of public and private enquiries for more than a century. Rather, they are seeking ways by which they may step up the plucking, and at the same time reduce the squawking.

Do not rely on the White Paper "The Future Shape of Local Government Finance" published in 1971 and which stated the central government's view to be: "The objective of new local taxes is not to increase the overall level of taxation; it is to find a means by which a greater part of local authority expenditure can be met out of income raised locally by the authorities themselves, and a correspondingly smaller part therefore met from government grants paid for out of national taxation." Fine words but what do they signify? Experience tells us new taxes mean more taxation.

Remember, we are all the geese they intend to pluck. There is, however, as I have outlined, an alternative to new local taxes and if you do not wish to be the subject of further plucking, with or without an anaesthetic, then the time to squawk is now.

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Editors' note:

For most of the last fifty years, local taxation in the UK has been equivalent to about 10% of total government revenue, split equally between domestic and non-domestic property. This was collected on a common system, based on the General Rate Act of 1967, and using notional rental values. On the other hand, local government expenditure has been around 25% of total government spending.

Under the Rating and Valuation Act of 1925 revaluations were called for every five years, but these were frequently delayed or suspended. Revaluations did take place in 1928/1929, 1934, 1956 (using 1939 values), 1963, and 1973. A revaluation was expected in the early 1980s, but this was cancelled in June 1979, following the General Election of that year, at which a manifesto commitment had been made to abolish domestic rates.

After the General Election of June 1987, the Local Government Finance Act of 1988 repealed the General Rate Act 1967 and introduced two new taxes (in England and Wales) from 1st April 1990.

The Community Charge, also known as the Poll Tax, replaced the rating of domestic property. The remaining non-domestic properties were to be covered by a modernised version of the General Rate called the National Non-Domestic Rate (NNDR) - also known as Uniform Business Rate (UBR), as it would be based upon a uniform rate of poundage across the country, and paid over to central government.

In 1991 the government increased the rate of VAT from 15.0% to 17.5% to pay for a large reduction in the Community Charge, with a corresponding rise in the level of central government block grants to local authorities. The unpopular Community Charge was then replaced by Council Tax, based on the estimated capital value of domestic property, in April 1993. A full revaluation was carried out to support the change (using April 1991 values), but the

Council Tax provided local government with less local income than the former rating system, because of the loss of the business rate component.

No domestic revaluations have been carried out in the UK since April 1993, except in Wales, where the bands were updated on 1st April 2005 using 2003 valuations, and an extra band was added. The Community Charge was not introduced into Northern Ireland, which continued to use the system of domestic rates, based on 1976 rental values, until a reform was introduced in April 2007. Domestic rates there are now based on estimated capital values as of 1st January 2005.

In some urban areas, due to rising capital values and the lack of revaluations, nearly all domestic properties fall into the upper bands and the tax has effectively become a flat rate assessment. This has strengthened popular demands for a long list of exemptions and rebates, and the introduction of an extensive system of 'benefits', such that in many cases the tax is not paid, or is only partly paid.

The system of Uniform Business Rates continues to be based on notional rental values. New rating valuation lists are normally created every five years, and the current list came into force on 1 April 2010. The 2015 revaluation has recently been postponed by the present government until 2017.

Central government continues to provide 75% of local government funding. Since 2013, a portion of Uniform Business Rates has been retained locally, whilst the remainder continues to be pooled centrally and redistributed. In 2015, the government announced a plan to abolish the block grants system and to allow each local authority to retain the whole of its Uniform Business Rate income.

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