Public Talks

Local Taxation – an Alternative

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Parliamentarians tell the story that local government is boring and local government finance is boring absolutely. For those in Whitehall and at the Palace of Westminster the story is useful – it serves as a smokescreen to obscure their actions or lack of action and to choke off or misdirect objections arising from the localities.

Earlier this year, for example, the Courts did their job of interpreting an Act of Parliament as it affected the issue of London Transport fares. The decision went against the Greater London Council. Yet, those who supported the GLC scheme presented the Master of the Rolls as some kind of Hampshire villain thwarting the will of Londoners. But clear away the smokescreen and it becomes apparent, if the Court's decision requires a villain, then it can be only Parliament, who passed the Act.

By the Road Traffic Act of 1930 Parliament took away from local authorities the licensing of passenger road services. In 1947 Parliament went further; under the Transport Act of that year all local authority owned passenger services became liable for transfer to new managements, to be nominated and controlled by central government.

More recently, London appeared to have re-established control over local passenger services; yet, as the Court determined, the powers passed back by Parliament to London's County Hall were circumscribed.

In this saga the fundamental issue is not the GLC's fare scheme. It is not even 'you pay your money and take your choice' – as taxpayers you will pay, with or without local choice. Rather, the issue is whether each and every one of us must accept: those in Parliament and Whitehall know best. Should Londoners, through

their elected local representatives, decide a local London transport issue or should it be decided over their heads by a vote in a central Parliament whose members claim to represent the whole electorate from the Shetlands to the Scillies?

The history of this issue is longer even than Lord Denning's tenure as Master of the Rolls.[1] Some seventy years ago Professor Cannan wrote in the preface to 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 he had found we enjoyed less of it than any other country he knew." Twenty-seven years ago reports prepared for a Congress of the International Union of Local Authorities similarly concluded that local authorities in this country had a far greater financial dependence upon central government and enjoyed far less freedom and autonomy than did local authorities in other comparable countries.

Lord Denning's decision marks but a stage in the history of a power struggle between Parliament and Whitehall on the one side and the Counties, Boroughs and Districts on the other, and it is entering now a critical phase. The struggle has political overtones, and some would assert that it is essentially a party political issue; nonetheless, the factor that will determine the outcome is finance. Political subjugation follows upon financial dependence. There are many current examples around the world and it is happening here. Indeed this country has drifted already into a position where the balance of administrative advantage lies with replacing the present rating system with national taxes. Such a proposal is thought likely to attract votes at a general election. These are powerful political party reasons for advocating the proposed measure, even though its enactment must then set up the United Kingdom as a centrally controlled state, with only the political hue to be decided.

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1 Lord Denning (1899-1999) was Master of the Rolls from 1962 until 1982.

At the last General Election the Conservative Party did commit itself to the abolition of the system of domestic rates. Such today is the dominance of central government money in local authority budgets that this limited measure raises no great tax difficulties. A general increase of say 5 percent on the standard rate of VAT would yield more than sufficient to finance the abolition of domestic rates by way of an assigned revenue or by an increase in central government grants. Moreover, in the recent Green Paper it was stated that some system of assigned revenues has a claim to serious consideration. But to proceed along this road raises further questions. Why hand over even more of the national taxpayer's money to be spent by local councillors? Why stop at the abolition of domestic rates?

If the central government took over, say, education, then the whole local rating system could be abolished without the need for the Exchequer to contribute more to local authorities by additional grants or by introducing assigned revenues.

Such an Act of Parliament would be no more than another small step in the direction we have been moving for decades. At one time the former London County Council was the largest hospital authority in the world and then, by Act of Parliament, it ceased almost overnight to be a hospital authority at all. Let us therefore do for schools this year what was done for hospitals in 1946. A reasonable enough proposal, on appearance.

The other side to the proposal is that local authorities can exist as free political institutions only to the extent that they have a measure of local financial independence for which they are fully accountable to their local electorate. Abolish local government's rate revenue and one abolishes local financial responsibility and with it local independence.

Thus, the outcome of the present debate will determine whether or not local councils are to be no more than local agents of an all-powerful central government in London. We are back again to the fundamental issue. Are we to have a local choice backed by local

financial muscle in respect of our local affairs, or must we all conform to a central plan and accept that Parliament and Whitehall know best?

The recent Green Paper, Alternatives to Domestic Rates, ruled out as not meriting further serious consideration a whole range of suggested new local taxes including: local duties on petrol, alcohol and tobacco; a local vehicle excise duty; charges for licences for the sale of alcohol and petrol; a local payroll tax. Of the remaining suggestions it concluded, "Probably none of the new sources of local revenue discussed in this Green Paper – local sales tax, local income tax, or poll tax – could be used on its own as a complete replacement for domestic rates."

As this is so for domestic rates, which account for only some 44 percent of the total rate revenue, then it follows inevitably, to avoid local issues coming completely under the thumb of the central government, the rating system must be kept in some form. From the sentiments and admissions published by the government in their Green Paper it is to be concluded that the present public debate on local authority finance should be concerned primarily not with the abolition and replacement of the rating system but with the reform of the rating system. Indeed, some Conservative Cabinet Ministers, although committed by their party to the abolition of domestic rates, talk now of reforming the rating system as a whole.

That a British government is forced to admit to the need for a local revenue from local rates is no cause for surprise. A notional income from land or buildings is used widely by industrialised countries as a basis for raising local revenue. The United States, for example, have their property taxes which account for about 90 percent of local tax revenue and form a higher proportion of total general government tax revenue – Federal, State and local – than does the revenue from rates in this country. The great advantage of using the notional income from fixed property is that the basis is essentially local. Land cannot be removed from one locality to

another in search of the lowest poundage rate. However, like all systems it can be abused and when persistently abused the rating system does become a cause of decay in certain areas, or even a cause of widespread distress.

Local	Other	19%	52%
	Loans	7%	
	Rates	26%	
Central	Loans	6%	48%
	Grants	42%	

Figure 1: Sources of local government funding

Figure 1 shows the main types of local and central funding for local government in the United Kingdom averaged over ten years. Although the local rate revenue in this country is proportionately smaller than local revenues in any comparable countries, our local authorities spend, largely as required by Acts of Parliament, one pound for every three spent by central government. Many British local authorities have annual budgets substantially larger than the annual budgets of many independent countries who are members of the United Nations. On the other side of the books, local rates raise only one pound for every nine raised by national taxes.

This imbalance between local spending and local revenue is the crux of the issue, and is the source of Whitehall power and of local weakness. It is largely Parliament that requires local authorities to spend 25 percent of total tax revenue whilst allowing them to raise only 10 percent.

The revenue from local rates is small not only relative to local spending but also relative to the yield of some national taxes. For example, VAT raises 50 percent more revenue than rates; national insurance and the surcharge raise twice as much; income tax raises nearly four times as much. Yet it is local rates that appear to be the final straw that breaks the back of many businesses, especially small businesses. That this should appear to be so is due not so much to the inherent weakness of the present rating system as to the cumulative effects of acts and omissions by successive central governments, in particular the persistent erosion of rateable values, the basis of rate revenue, by Acts of Parliament.

One way by which Acts of Parliament cause the erosion of rateable values is when they create privileged classes who are exempted from rates, or at least not liable for the full rate. Way back in 1875 Parliament enacted that the general district rate was to be assessed on one fourth part only of certain classes of property, mainly farming, canals and railways. After changes and much parliamentary pressure agricultural users gained a complete exemption in 1929.

During the past twenty years a Royal Commission on Local Government, a government White Paper on the Future Shape of Local Government Finance, and the Layfield Committee of 1976, have all reported it to be reasonable to re-rate the farming industry, yet Parliament has taken no action and the industry continues to enjoy its privileged position.

I am not concerned in this talk with the rights or wrongs of any particular case for exemption. What I do wish to bring to your attention is that when Parliament create privileged classes who are exempt from local rates they reduce total rateable values and local councils, as a result, have little option but to increase the poundage on the rest. If some are exempted then the rest must pay more. Raising the poundage causes further distortions and in turn these distortions are a cause of hardship and distress among those who continue to have to pay local rates.

Again, since 1915 Parliament has continuously interfered in the private market for rented dwellings. The 1915 Increase of Rent and Mortgage Interest (War Restriction) Act froze at their August 1914 level all rents on dwellings with a rateable value below £26, or £35 in London. A necessary war emergency measure, maybe, but after the war the restrictions were extended. It has been estimated that in 1939 one in three of all rented flats and houses were controlled at rents not exceeding 40 percent of the rent charged in August 1914. With another war, another necessary emergency measure, which froze rents at their September 1939 level on all dwellings with a rateable value below £75 (£100 in London). The Act was estimated to bring two-thirds of all dwellings within the freeze.

As after 1918, so after 1945 – the restrictions were continued. Between 1939 and 1954 the general price level more than doubled yet the Housing and Repairs Act of 1954 was intended to keep 'net' rents at their 1939 level. Since then, Acts of Parliament have changed the position from time to time, some one way and some another; nonetheless the parliamentary restrictions and interference continue what began in 1915 as a wartime emergency measure.

When Parliament restricts rents to less than the current market level, then automatically they also restrict rateable values. Rate poundages are then increased and the system is distorted. Those occupying the controlled dwellings may gain a little at everybody else's expense, but the cumulative effect of all this legislation has been disastrous for the rating system and local authority finances.

Further, the owners of controlled dwellings are then prevented by law from obtaining the current market rate of return on their investment. When the condition persists the private sector supply of dwellings for letting at reasonable rents begins to dry up and eventually ceases altogether. This hits local authority finances in two ways.

First, Parliament has imposed on local authorities a statutory duty to provide dwellings for letting at reasonable rents. As the private sector supply dwindles, local authority spending has to

increase in an attempt to make good the deficiency. Second, rateable values are required, by Act of Parliament, to be assessed on the basis of rental evidence from the private sector market. As this market contracts to near extinction, so does the evidence for making valuations for rating purposes. I will return to this later. For the moment we may note that the series of Acts of Parliament affecting housing and rents have not only eroded rateable values and increased local expenditure, but have also destroyed the very basis of the present rating system in an important area.

All this may seem bad enough yet it fades into insignificance in comparison with what followed from the Local Government Act of 1948. From time immemorial valuations for rating purposes had been carried out by local authorities. Then, in 1948, Parliament transferred the responsibility to a central government department – the Inland Revenue. What was the result? There was no full post-war revaluation until 1963. The fifteen years that it took the Inland Revenue to produce their first full up-to-date list meant a break of a quarter of a century during which prices had trebled, quite apart from all the upheavals and destruction of property as a result of the war. It took the Inland Revenue another ten years, until 1973, to produce their next and last full revaluation list. Now the job of revaluing for domestic rates has become impossible.

If it were not a fact of recent experience it would be incredible that an educated electorate, claimed to be the most experienced free electorate in the world, would stand by and allow successive central governments to bring the system of collecting local revenue into disrepute and to a near breakdown by completely ignoring a statutory duty. Worse, Ministers of the Crown now accuse local councils of financial irresponsibility, of failing to do their duty to their localities and to the country as a whole. There have been no searching questions from the media, from backbench MPs, or from Her Majesty's Opposition. It would seem to be the cover up to beat all cover ups.

Let us just suppose that the Inland Revenue had managed only

to re-assess personal incomes for the purpose of income tax twice since the war and that the last time was in 1973 – that for each and every one of us our liability for income tax this year was to be assessed on our 1973 taxable income. Distortions and injustices apart the standard rate of income tax would be not 30 percent but well in excess of 100 percent. Could any Chancellor even begin to attempt the management of government finances on such a basis?

What an outcry would arise in the country, stirred up by the combined efforts of the media, backbench MPs and Her Majesty's Opposition. My supposition may seem beyond credibility, yet it is analogous to what has been foisted upon local authorities without so much as a murmur from self-styled guardians of our liberties.

What is frequently asserted today is that the rating system, although it served well enough in the past, is an ancient system totally unsuited to modern inflationary times. It is unfair, a cause of hardship, a source of injustice, incapable of raising sufficient revenue for modern expanded local government. All this is safe ground for it is so – but when one considers how the system has been abused over the past 150 years of reformed Parliaments, how central government have kept rateable values in deep freeze, then the present defects are less than might be expected. However, all this abuse has happened, and it has brought the country to a critical point where the rating system, which is the only sufficient source of independent local revenue, must be either replaced or reformed, and quickly.

The key issue for a decision to replace or reform local rates is whether updated rateable values may be expected to be sufficient and to move in step with the income requirements of modern local government, for aggregate rateable values limit the revenue yield.

Little purpose is to be served by reforming the rating system so that it ceases to be unfair, ceases to cause distress, if at the end of that process of reform the system is incapable of yielding sufficient local revenue. Figure 1 shows that the system at present does not raise sufficient revenue but, as has been argued, this is largely the

result of parliamentary abuse; in particular the failure of successive central governments to carry out their statutory duty of full, regular revaluations. The general picture is shown in Figure 2.

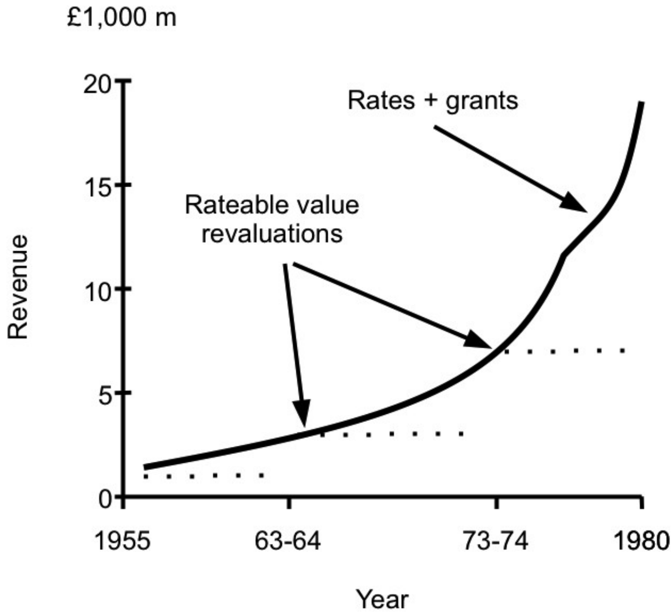

Figure 2: Local government revenue, 1955 to 1980

Until 1939 local authorities carried out revaluations at regular intervals and aggregate rateable values moved in step with local revenue needs. During the following 25 years there was only a partial revaluation in the mid-fifties and aggregate rateable values did not move in step with local revenue needs.

Nonetheless when the full revaluation was carried out in 1963, the pre-war relationship was found to hold. On the 1963 returns rate revenue represented an average rate of 45 pence in the pound whilst an average rate of 97 pence in the pound would have yielded sufficient to cover total rate revenue and total income from grants by central government.

When the full revaluation was carried out in 1973 the pre-war relationship was again re-established. Rate revenue represented only an average rate of 37 pence in the pound, whilst an average rate of about 97 pence would have been sufficient to cover both spending out of rate revenue and income from central government grants.

It is only when central government fail to carry out their statutory obligations that local income needs rapidly outpace the growth of rateable values – inevitable, over years of double-digit inflation. Today we are in a position again where an average rate of £3 on every £1 of rateable value would not be sufficient to cover rate revenue plus the grant contribution from the national taxpayer.

The evidence shows that the present rating system, given full revaluations, is as capable today of yielding a revenue that is uniquely local and sufficient to meet the needs of modern local government as it ever was in the past. This is so in spite of the erosion of rateable values and all the other abuses I touched upon earlier. Thus the present rating system warrants reform rather than replacement. To argue otherwise is to ignore the evidence to hand, particularly the most recent evidence of the two Inland Revenue valuations of 1963 and 1973.

The first step in the reforming process must be to get a full revaluation without exemptions and an assurance that the list will be kept up-to-date. It is only on this basis that firm decisions can be made on issues such as rate exemptions, equalisation schemes or contributions from the national taxpayer. On the information from the form book, it would seem reasonable to transfer responsibility for valuations back to the local authorities. Central government have no immediate direct interest and for the past 34 years have dragged their feet. Local authorities have an immediate and direct interest and did perform their task regularly for 340 years.

Unfortunately past form and a willingness to complete the job with alacrity is now not sufficient to produce an up-to-date list of rateable values. As I stated earlier, Acts of Parliament have worked

to destroy the necessary evidence. Following the 1973 revaluation the Deputy Chief Valuer of the Inland Revenue stated: “although some 17 percent of privately owned dwellings were rented, less than two percent of those dwellings were let at rents that could be reconciled with the definition of gross value.” In other words, ten years ago the Inland Revenue had to infer from just two percent of domestic dwellings rateable values for the other 98 percent. Since 1973 the private market for rented dwellings has contracted further so that it has become an impossible task to complete a revaluation, given the definitions currently laid down by Act of Parliament.

As a solution to the difficulty of a lack of current market rental evidence it has been proposed that the basis of valuation be changed from a rental basis to a capital value basis.[2] Throughout the country there is abundant evidence of current market capital values for all types of property. The snag with this proposal is the Inland Revenue estimate that to start from scratch on a full capital revaluation of land and buildings might take until the end of the century to complete. Maybe their estimate is exaggerated and local authorities having a direct interest would work faster, but even assuming a 100 percent exaggeration a capital valuation of land and buildings is unlikely to be ready until well into the 1990s. The capital valuation of land and buildings for rating purposes is not, it seems, an immediate solution to the present issue.

An alternative proposal has been put forward by the Land Institute – an independent body formed by those professionally concerned with rating matters. The Land Institute has proposed simplifying the process of valuation by excluding from rateable values all buildings and improvements. Their proposal is based on practical experience in the field. Members of the Land Institute have been associated already with two pilot schemes, which covered the former Urban District of Whitstable, and were timed to coincide with the Inland Revenue revaluations of 1963 and

2 The change to capital values as a basis for valuation in a series of bands was implemented with the introduction of Council Tax in 1993.

1973. The pilot schemes showed that aggregate rateable values, excluding buildings and improvement but allowing for no other exemptions, were of the same order of magnitude as aggregate rateable values yielded by the Inland Revenue list.

As the aggregate rateable values are approximately the same, then it is reasonable to assume that both assessments are capable of yielding a similar rate revenue. This means that, with up-to-date information, an average poundage of less than 100 pence may be expected to yield, in aggregate, a revenue equal to current rate revenues plus total government grants to local authorities.

It is reasonable to conclude that a rating system based on the Land Institute's method of valuation, for which current market evidence is available, is capable of yielding a local rate revenue not less than that yielded by the present system, which in any event is impossible to continue due to a lack of current market evidence as required by Act of Parliament.

More important to the resolution of the immediate issue is the speed at which the simplified task of evaluation can be carried through to a final published list of individual valuations. In 1963 work on the pilot scheme began in April and was completed by Christmas. The full valuation list with the surveyor's report was published by the Rating and Valuation Association in February 1964 – eleven months from start to finish. The 1973 pilot scheme was carried through on a similar time scale.

Thus, by accepting the Land Institute's method of simplified valuation and making a start when Parliament returns in October, the government could introduce an up-to-date and reformed rating system in April 1984, having allowed ample time for the hearing of objections, as well as Parliamentary time for deciding issues of exemptions, equalisation schemes, central grants and so on.

This government may like to note that private enterprise, albeit charitable, has twice demonstrated that the job can be done. All that is needed is a little of the political will and determination to be applied to a local issue as was recently applied to the settlement of

an issue 8,000 miles away in the South Atlantic.[3]

At a time of slump with youth unemployment a major problem, prompt action by government on revaluations could offer a bonus. The pilot scheme at Whitstable was completed in eleven months under the direction of Mr. Wilks as the only fully qualified and experienced rating surveyor. He was assisted by an experienced office manager and five office staff, plus a host of inexperienced and unqualified field workers. What an opportunity this offers for resolving youth unemployment - by combining with the existing Youth Opportunity Programme and job creation schemes, every unemployed school leaver could be offered fieldwork in their own locality. The country could have a reformed rating system by April 1984 at a relative small additional cost over the sums that will be paid out through social security and employment subsidies.

However, although the Land Institute's proposal does offer a practical solution to more than one immediate issue it does contain also a detail which I must dispute. It arises from economic theory but is of importance in the context of contemporary politics. The Institute proposes that freeholders rather than occupiers should be made liable for the payment of domestic rates on the grounds that it is logical for property owners to be liable for 'the payment of a property tax'. It seems that this proposal is made without giving due consideration to current theory and contemporary politics.

When buildings and improvements are excluded from rateable values, then what is being assessed is the current market price for the occupation of a particular location or site – what Professor Alfred Marshall described in his *Principles of Economics* as the public value.

In a modern industrialised country such as the United Kingdom, this market price, be it expressed on a rental or capital basis, is determined to a great extent by the quality and quantity of public goods and services being made available to the occupier of that particular location or site.

3 A reference to the Falklands conflict of six months earlier, in April 1982.

The Rating and Valuation Association admitted to this in 1964 and gave it as the reason for omitting public utility services from the valuation list. Their Surveyor stated in his report: “The values in the urban areas are the result of the installation of public utility services” and, he concluded, “there will be double valuation if one values them as well.”

It follows that when buildings and improvements are excluded from rateable values then the rate payment which any particular site attracts will be in the nature of a current market price for the public goods and services being made available to the occupier of that site. This is to say there would exist a direct ‘quid pro quo’.

Although one distinguished academic[4] told an earlier Royal Commission on Local Taxation that “The state revenues which are always called taxes do not appear to us to be divided by any sharp line from those which are never called taxes”, nonetheless, today it is generally admitted by economic theorists that the distinguishing characteristic of a tax payment is the absence of a direct ‘quid pro quo’ between the payment made and the public goods and services received by the individual taxpayer.

Hugh Dalton, who not only was a distinguished academic in the sphere of public finance but also had practical experience as Chancellor of the Exchequer, wrote in his work *Principles of Public Finance*, “a tax is a compulsory contribution imposed by a public authority, irrespective of the exact amount of service rendered to the taxpayer in return, and not imposed as a penalty for any legal offence.” Thus, economic theory leads to the conclusion that when buildings and improvements are excluded from rateable values, then, if the annual rate is charged to the occupier, it cannot be properly be described as a property tax, for it is not a tax. It is misleading to describe it as a tax since the rate payment is directly related to the current market price of the public goods and services being made available to the occupier – the rate payer.

All this is not just an exercise in semantics for it has immediate

4 Edwin Cannan, 1899. Evidence to the Royal Commission on Local Taxation.

important implications in contemporary politics well beyond the question as to who should be made liable for rate payments. This government fully appreciates that the provision of public services conveys benefits which are measured by the market in terms of rents, or capital values, in the localities affected.

In the summer of 1982 the central government was considering ways of obtaining £65 million of private finance for building a light railway connecting the London Docklands development area to the City. What they wished to tap was the expected increase in site-only capital values – that is valuations excluding buildings and improvements – from the then current level of £100,000 per acre to an estimated £l million per acre given a rapid transit system.

Once it is seen that the Land Institute's proposal is not some new and ingenious method of property taxation, but a method of collecting the current market price for public goods and services being made available, then the proposal may be seen also to offer the government a solution to yet another immediate difficulty.

Given the reformed rating system the GLC would collect automatically the current market price of the benefits generated by a rapid transport system. If, as the Labour Party currently argue, the government estimate for the increase in local value is based on "dubious assumptions", and the estimated increase in rate revenue insufficient to service the capital cost, then the proposed transport system is not an economically viable proposition. In this case it remains with the central government to decide whether on social grounds additional finance should be provided by the national taxpayer. One has, as it were, a built in cost-benefit analysis.

But let us not get too involved now with the possibilities arising from a reformed rating system based on simplifying the method of valuation by excluding buildings and improvements from rateable values. It has been demonstrated to be a practical method capable of yielding sufficient local revenue and when presented with due regard for current economic theory it may be seen to accord with this Conservative government's oft-stated market philosophy.

What I wish to stress is that underlying the present public debate about the future of local finance is the power struggle between central government and the localities.

This struggle has entered a critical phase, and it is the method of financing local authorities that will determine the outcome – whether, in the future, the United Kingdom is to be a centrally controlled state in which every locality conforms to a central plan drawn up by Whitehall experts and imposed by central government power irrespective of local needs, or a country in which the wide variety of local needs can be met by independent local government fully responsible to their local electorate.

I do not suggest that the Land Institute's proposal is the final solution to the fundamental issue but it does offer the possibility of a speedy solution to immediate issues in a way pointing towards a just and lasting solution of the fundamental issue. As a first step it is worthy of more than "serious consideration" – it demands from individual electors and from Parliament immediate action.