Public Talks

Rate Reform

National Liberal Club, London

20th January 1986

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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 the 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 book *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 judgment 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 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 very near to 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 its 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 that is 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 upon 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, and 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 raised to 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 seems to consider rates to be the most obnoxious of all methods of taxation. With their eye on collecting votes as well as revenue, politicians therefore quietly prefer what Professor Taussig[1] has 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 very slippery slope. In this country our democratic freedoms rest upon the foundation that many centuries ago our forefathers objected to the use of 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 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 showed conclusively[2] 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 the domestic rates is greatly accentuated by the current method of valuation, which results in most domestic rateable values being far higher than they should be relative to non-domestic valuations.

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1 In *Principles of Economics*, vol. 2. Taussig was a Professor of Economics at Harvard. A similar quotation is generally attributed to Jean-Baptiste Colbert.

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

This is admitted by central government and, since 1967, it has spent an ever increasing amount of 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 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 upon others, is that private households must pay their rates from their taxed income, whereas for others in the case, the 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 simply a matter of administration. 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 it by way of withholding the tax from employees' pay. Where the ratepayer is agreeable, the same could be done with domestic 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 tax base is too narrow, but this is not something that is inherent in the system.

The narrowness of the base is the outcome 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 also create an under-privileged group. If some pay less than is due then others must pay that much more than is due. To meet this particular 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 rates are levied only upon the owner or tenant of a property. Whilst this is so, it is also true that any tax upon 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 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 any goods or services the seller will have included the rate demand when fixing the price, in just the same way as with VAT, or a local sales tax, or any other tax.

A fourth main objection to the present rating system was clearly set out in a government white paper, published in February 1966.[3]

This 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 our 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 revaluation 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, central government took the job away from local government and gave it instead to a central government department – the Inland Revenue. Since then, during the past forty years, there have been only two full revaluations in England and Wales; one in 1963, and one in 1973.

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3 In para. 3 of *Local Government Finance – England and Wales* (Cmnd. 2932) One of two white papers issued prior to the Local Government Act of 1966; the second white paper dealt with Scotland only (Cmnd. 2921).

Nonetheless, these full revaluations 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, for it is common knowledge that a freehold property is a good hedge against inflation and, to the extent that local government spends responsibly, then the resulting improvements in local services will be reflected automatically in the assessments for rates.

If however the central government did its job of revaluing at regular intervals, and also 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 successive 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 too can be remedied easily enough by excluding development from the valuation.

At the time of the 1963 revaluation the Rating and Valuation Association, a professional body, carried out a pilot survey[4] 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 the given 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 revaluation on a strict 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 readily available 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.

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4 *Rating of Site Values: Report on a Pilot Survey at Whitstable*. H. M. Wilks, for the Rating and Valuation Association, London, 1964.

I trust I have said enough now 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 even 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 directly 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, and creates a pleasing garden, then the market price of his property will be much more than if he had not carried out the improvements.

All such enhancements of the market price of freehold property that resulted 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 terms, 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 total 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 who are holding or occupying the property. This part he called ‘public value’.

He instanced the case of some 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. On this point 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 total 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 public value determines the margin of profitable private expenditure at any particular site.

As private value gives rise to private profit or private income, so public value must give rise to what is properly public revenue.

If local rates were to be levied on the 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 use 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 be paying to the local authority the current market price of all the advantages being made available to him by the locality.

This solution to the levying of rates should appeal to the present administration, 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, and their answer is: 'Yes, it is a practical proposition, for we do that job every day for our 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, even 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 that local government spending met the needs of their localities. Thus, 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 assessments, and by the same token, the excessive burden on householders would vanish.

The central government would no longer need to spend national taxpayers' money on grants and subsidies to reduce domestic rates, and this should appeal to the national taxpayers, to the Chancellor, and to the would-be Chancellors.

Providing central government abolished the legislation which has created privileged groups of non-ratepayers at the same time that new valuation lists were enacted, the base of the rating system would be as wide as possible, and 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 of the development carried out privately, 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 that it is a much easier task than is demanded by the present system.

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

In these days of high unemployment, especially amongst young people lacking work experience, one by-product of an assessment of public value is worth noting. When making assessments in any local area the professional assessors can with advantage make use of a considerable number of numerate but otherwise inexperienced field-workers. Young people could be offered work experience in their own localities, whilst reducing the net cost to the central government of preparing the new valuation lists – for one way or another, taxpayers' money has to be used for their support.

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 also been promised that the government proposals will be made well in advance of any legislation – with 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 that 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 18.

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 new ways by which they may step up the plucking, and at the same time reduce the squawking.

Do not rely upon the 1971 White Paper on the Future Shape of Local Government Finance, 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." These are 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 local taxes. If you do not wish to be the subject of further plucking, with or without an anaesthetic, then the time to squawk is now.