Local Government Finance

By Ronald Burgess

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Contents

Foreword

This paper concludes that causes of much of the present clamour for local government reform can only be removed by a reform of local government finance.

The excessive reliance of local authorities upon loan finance and central government grants has led to extensive control from Whitehall with the result that local authorities are rapidly tending to become little more than the local agents of central ministries.

The wide difference in prosperity between the various regions has created special difficulties, both for the local authorities in the areas of rapid growth, and for those within the declining areas. The central government measures designed to correct this imbalance have caused much local frustration and resentment and speeded the erosion of local responsibility while being only partially successful in their declared objective.

This paper suggests that by changing the method of assessing rateable values, local revenues could be increased by at least fifty per cent and on this base, with certain statutory safeguards, local government could assume the responsibility for local prosperity and welfare.

The Association wishes to thank the many industrialists, Council members and local government officers throughout England and Wales for their co-operation. Once again we also have to acknowledge our debt to Edward Holloway of the Economic Research Council for his help in publishing this our second paper.

January 1970.

Introduction

There are nearly two thousand local government authorities in Britain, ranging in size from the Greater London Council with a population of millions, to those with populations of less than a thousand. Further, there are over ten thousand parish councils, or ‘meetings’. All, within a variety of limits, have some governmental function and some financial responsibility, including in most cases the power to borrow.

Local government today is largely based on areas determined a thousand years ago; they first arose to deal with conditions and economic systems that have long since vanished. The system of local taxation also has a long history, but for the most part it was hammered out over the past three hundred and fifty years to meet expenditures which have largely ceased to be the responsibility of local government.

What is surprising is not that the system occasionally fails, but that it continues to function and cope, reasonably successfully, in the circumstances of the second half of the twentieth century.

During Saxon times there arose, at least over most of England, relatively strong, independent local government; but during the last nine hundred years most of this strength and independence has been whittled away by increasingly powerful central governments. This transfer of power continues at an increasing pace.

In 1930 the Road Traffic Act took away from local authorities the licensing of passenger road services, and under the Transport Act of 1947 local authority owned passenger road services became liable for transfer to new managements to be set up by the central government. Since 1936, the responsibility for thousands of miles of road has been transferred from the local highways authorities to the central government’s Ministry of Transport.

By the National Health Services Act 1946, central government took over responsibility for hospital services and reduced local authority influence over these services to negligible proportions.

For example, the then London County Council, which was the largest hospital authority in the world, almost overnight ceased to be a hospital authority at all.

The system of social security which has been developed over recent decades has also been marked by the creation of new central government Ministries and the reduction in scope and magnitude of local authority responsibility. In this field, the local authority functions are now almost entirely restricted to providing services in kind to certain categories of persons.

From time immemorial, until 1948, the business of valuation, assessment and collection of rates was the responsibility of the local authority; but the Local Government Act of that particular year transferred the valuation of property for rating purposes to the Inland Revenue. There has been no general re-valuation carried out since 1963. Local authorities are almost powerless to take effective action, although rate income remains their sole local tax.

The process of nationalisation has taken away local authority responsibility in such public utilities as electricity, gas and water supply, and among other services, local responsibility and choice is being steadily eroded. For example, public libraries are no longer a local service established at the local authorities' option, since the Public Libraries and Museums Act of 1964 makes it the duty of the Secretary of State to "superintend and promote the improvement of the public library service".

Again, in July 1965, the Department of Education requested local education authorities to submit their plans for comprehensive education, but only eight months later that Department circularised a near veto on the building of schools that could not be adapted to comprehensive use.

Saxon beliefs, like old soldiers, seem only to fade away. While in 1957 Lord Hailsham declared: "We have never believed that the Gentleman in Whitehall knows best," in 1966 the Burton-on-Trent branch of the National Union of Bank Employees sought to have an increase in local rates referred to the Prices and Incomes Board.

That local authorities are now, in practice, little more than the agents of the central government, and are commonly regarded as such, was emphasised by the failure of the First Secretary, in his reply to the trade union branch, to suggest that the remedy for an increase in local rates lay via the local ballot box.

In 1912 Professor Cannan reported that: "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." (1)

This judgement was confirmed by the reports prepared for the Congress of the International Union of Local Authorities at Rome in 1955, which showed that local government in this country had a far greater financial dependence upon the central government and enjoyed far less freedom and autonomy than did local governments in other comparable countries.

The central government has declared its intention to put forward its own proposals for the reform of local government, and the Royal Commission it set up to undertake a comprehensive review has recently submitted its Report. (2)

Undoubtedly, the centuries of improvisation, to which has now been added rapid administrative, technical and social change, does make some degree of reform a matter of urgency. It must, however, be remembered that local authorities are much more than part of the machinery of government, and the object of reform should not be merely an administratively efficient planners' paradise.

Local self-government is part of the political process essential to the full realisation of civil liberties.

Speaking at Hastings in 1891, Mr. Gladstone said: "The finance of the country is ultimately associated with the liberties of the country…" and indeed, British history shows they are inextricably interwoven. From this it follows, if one is to achieve in Britain full local self-government capable of playing its part in the realisation of civil liberties, then it must be well founded upon local financial responsibility.

The Redcliffe-Maud Commission noted that an "examination of foreign practice confirms the close connection between local self-government and the possession of adequate taxation power". (3)

It then went on to assert that part of local authority income *must* take the form of central government grants; and the Commission then further asserted that all local authority investment expenditure "must" be subject to some control. (4)

This latter assertion also carries an implicit assumption as to the validity of the distinction between current and capital expenditure as currently applied to local authority finance.

We have concluded however that the financial viability of local government requires the questioning of this and many other similar assumptions basic to current public financial theory. This paper is concerned with the financial aspects of local government reform needed to sustain a viable system of local democracy irrespective of the structure of local government which is eventually enacted.

Notes and references

1. Edwin Cannan, *The History of Local Rates in England*. 2nd edition, P. S. King & Son, Westminster, 1912. Preface, p.xiv.
2. The *Royal Commission on Local Government in England 1966-69*. Cmnd. 4040, 4040-I, 4040-II, Maps. H.M.S.O., London, June 1969.
3. *Ibid*. Ch. XIII, para. 529.
4. *Ibid*. para. 531.

Chapter I

Some Historic Principles

Much of public finance history, as with general economic theory, rests upon the shifting foundations of current political decisions and practice. For example, current macro-economic theory divides the economic organism into two parts: the public sector and the private sector. This division, however, is not so clean, incisive or fundamental as it first appears, or is so frequently assumed to be.

In a political entity such as the United Kingdom, much of the private sector is at this time controlled and directed by the public authorities. Indeed, in many instances, public authorities, and in particular local public authorities, have greater control over private sector industry than they have over industries included within the public sector. Further, direct public authority ownership within the private sector is not insignificant and is gradually being extended.

On the other side, much of public sector industry, particularly public corporations, is subject, at least in accordance with the letter of the statute book, to the same economic forces and conditions as the private sector. It is generally accepted that public corporations are, or should appear to be, subject to competitive market forces. Parliament has legislated that the nationalised industries should be both profitable and efficient according to the criteria operative in the private sector; and in the name of efficiency, guidelines are laid down as to the minimum returns on their capital investment.

In a recent work on public finance Professor Prest raised the question as to the size of the public sector and, finding both the ability-to-pay principle and the benefit principle wanting, he then asks: “Are there any other ways of proceeding?” He concludes: “The very bareness of the economic principles set forth will make it clear that we are now on the borderland where economic and political considerations meet and mingle inextricably with one another. Recent years have in fact seen the publication of various ideas by economists on the appropriate principles of voting, on the grounds that one simply has to seek a political solution to these issues." Again, when considering the government as a whole, he is forced to conclude: "As with so many economic problems, there simply is no clear-cut general answer, and we have to content ourselves with pointing out the way to avoid giving the wrong sort of answers to particular questions." (1)

Lady Hicks has noted that 'the public sector' is "a convenient term, which is then contrasted with the private sector comprising the social and economic activities of the community in pursuit of their individual private aims." (2)

Clearly, as currently understood, the distinction between the public and private sectors lacks the necessary objectivity required for the proper study of public finance and related problems. It is a distinction that accords with the fashionable political opinion and the results of political decisions, and as such its sphere is most suited to that of accountancy or a national audit. The question of the size of the public sector raised by Professor Prest, particularly as it relates to both public expenditure and taxation, is however an important political question and a subject of much public debate.

Until 1963, total public expenditure as calculated by the Central Statistical Office in the annual publication of the *National Income and Expenditure Blue Book,* increased at an average rate of just over 6% per annum. Since 1963, however, the rate of growth has increased to nearly 11% per annum. [1]

Tax receipts show a similar pattern, growing at a rate of nearly 6½% per annum until 1963 and at over 10% in more recent years.

The national income at current prices increased on average at about the same rate as public expenditure and taxation until 1963; but then, rather than increasing, its rate of growth fell, and since 1965 it has averaged only a little over 4% per annum. (3)

1 Excluding current expenditure on goods and services on operating account of public corporations and other public enterprises.

These figures show clearly why this matter is the subject of public concern, and they have given rise to public questions which economists must attempt to resolve.

Professor Prest has called attention to the fact that those who argue that government expenditure in goods and services should continue to grow are really proposing that the full burden of any adjustment in the economy should fall on the private sector. (4)

Indeed, it would appear that many ‘socialist’ economists who argue in this way envisage a state of society where the private sector, as defined by Lady Hicks, almost ceases to exist. At the other extreme are those ‘free market’ economists who propose to drastically reduce the public sector by the indiscriminate use of the price mechanism, and appear desirous of putting back the clock by a hundred years.

This polarisation is unlikely to lead to the uncovering of the fundamental principles necessary to the achievement of social justice since, as pointed out above, the terms themselves are at best merely describing the results of political decisions.

Personal liberty

A study of history shows that the current practice of public finance emerged over the centuries as the result of certain forces acting in certain conditions, and that the dangers to personal liberty which are still inherent in much of current practice were recognised at an early date. The House of Commons grew in stature and power to act as a safeguard against any encroachment upon personal liberty consequent on rapacious financial demands that might result from extravagant national expenditure. Local authority finance practice followed the pattern set by central government, and with similar safeguards. Although the first records of what may be described as taxation begin towards the end of the 10th century, [2] no distinction was observed for many centuries between the private and public

2 Danegeld was first raised in 991 as a tribute to buy off the Danish invaders.

capacity of the Crown; and indeed it is not until 1862 that we find in Statute such a phrase as “the private assets of her Majesty”.

In olden times the notion was that the king had a large income of his own, and that he ought not to come begging to his subjects except on special occasions. This notion is still echoed today in the preamble to the annual Finance Act. (5)

It is the same notion that lies behind the idea of ‘no taxation without representation’, although certainly in Norman times it appears that the consent required was the consent of the individual taxpayer rather than that of a national assembly.

With the first attempt to tax personal property in 1188, the idea that representation should accompany taxation gains ground. By the end of the 13th century it would appear that the imposition of any direct taxation without the common consent of the realm was against the very letter of the law.

Since it had by then become the regular practice to summon representatives of the commons and inferior clergy, the common consent of the realm had its appropriate organ in a parliament of the three estates: “The really healthy element of the constitution as it stood on the eve of the conquest lies here–that as yet no English king has taken on himself to legislate or to tax without the counsel and consent of a national assembly, an assembly of the wise, that is of the great.” (6)

However, this right of parliament in respect of all taxes was not firmly established until near the end of the 17th century, when the Declaration of Rights and the Bill of Rights of 1689 declared that: “The levy of money for or to the use of the Crown by pretence of prerogative, without grant of Parliament, for longer time, or in other manner than the same is or shall be granted, is illegal.”

The House of Commons

Having once admitted, in practice, that special circumstances did arise from time to time in which the king could not be expected to meet such expenditure from his hereditary or ordinary revenue, the germ of the notion that income is adjusted to expenditure has also been introduced. As such a notion takes shape and grows, even the establishment of the illegality of raising extraordinary revenue without the consent of Parliament is only a frail safeguard for the liberties of the subject. The extraordinary revenue granted may be frittered away, or Parliament may find itself presented with a *fait accompli*. It is therefore to be expected that one also finds over the centuries attempts by Parliament to control expenditure and to appropriate grants.

In 1340 Parliament first demanded the production of the Royal Accounts, and in 1377 two persons were appointed by Parliament to receive and expend the monies voted for the wars in France. In 1406 the Commons were allowed to choose auditors.

It was not, however, until after the revolution that it became the practice to insert a clause in the Statutes forbidding the Lords of the Treasury to use the money for any other purpose than that for which it was appropriated. By the end of William III's reign in 1702 a certain annual sum was being assigned to the King's own use, and the residue voted for various purposes.

Blackstone laid down that the revenue consists of the hereditary or ordinary revenue of the Crown and of the extraordinary revenue depending upon taxes imposed by Parliament.

Today we have in effect a salaried monarchy, and all revenue, both ordinary and extraordinary, forms part of public authorities' incomes. Further, given the various statutes limiting the powers of the House of Lords, it is the House of Commons, as a matter of practice, that now reigns supreme in the matter of spending public monies and of levying taxes.

After a long period of gestation, lasting for many years, 1941 marked for Britain the birth of a new era in the practice of public finance. In that year the Chancellor of the Exchequer published a White Paper on *The National Income and Expenditure and the Sources of War Finance*. This has become an annual publication.

In his Budget Speech of that year, the Chancellor used the term ‘inflationary gap’, and within two years a correspondent of *The Times* could use the term ‘deflationary gap’ in relation to 1938.

This new era toppled the golden maxim of Jean-Baptiste Say, that “the best of all plans of finance is to spend little, and the best of all taxes is that which is the least in amount”, and swept away the prior worship of the ‘balanced budget’. Instead, the idea that a public authority adjusts income to expenditure remained supreme, both in theory and in practice. (7)

As a consequence, given the political conditions over the past quarter of a century, the effective restraint of public expenditure has become nearly impossible. Arguments have been produced to show that it is possible to close the inflationary gap by squeezing the private sector by means of additional taxation; and the fact that this would be merely another way of public authorities adjusting their income to expenditure has not been adequately stressed. (8)

The question as to the right size of the public sector needs to be considered in two parts. Firstly, there are the activities of public authorities in and about the business of government and its many associated spheres. Secondly, there is the question as to the various commercial enterprises which at any given time might be included within the public sector.

So long as it is an accepted principle of public finance for the public authorities to adjust income to expenditure, it is difficult for economists to treat the activities of public authorities objectively, since in practice this is a matter of public expenditure. If, however, it were possible to lay down the natural parameters determining public authorities’ income, then it follows that one has, at the same time, placed a restraint on public authorities’ expenditure, and as a consequence limited their activities.

This of course means reversing the present principle of public finance, so that public authorities would need once again to adjust expenditure to income–that is, public authorities would be subject to the same discipline as persons.

If, in addition to laying down parameters for public authorities' income, one could also elucidate the criteria for deciding which enterprises should be included within the public sector and which left outside, the question of the right size of the public sector in any particular case becomes possible of solution in accordance with objective theory. In this paper we shall attempt to lay down the natural parameters for local authority income.

Notes and references

1. A. R. Prest, *Public Finance in Theory and Practice*. Weidenfeld and Nicolson, London, 3rd edition, 1967, p.63, pp.65-66, p.207.

2. Lady Ursula K. Hicks, *Public Finance*. C.U.P., 3rd ed., 1968, p.6.

3. A. E. Holmans, *The Growth of Public Expenditure in the United Kingdom since 1950*. The Manchester School, December 1968.

4. A. R. Prest, *Sense and nonsense in budgetary policy.* Presidential Address, Leeds, 1967. The Economic Journal, Vol. 78, No. 309, March 1968, pp.1-18.

5. The preamble to the annual Finance Act states:

   "We, your Majesty's most dutiful and loyal subjects, the Commons of the United Kingdom in Parliament assembled, towards raising the necessary supplies to defray Your Majesty's public expenses and making an addition to the public revenue have freely and voluntarily resolved to give and grant unto Your Majesty the several duties hereinafter mentioned."

6. F. W. Maitland, *The Constitutional History of England*. C.U.P., 1908 (reprinted 1963). Lecture I, Central Government before 1066, p.60.

7. Hugh Dalton, *Principles of Public Finance*. Routledge & Kegan Paul Ltd., 3rd ed. 1935 (reprinted 1954). Ch. III, para. 1, p.17.

8. See also *Enquiry into Prices and Incomes*, E.S.A. Paper No. 1, 1968.

Chapter II

Local Authorities and the Exchequer

A remarkable feature of local government in England and Wales today is its heavy dependence upon monies disbursed from central government. For the period since 1918, the increase of grants from central government is illustrated in Chart 1, later in this section.

History, however, records that, from the time of the Norman conquest until at least the 16th century, the degree and extent of independent local government depended on how much the local community was prepared to pay the king or overlord. A measure of independence was seen to be highly profitable to the locality and therefore worth paying for. Prices varied; while the men of Derby offered King John 60 marks for a charter like that of Nottingham, the men of Gloucester offered not less than 200 marks for customs, laws and liberties like those of Winchester.

During the last century and a half the movement described by Edwin Cannan as the struggle of 'the local ratepayer against the national taxpayer' has grown apace. (1)

Nearly 60 years ago Professor Cannan warned: "The English people are said to have bought their liberties–chiefly through the municipalities–but if the demand for a transference of expense from the localities to the State is successful, they are likely to sell them again, and to sell them for a mess of pottage." (2)

The immediate cause of this change of attitude, which has since continued to the present day, was probably rooted in the growing desire for tax avoidance arising from the extensive system of local and national taxation which was evolving, and from the changes in the Parliamentary enfranchising of ratepayers.

At the beginning of the 19th century only about 3% of the adult population were enfranchised, and Parliament in fact represented the interests of the large landholders.

The first Reform Act of 1832 extended the franchise to about 5% of the adult population, but more important in this context was that it swept away the former anomalies of the borough franchise and introduced a uniform qualification in all boroughs, generally spoken of as the £10 occupation franchise. Among other things, it was necessary for the occupier to have been rated in respect of his tenement and to have paid his rates. The 1832 Act also transferred 143 seats to the large towns in the north of England.

The second Reform Act of 1867 extended the franchise still further so that 13% of the adult population were enfranchised, and it also made a further redistribution of seats in favour of the new and rapidly growing large towns.

In the counties, the Second Reform Act introduced an additional qualification–the occupation of a tenement of a minimum rateable value of £12, and the occupier must have been rated for the poor rate and have paid his rates.

In the boroughs the changes were even greater, and two new qualifications were created. These were generally known as the Household franchise and the Lodger franchise. The Household franchise could be claimed by any man who had occupied, as an owner or tenant, for a year a dwelling house in the borough; again, he had to be rated for the poor rate and to have paid his rates. The Lodger franchise also required one year of residence.

The third Reform Act of 1884 extended the franchise yet again so that about 25% of the adult population had the right to vote.

Further, by extending the Household franchise of the 1867 Act to the counties, and lowering the qualification of the £12 rateable value to a clear yearly value of only £10 for any land or tenement in both boroughs and counties, it had the effect of enfranchising practically all ratepayers.

The Redistribution of Seats Act 1885 discarded the ancient idea of the representation of traditional communities in favour of the representation of masses of men organised for the single purpose of choosing a Member of Parliament.

Total franchise

The Representation of the People Act of 1918 is most noted in that, for the first time, many women received the right to vote. Its effect was to enfranchise about 75% of the population. This increased to 100% in 1928 when women were placed on an equal footing with men, although some electors still enjoyed more than one vote until 1948. The importance of the 1918 Act in this struggle of ratepayers against taxpayers was that, by establishing the simple qualification of six months' residence or the occupation of business premises, the question of rateability or payment of rates no longer arose. It also removed the disqualification of being in receipt of poor relief.

During the period of the Napoleonic Wars the revenue of the national government multiplied four times, and by 1815 there was no person rich or poor, and few incidents in life, that escaped the pressure of taxation. The summary given in Table 1 below shows the wide net and great extent of national taxation, while a further £500,000 was raised by such diverse means as taxes on pensions, pamphlets, mead, perry, racehorses and so on, as well as the yield from various trade licences. (3)

Table 1: Taxation in 1815

I - Direct Taxes

	£	£
The land tax	1,196,000	
The taxes on houses and establishments	6,500,000	
The income tax	14,600,000	
The tax on succession to property	1,297,000	
Property insured	918,000	
Property sold at auction	284,000	
Coaches, posting and hackney cabs	471,608	
Tonnage on shipping	171,651	
Total		25,438,259

II - Taxes on Articles of Consumption

	£	£	£
(a) Eatables:			
Salt	1,616,671		
Sugar	2,957,403		
Currants, raisins, pepper etc.	541,589	5,115,663	
(b) Drinks:			
Beer, malt, hops and licences	9,796,346		
Wine	1,900,772		
Spirits	6,700,000		
Tea	3,591,350		
Coffee	276,700	22,265,168	
(c) Tobacco:		2,025,663	
(d) Other articles:			
Coals and slate	915,797		
Timber	1,802,000		
Cotton wool	760,000		
Raw and thrown silk	450,000		
Indigo, potash, iron, and furs	297,000		
Hemp	285,000		
The duties outwards	364,417		
Other customs duties	1,188,000	6,062,214	
(e) Manufactures:			
Leather	698,342		
Soap	747,759		
Bricks and tiles	269,121		
Glass	424,787		
Candles	354,350		
Paper	476,019		
Printed goods	388,076		
Newspapers	383,000		
Advertisements	125,000		
Plate	72,151		
Minor taxes	132,116	4,080,721	
Total			39,549,429

III - Stamp Duties

		£	£
Bills and notes		841,000	
Receipts		210,000	
Other instruments		1,692,000	
	Total		2,743,000
	Grand total		67,730,688

Immediately following the Napoleonic War, income tax and the additions to the malt tax were repealed and replaced by an excise on soap, but the income tax was re-introduced in Sir Robert Peel's budget of 1842 at a rate of about 3% and has continued ever since.

While the basis of national taxation was thus being extended to include the whole adult population, the basis of local taxation was narrowing. By the turn of the century it had become customary in most parts of the country to rate only immovable property, although statutory enactments were rather slow to follow suit.

Since one of the results of the Reform Acts was greatly to increase the political power of the ratepayers, and since local rates were levied upon a particular class of property, while the burden of national taxation was widely distributed, it is not surprising that a struggle between ratepayers and taxpayers began.

One of the first acts of the reformed Parliament in 1832 was to appoint a Royal Commission which led directly to the Poor Law Act of 1834. The Act provided, among other things, for guardians to be elected by the ratepayers. In 1831–32 the poor rate amounted to £7,036,968. By 1836–37 it had been reduced to £4,044,741 but immediately began to rise again.

Although this move was initially successful in reducing the poor rate and, through the elected guardians, appeared to give local ratepayers a measure of control, poor relief became increasingly centralised. The Local Government Act 1929 then transferred the poor law functions to the County Councils and County Borough Councils, and abolished the poor law guardians.

Under the National Assistance Act of 1948, poor relief virtually ceased to be a matter for localities and became a Ministry of the central government. The effect of transfers of responsibility under the 1948 Act was an estimated relief to ratepayers of £62½m.

Direct subsidisation of the ratepayer by the taxpayer may be dated from a Select Committee of the House of Commons which was appointed in February 1834 "to inquire into the county rates and highway rates in England and Wales, and to report their Opinion whether any and what regulations may be adopted to diminish their pressure upon the owners and occupiers of land."

The Select Committee concluded that "some portion, at least, of the present charges entailed by improvements in our criminal jurisprudence may justly be placed upon those funds to which the general mass of property throughout the country contributes more equably than it does to the county rate." (4)

This grant amounted to very little in the beginning, but it was generally extended and increased so that in 1852–53 it was a little over 5% of total rates raised. The Police (Counties and Boroughs) Act of 1856 followed, and the sum then required for the grant to be provided by the taxpayer was £140,000 in the first year, 1857–58. There was a complementary grant for London.

From these small beginnings the taxpayers' grant of subsidy for the relief of rates has grown. For England and Wales in 1913–14 it totalled £22,617,000 or about 32% of the rate income.

As shown in Chart 1, by 1919–20 this figure had increased to £48,263,000 or 46% of rate income, and by 1966–67 it amounted to £1,434,012,000 or the equivalent of 113% of the rate income.

The process still continues, and in June 1963 a Committee of Enquiry was appointed by Parliament "to assess the impact of rates on households in different income groups and in different parts of Great Britain, with special regard to any circumstances likely to give rise to hardship". The Committee's Report was published in February 1965, and legislation followed to provide further relief of rates at the taxpayers' expense. (5)

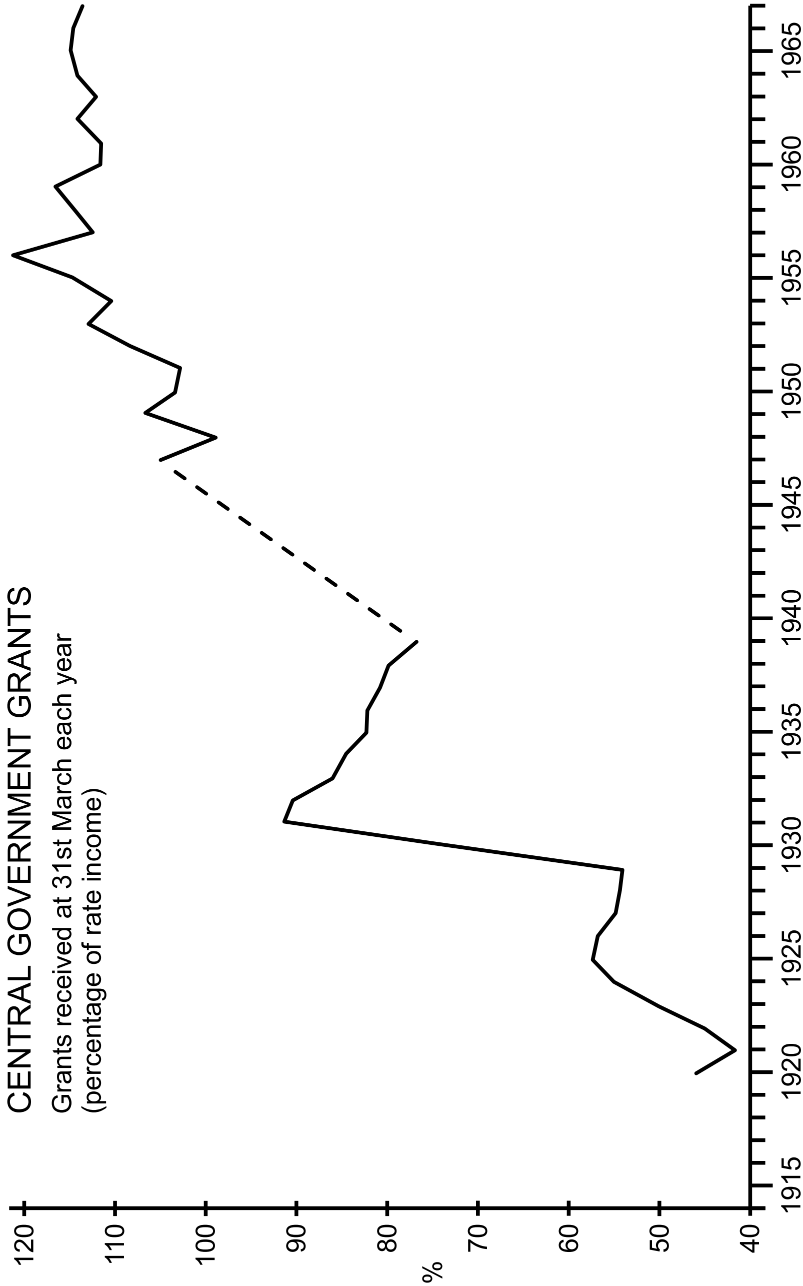
CENTRAL GOVERNMENT GRANTS
Grants received at 31st March each year
(percentage of rate income)
%
120
110
100
90
80
70
60
50
40
1915
1920
1925
1930
1935
1940
1945
1950
1955
1960
1965

Chart 1

De-rating

Another development in this battle has been the narrowing of the local authorities' tax base by statutory de-rating. At the same time, this has led to the creation by the Parliament at Westminster of privileged classes of local government electors no longer liable for the payment of rates, or at least not for full payment.

It is generally held to be fundamental to the constitution that there should be "no taxation without representation", and as early as 1297 the *Confirmatio Cartarum* made the Commons necessary parties to taxation.

During the past century in local government, however, the idea of 'representation without taxation' has been established. This new twist may be dated from 1875 when it was enacted that the general district rate was to be assessed on one-fourth part only of certain classes of property. These were mainly agricultural hereditaments, canals and railways.

By an Act of 1896 occupiers of agricultural land were required to pay only one-half of the rate in the pound levied for the poor rate, and by an Act of 1923 this was reduced from one-half to one-quarter. In 1929 agricultural hereditaments were completely de-rated, and industrial and freight hereditaments were de-rated to the extent of three-quarters of the net annual value.

In 1954 the President of the Institute of Municipal Treasurers and Accountants estimated that, as a consequence of the 1929 de-rating, local authorities in England and Wales suffered a loss of income in the financial year 1953–54 in the region of £55m.

The Local Government Act of 1948 then removed railways and electricity from the valuation list, although sums in lieu of rates were to be paid to local authorities. Upon the revaluation of 1963 coming into effect, it was intended that all these privileged classes, with the exception of agricultural hereditaments, should be swept away; in fact, central government has once again busily extended them in various ways.

"Necessity" said William Pitt in 1783, "is the plea for every infringement of human freedom. It is the argument of tyrants; it is the creed of slaves." One hardly cares to describe H. H. Asquith as a tyrant, or the British people of 1915 as slaves, yet the Increase of Rent and Mortgages Interest (War Restriction) Act of 1915 marked the beginning of the end of the system of financially independent local self-government in Britain. The Act laid down that all rented dwellings with a rateable value below £26 (£35 in London) were to be let at no more than the rent charged in August 1914.

Borne on the plea of necessity in an attempt to mitigate in part the grave effects of wartime inflation, rent restriction now has an unbroken tradition of over half a century. During the First World War the general price level more than doubled, and so after the war the restrictions were extended to cover most rented property, and the permitted rents increased to 40% over the rent charged in 1914.

Rent acts

The Rent and Mortgage Restrictions Act of 1923 freed the rents on any houses that fell vacant, but tenants had security of tenure and, under certain conditions, the controlled tenancy could be inherited. Acts of 1933 and 1938 generally freed houses with higher rateable value but imposed tighter controls on others. It was estimated that in 1939 about one in three of all houses and flats were controlled at rents not exceeding 40% above the rent charged in August 1914.

Upon the outbreak of the Second World War, the rents of all dwellings with a rateable value below £75 (£100 in London) were frozen at their September 1939 level, including over two-thirds of total dwellings within the freeze. The post-war Acts of 1946 and 1949 extended these controls.

The Housing and Repairs Act of 1954, while allowing increases under certain conditions, was designed to keep 'net' rents at their 1939 level. Between the years 1939 and 1954, however, consumer prices had risen by 232.8%. The Rent Act of 1957 freed about 10%

of dwellings subject to the restrictions, with the promise that there would be a further de-control by ministerial order. This promise was quickly rescinded in face of a general election.

The effect of rent restriction on the local authorities' income base is impossible to estimate, although its cumulative effect must be far greater than that of any other force. The restriction of rents restricts rateable values, which are based on rents. Further, these restrictions, by reducing the incentive to repair and to improve rented property, speed up its deterioration, which in turn depresses rateable values.

On the expenditure side, local authorities have been forced to make good the near cessation of private investment in dwellings for renting, which is the result of parliamentary interference. In the financial year 1966–67 expenditure by local authorities in England and Wales on housing amounted to £1,124.4m or nearly 25% of their total rate fund services expenditure. Against this, rent income totalled about £400m. No doubt there are some capital assets in the shape of land and dwellings to be set against the difference, but to what extent these are real or realisable assets is open to question, while the debts and interest charges incurred must be met.

The dependence of local government on Exchequer grants has also been increased during the past twenty-five years by national parties pursuing policy objectives, the realisation of which directly increased local authority expenditure. For example, the Education Act of 1944 increased the cost of the school building programme, as does the present policy for comprehensive education. Again, the school-leaving age was raised from 14 to 15, and it has now been decided by Parliament that it should be raised again to 16. In other spheres also the national parties in Parliament have vied with each other in respect of services to be provided by local authorities.

However necessary or desirable the realisation of such policy objectives may be, the local authorities have had little or no part to play in the decision-making although the result has been directly to increase their expenditure.

On the other side, apart from one partial and one general re-valuation, there has been no effort made by the central authorities to expand local authorities' tax base. An ever increasing proportion of Exchequer grants to local authorities is then in no way a subsidy but represents a part of the cost to the national taxpayer of the central government's actions and omissions. Unfortunately, the use of the term 'grant', and the method of distribution, tend to obscure the true nature of the transaction. (6)

The dependence of local government in England and Wales on these central government grants has its roots firstly in Parliament yielding to the increasing political pressures of newly enfranchised ratepayers to shift at least the formal incidence of the tax necessary to meet local expenditure onto the national taxpayer. Secondly, as a consequence of Acts of Parliament, situations have arisen tending both to restrict local authorities' revenue and also to increase their expenditure.

Many measures have been enacted piecemeal to mitigate results rather than to eradicate causes which, in turn have caused local authorities' expenditure to expand rapidly in some directions, and have necessitated central government taking over completely some other local authority functions.

It is apparent that the establishment of a viable system of local democracy necessitates local financial responsibility; that is to say, expenditure incurred by a local authority upon its own decision should be met by its own electors.

From this it also follows, however, that where Parliament enacts that certain classes of persons should not be liable for the payment of rates (e.g. farmers, or approved charitable institutions) then the Chancellor of the Exchequer should become liable, and it should be seen by the elector that certain national taxes are raised in order to pay these local rates. Such rate payments by the Chancellor to the local authorities would constitute a proper division of financial responsibility; they would not be grants to local authorities as such but grants to persons.

It would be difficult indeed, if not impossible, to allocate the rate liability of the central authorities arising from the restriction in the growth of rateable values as a consequence of the various Rent Control Acts, since these Acts have made any local valuations of domestic properties a matter of guesswork, and this in turn has necessitated further legislation. (7)

However, bearing in mind that a net surplus of housing has been forecast for the 1970s, and given a change in the existing system of valuation for rates as suggested below, it should be feasible for the central government authorities to dismantle entirely the whole of the present rent control machinery and deal with individual cases of hardship directly.

If then a viable system of local democracy is to be sustained the principle that needs to be enforced is that all levels of government are financially responsible for their own actions.

In practice this would mean that Parliamentary Acts in respect of de-rating, whether wholly or in part, would incur an immediate financial responsibility to the Chancellor of the Exchequer. This liability could then be distributed either as a direct grant to persons or indirectly by a payment made to the local authority concerned, as central government might deem expedient in the circumstances.

In cases where Parliament enacts that the local authorities must provide services to a definite national standard as laid down and enforced by central government Ministries, it seems right that at least 50% of the financial liability should be met by the Chancellor of the Exchequer.

The election campaigns of the national parties over recent years lead to the conclusion that there is as much, if not more, financial irresponsibility in the House of Commons as in the local council chamber, and the constitutional enforcement of the principle that each level of government is financially responsible for its own actions would provide restraint at all levels.

Given enforcement of the principle outlined above, the present Exchequer grants can be and indeed should be abolished, together with the notion that local government is subsidised or assisted by the central authorities. The Exchequer would be required to make payments to local authorities but only for the purpose of adjusting Parliament's financial responsibilities. The relationship of the total of such payments to the sums currently being transferred by way of Exchequer grants would then depend upon the extent to which Parliament has restricted local tax revenues and increased local authorities' expenditure by Acts and Ministerial Orders.

Notes and references

1. Edwin Cannan, *The History of Local Rates in England*. 2nd edition, P. S. King & Son, Westminster, 1912. Chapter VI, p.132.
2. *Ibid.* Preface, p.viii.
3. Stephen Dowell, *A History of Taxation and Taxes in England*. 3rd edition, Frank Cass & Co. Ltd., London, 1965. Vol. II, pp.257-259.
4. Hansard, *County Rates*, HC 7th March 1834, Vol. 21, cc1346-52; and *Parliamentary Papers 1834*, No. 542, p.14.
5. *Committee of Inquiry into the Impact of Local Rates on Households*. Cmnd. 2582, H.M.S.O., London, February 1965.
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7. The *General Rate Act 1967* and *General Rate Bill 1969*.

Chapter III

The Loan Finance of Local Authorities

In addition to local authorities' increasing dependence upon central funds by way of grants, local independence is also being eroded by the operation of the present system of loan finance. Although local authorities are not required by law to borrow, the pressures upon them are such that in practice they have little option.

In exercising their borrowing powers local authorities are not only circumscribed by statute, but today, expenditure to be met out of loans is subject to detailed control by the central authorities; this detailed central control, while directly eroding local independence and producing frustration and resentment at local level, is also a cause of delay. This in turn results in recriminations between local authorities and the central ministries. Unfortunately, this aspect of the present system is rarely recognized by the local electors. (1)

From time to time there is public concern over both the rate of growth and the size of local authorities' outstanding debt. In 1900 Sir Henry Fowler, in a Presidential Address to the Royal Statistical Society, called attention to the fact that the amount of debt incurred by local authorities was estimated in 1868 to be £60m, but in 1875, the first year for which the returns gave the amount of local debt, it was £92.820m; and by 1898, it had risen to £262.017m. (2)

This rate of growth has tended to accelerate, and over the next 70 years the debt was multiplied some fifty times. Today local debt exceeds £14,000m and is still growing at a rate of about 10% per annum. Chart 2 shows the growth of total outstanding debt of local authorities in England and Wales as at 31st March each year, from 1914 up to 1966 inclusive. Between the two World Wars, total debt increased from £544.2m at 31st March 1919, to £1,594.7m at 31st March 1939. This period shows an average annual rate of increase of just under 5½%, similar to that noted by Sir Henry Fowler.

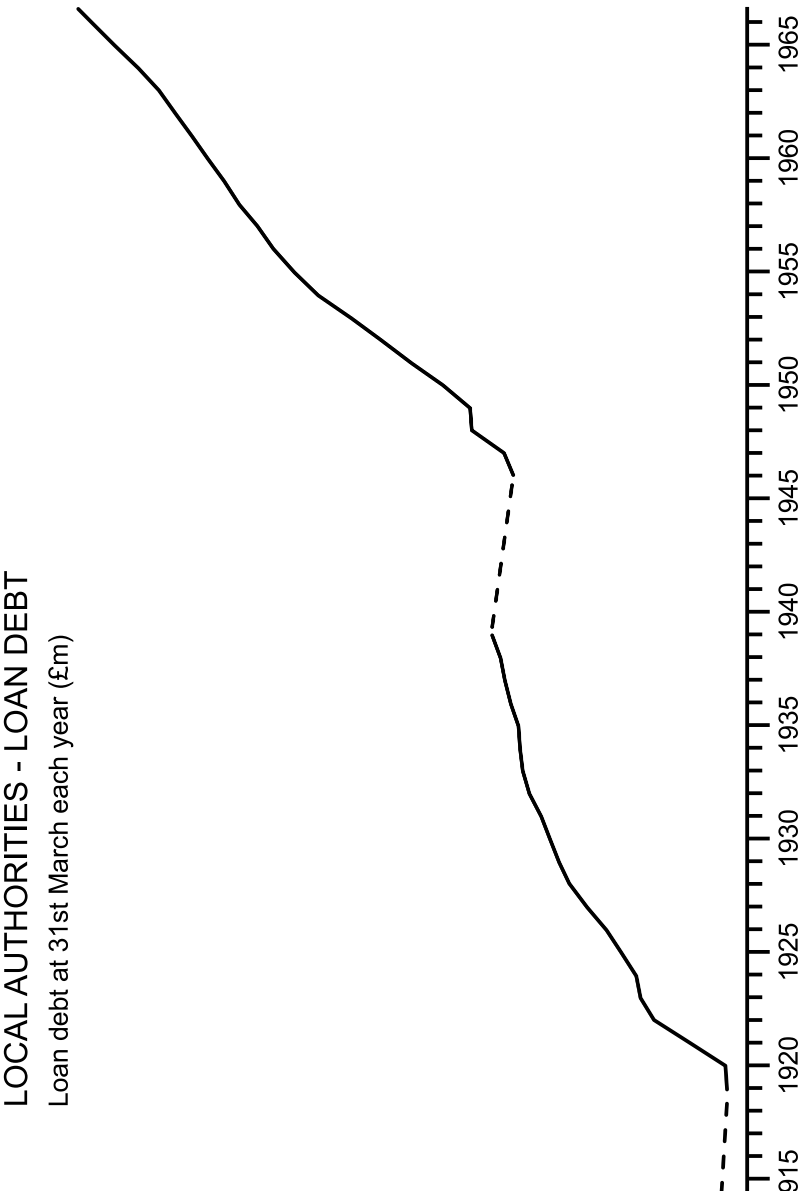
LOCAL AUTHORITIES - LOAN DEBT
Loan debt at 31st March each year (£m)
£m
9600
4800
2400
1200
600
1915
1920
1925
1930
1935
1940
1945
1950
1955
1960
1965

Chart 2

Since the end of the second World War, however, the average annual rate of increase has been about 9½% per annum. The total amount of debt has risen from £1,426.1m at 31st March 1946, to £10,193.5m as at 31st March 1967; today it exceeds £12,000m.

Although such figures are startling, and quite rightly a matter for ratepayers' concern, neither the size nor the rate of growth of local authority debt are of themselves of paramount importance, and indeed, an over-emphasis of these aspects can be misleading.

For example, if one makes due allowance for the decline in the internal purchasing power of sterling, then in real terms the rate of growth of local authority debt during recent years is very close to that maintained through the interwar period.

The important question here is: to what extent, during a period of full employment, did the continuing high level of local authority expenditure (made easier by the existing system of loan finance) contribute to the national inflationary pressures? (3)

Again, if one compares total local authority debt with the total rateable values which are its base there would appear to be, given full valuations, little change in the relationship for over fifty years.

Although at 31st March 1963 the total debt of local authorities in England and Wales was nine and a half times the total rateable value, at 31st March 1964 after revaluation, the total debt was only 3.7 times the total rateable value. This latter relationship compares favourably with the 1930s, when total debt fluctuated around five times total rateable values, and after due allowance is made for de-rating and undervaluation is not far different from the relationship of 2.7 which existed at 31st March 1914. (4, 5, 6 and page 17)

Today the relationship between total debt and total rateable values has crept back to around five times, but undoubtedly this is the result of the central government's failure to fulfil their statutory obligations in the matter of quinquennial revaluations.

From the preceding it may be concluded that local authorities have not used their borrowing powers extravagantly, and that their ability to meet their commitments, in so far as this is reflected in the greater rateable values, remains unimpaired. However, it must be noted that the creation of public debt, even though matched by public assets and by taxable capacity, still throws burdens onto the debtor community; the disadvantages of these may well outweigh the benefits which accrue from the creation of public assets.

In this respect it is important to distinguish between internal and external debts. Money payments for interest and the repayment of principal in the case of an internal debt are in effect a series of transfer payments within the community, and therefore the debtor community as a whole incurs no direct money burden. In the case of external debt, a direct money burden does arise since the money payments for both interest and repayment of principal are made to external creditors.

Until recently most local authorities' debt was internal; but now, attracted by the low interest rates prevailing overseas, many local authorities are seeking powers directly to incur external debt. (7)

The interest and principal repayments of such local authority external debt will have to be met by future exports of goods and services, for which there will be no corresponding imports, and it therefore follows that the surplus from international trade will have to be increased significantly, if the international parity of sterling is to be maintained. (8)

It may well be that many overseas markets are prepared to make loans to UK local authorities at attractive rates, in the expectation of gains from relative sterling devaluation. Moreover, the extent to which such external debts are created increases the possibility of such gains.

For the successful prosecution of a war, belligerent countries often find it necessary to create external debt; while in times of peace the creation of external debt may well prove advantageous for under-developed or developing countries.

Commercial companies also find the raising of overseas loans to be, in certain circumstances, both profitable and the best way of improving their future export performance.

The creation of an external debt by local authorities is not, however, dictated by such considerations, but is determined by the possibility of savings on loan charges which, as noted above, may in the event prove illusory. The direct money burdens incurred by the repayments of interest and principal on external local authority loans are likely, then, to have no offsetting advantages.

Loan charges

Annual loan charges made by the local authorities in England and Wales have already increased to around £1,000m. In comparison, balances on our international transactions do not amount to more than a few £100m each year, in either direction. It follows that the transfer of even a small proportion of local authority internal debt to an external debt will have a significant effect on our already precarious balance of payments position; and the consequences would be out of all proportion to the public assets which might be created by incurring the debt.

Hugh Dalton has pointed out that, although the total amount of the national debt was reduced between the end of the Napoleonic Wars and the beginning of the First World War by some 17%, due to an increase in the purchasing power of sterling during the same period both the interest charge and the outstanding principal sum were, in real terms, greater in 1914 than in 1817. (9)

However, it must be noted that during the same period national production greatly expanded. At the end of the Napoleonic Wars the national debt amounted to twice the annual national income, and by 1913 it was the equivalent of only 30% of national income. Similarly, in 1818 interest charges on the national debt accounted for 7.7% of the estimated national income; but by 1913, although greater in real terms, interest charges represented only 0.7% of the national income. Clearly the rate of growth of the whole economy, as well as movements in the general price level, are of importance in determining the burden of public debt.

The national debt has largely been incurred to pay for wars, and until the end of the Second World War it was normal for the national debt to expand very rapidly during wartime and to decline during the time of peace. In contrast, local authority debt normally declines during major wars and expands during the peace. (10)

At 31st March 1948 the outstanding debt of local authorities in England and Wales totalled £1,713.5m. By 31st March 1967 it had multiplied nearly six times and totalled £10,193.5m. During this period, production had expanded by some 60% while prices had about doubled; as a proportion of the national income, outstanding debt in 1967 was only slightly higher than that prevailing in 1938.

Similarly with loan charges; although between 1948 and 1967 the total annual amount multiplied by five times, as a proportion of the U.K.'s national income it had only increased from about 1% in 1948 to nearly 3% in 1967. In 1938 loan charges had amounted to about 24% of the U.K. national income.

While it would appear from these figures that the burden of local authority debt and annual loan charges is not at the moment a matter for immediate concern, it must be noted that this is largely due to the steady decline in the internal purchasing power of sterling. Should this steady decline be halted, or should the internal purchasing power of sterling rise as it did during the 19th century, the annual loan charges incurred by the outstanding debt at its present level would become a very heavy burden indeed, and result in an uneven distribution of wealth within the community.

Evidence of the past twenty years points to the conclusion that a situation has now been reached where any effective action by the central authorities that is directed towards maintaining the internal purchasing power of sterling is, in fact, limited by their ability to restrain local authority debt while at the same time encouraging rapid acceleration in production. Alternatively, it may be said that effective action by the central authorities is limited by their ability to reduce both the size of the outstanding debt, and the annual loan charges in money terms, of local authorities.

Chart 3 shows the growth of loan charges for local authorities in England and Wales for the financial years from 1919–20 through to 1965–66. During this period the average annual increase of loan charges was about a half per cent greater than that of the total debt; that is, between the two World Wars, loan charges increased at an average annual rate of about 6%, and since the end of the Second World War at an average annual rate of about 10%. As can be seen from the chart, however, the average annual rate for the post-war period is somewhat misleading, due to considerable changes made in local authority responsibilities during the term of office of the first post-war Labour government.

If one takes the base year as 1948–49, the rate of growth of loan charges is just over 12%, compared to the growth of outstanding debt at just under 10½% per annum. Since loan charges combine repayments of principal as well as interest charges, the overall rate of growth is affected by changes in the interest rates. Over recent years loan charges have been increasing at a rate of about 15% per annum; total outstanding debt has only been increasing by between 10½% and 11% per annum.

It has generally been accepted, and was confirmed by the Allen Committee Report, that rates are of a regressive nature. (11)

Since, after allowing for government grants, loan charges are in effect a transfer payment from all ratepayers to that minority who have actually lent money to local authorities; and since, further, it is a reasonable assumption that the minority who do lend money to local authorities are from the higher income brackets, one must conclude that the loan charges add to the regressive nature of the rating system. This addition is not insignificant, since loan charges met annually by local authorities in England and Wales represent about two-thirds of their total income from rates; while the interest element is about the equivalent of half their rate income. Even after allowing for government grants, which currently exceed 50%, the burden of loan charges, and in particular interest charges, at the currently very high level remains substantial. (12)

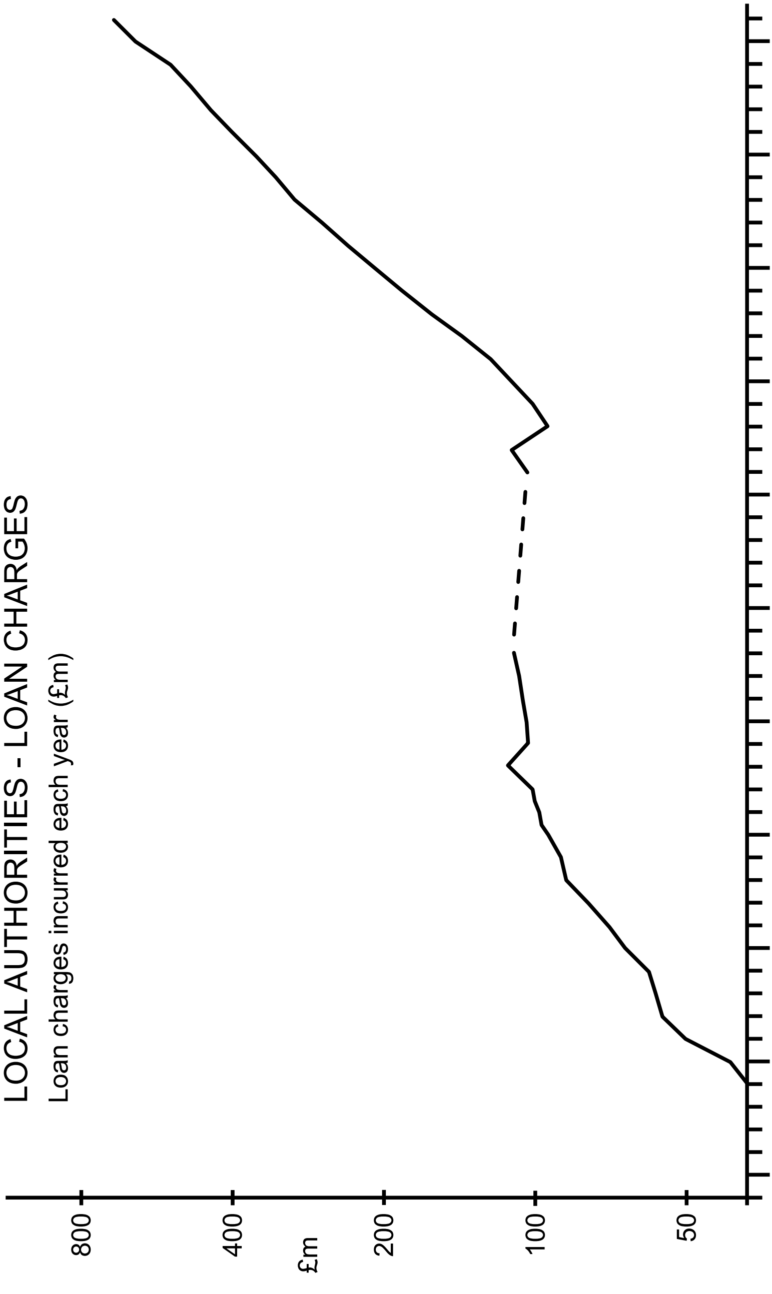
LOCAL AUTHORITIES - LOAN CHARGES
Loan charges incurred each year (£m)
£m
800
400
200
100
50
1915
1920
1925
1930
1935
1940
1945
1950
1955
1960
1965

Chart 3

Advantages of the present system

There are a number of arguments put forward in support of the present system of loan finance, but in view of its inherent dangers to the national economy, which necessitates central control and results in a loss of local independence, it is pertinent to consider whether the advantages claimed for the system are sufficient to outweigh its defects.

Firstly, it is claimed that items of capital expenditure are in the nature of an investment; that is, they benefit more than one year and result in the acquisition of a valuable asset. It is therefore held that by meeting such expenditure in the year in which it arises by means of a loan, the loan charges thereby incurred spread the cost over the life of an asset. This argument assumes distinctions which either do not exist, or at best, can only be made by highly arbitrary judgments.

Certainly, so far as education is concerned, the distinction would appear to be determined by a particular authority's opinion, policy, or its arbitrary decision as to the relevant time period. It is normal practice to count the erection and adaptation of school buildings as capital expenditure, and it is reasonable to expect that such expenditure will confer benefits in later years and will result in the authority's acquiring an asset.

On the other side, however, most authorities appear to consider the purchase of much education equipment, such as textbooks and library books, etc., as revenue expenditure, although with equal certainty a large proportion of such expenditure will also benefit future years and will result in the acquisition of assets. Expenditure on teacher training is normally considered as a revenue item, yet the benefits from such expenditure can only accrue to future years.

Indeed, from an extreme standpoint, all expenditure by local authorities on education might be considered as an investment, and is in fact often so considered, although not necessarily in the strict accounting sense.

Thus, items of expenditure on education which result in the acquisition of an asset, or benefit more than one year, may be found in either the revenue account or the capital account. Total expenditure on education amounts to approximately 50% of all local authorities' current expenditure on goods and services and, excluding housing, about 50% of their annual capital expenditure.

It must also be noted that commercial investment is very different from local authority capital expenditure, other than that for trading services. A commercial concern undertakes investment with an eye to future profits, and clearly it could not continue as a viable undertaking unless in future years it made due allowances for depreciation and replacement before deciding its profit figure for distribution purposes. Such criteria do not apply to the local authorities.

Further, whether or not a commercial undertaking decides to invest on the basis of a loan, or from its own savings, or from its current revenue, will depend on its particular circumstances at the moment of time and its appreciation of future conditions. If the undertaking decides on some form of loan finance, it will certainly be in the expectation that future earnings from the investment will more than cover repayment of the principal and the interest charge.

Again, such criteria cannot be applied to local authorities; and the mere fact that certain items of expenditure, such as on social or environmental services or the like, will confer a benefit on more than one year, and will result in the acquisition of an asset, is not of itself sufficient reason for incurring a debt.

Secondly, it is held that the present system of loan finance for capital spending is a fair procedure, and that it would be wrong to place the full burden of such expenditure on the present generation when the benefit will accrue to succeeding generations. (13)

The real question here is whether the capital expenditure is a constant feature in local authority accounts, or whether it is highly irregular. In part this is a matter concerning the structure of local government and the size of the individual authorities; for example, if the life of a school building is taken to be about 40 years, and a particular authority is responsible for 40 schools, then the question of spreading its burden may be resolved by replacing one school every year.

It must be admitted, however, that as shown in Table 2, those items placed in the capital account do show much greater annual fluctuations than the items placed in the revenue account; although this may be misleading in so far as it affects the annual income requirements of local authorities. (14)

The *third* argument then holds that since capital expenditure is irregular, meeting the cost by initial borrowing, and debiting only annual loan charges and expenses to the revenue account, smooths out the flow of annual income needs which must be met by the ratepayers, and also by taxpayers through government grants.

Table 2 shows capital expenditure and revenue expenditure, and the percentage increase or decrease at current prices for one year over the previous year, for local authorities in England and Wales from 1927–28 to 1938–39, and then for the post-war period.

Post-war capital expenditure shows a range of fluctuation of between 4.8% decrease in 1957–58 over 1956–57, and an increase of 23.4% in 1963–64 over 1962–63, while the mean deviation of the annual fluctuation is 6.3%. For revenue expenditure the range of fluctuation is from a 9.8% decrease for the year 1948–49 over 1947–48, to an increase of 13.9% in 1965–66 over 1964–65, while the mean deviation of the annual fluctuation is 3.2%.

For the pre-war period, both the range of fluctuation and the mean deviation at 10.7% for capital expenditure are much greater than capital expenditure fluctuations over the past 20 years. On the other side, the range of fluctuations for revenue expenditure and the mean deviation of 1.9% is much less than post-war; although on this comparison one must allow for the fact that the decrease in revenue expenditure shown for 1948–49 and 1949–50 is to a large extent the result of the transfer of services from local authorities to the central government.

Table 2: Local Authority Expenditure

Year	Capital expenditure		Revenue expenditure	
	£m	%	£m	%
1927-28	119.957	-	402.633	-
1928-29	102.820	– 14.3	405.933	+ 0.8
1929-30	108.874	+ 5.9	423.655	+ 4.4
1930-31	110.880	+ 1.8	432.704	+ 2.1
1931-32	116.776	+ 5.3	435.019	+ 0.5
1932-33	84.754	– 27.4	430.320	– 1.1
1933-34	89.289	+ 5.4	433.225	+ 0.7
1934-35	80.658	– 9.7	454.759	+ 5.0
1935-36	96.850	+ 20.1	470.885	+ 3.5
1936-37	116.770	+ 20.6	484.588	+ 2.9
1937-38	142.182	+ 21.7	505.567	+ 4.3
1938-39	150.779	+ 6.1	532.824	+ 5.4
1948-49	329.488	+ 0.5	866.215	– 2.0
1949-50	331.118	+ 11.4	849.099	+ 4.5
1950-51	368.792	+ 15.6	887.361	+ 11.3
1951-52	426.486	+ 16.7	987.679	+ 7.6
1952-53	497.772	+ 9.2	1,062.263	+ 6.1
1953-54	543.641	– 3.3	1,127.517	+ 8.7
1954-55	525.737	+ 2.9	1,125.337	+ 8.6
1955-56	541.052	+ 2.6	1,330.779	+ 12.5
1956-57	555.041	– 4.8	1,497.088	+ 8.9
1957-58	528.585	– 3.2	1,630.152	+ 6.2
1958-59	511.896	+ 11.6	1,731.287	+ 7.8
1959-60	571.472	+ 8.6	1,865.718	+ 8.2
1960-61	620.754	+ 19.4	2,018.451	+ 10.6
1961-62	741.218	+ 7.4	2,232.254	+ 9.6
1962-63	793.714	+ 23.4	2,446.859	+ 9.0
1963-64	979.443	+ 25.2	2,667.488	+ 8.8
1964-65	1,225.823	+ 25.2	2,902.829	+ 13.9
1965-66	1,289.253	+ 5.2	3,306.382	+ 13.9
1966-67	1,411.900	+ 9.5	3,621.425	+ 9.5

Source: Local Government Financial Statistics, England and Wales.

These figures show clearly the irregularity of what is described as capital expenditure relative to what is described as revenue expenditure. It must be noted, however, that a separate analysis of capital and revenue expenditure does not necessarily indicate the annual income requirement of the local authority; it is the annual income requirement which is of importance to the local ratepayers and to the national taxpayers.

If it is assumed that local authorities had no outstanding debts, and were not empowered to borrow (other than normal overdraft arrangements), then their annual income requirement is equivalent to their expenditure of revenue monies for capital purposes, plus other expenditure from revenue monies, plus expenditure met from capital monies. These total amounts are shown in Table 3 for all local authorities in England and Wales.

The annual income requirement of local authorities under the system of loan finance is as above, plus loan charges, plus capital monies assigned to the repayment of debt, less the amount of the loans. These totals are also shown in Table 3, together with the percentage increase or decrease in the annual income requirement over the previous year for the alternative methods of finance.

The figures given in Table 3 show that before the Second World War the range of fluctuations in the annual income requirement would have been larger and the mean deviation greater with a non-loan system than it was under the loan system of local authority finance. Post-war, however, the range of fluctuations of the annual income requirement of a non-loan system is somewhat less than for the present loan system of finance, although the mean deviation is fractionally greater. It may be observed that, while pre-war the loan system of finance appears to have smoothed out the annual income requirement, it achieved this by holding the requirement at a higher level during the depression.

Between the years 1927–28 and 1938–39 the cost of smoothing out the annual income requirement by the loan system of finance was about £100m in additional income requirement.

Table 3: Local Authority Income Requirements

Year	Non-Loan System £m	Non-Loan System %	Loan System £m	Loan System %	Difference £m
1927-28	439.2	-	394.4	-	44.8
1928-29	425.4	– 3.1	415.1	+ 5.4	9.8
1929-30	439.3	+ 3.3	445.1	+ 7.1	– 5.8
1930-31	444.0	+ 1.1	443.6	– 0.3	0.4
1931-32	449.7	+ 1.3	455.2	+ 2.6	– 5.5
1932-33	408.3	– 9.2	434.3	– 4.6	– 26.0
1933-34	404.6	– 0.9	459.7	+ 5.9	– 55.1
1934-35	426.1	+ 5.3	470.6	+ 2.4	– 44.5
1935-36	459.1	+ 7.4	485.4	+ 3.1	– 26.3
1936-37	490.4	+ 6.8	500.3	+ 3.1	– 9.9
1937-38	533.0	+ 8.7	525.0	+ 4.9	8.0
1938-39	565.5	+ 6.1	553.8	+ 5.5	11.7
1948-49	1,093.7	-	908.4	-	185.3
1949-50	1,068.1	– 2.3	872.7	– 3.9	195.4
1950-51	1,132.5	+ 6.0	915.8	+ 4.9	216.7
1951-52	1,276.5	+ 12.7	1,016.2	+ 11.0	260.3
1952-53	1,401.5	+ 9.8	1,086.1	+ 6.9	315.4
1953-54	1,486.7	+ 6.1	1,176.4	+ 8.3	310.3
1954-55	1,540.5	+ 3.6	1,259.6	+ 7.1	280.9
1955-56	1,633.6	+ 6.0	1,359.9	+ 8.0	273.7
1956-57	1,779.3	+ 8.9	1,551.2	+ 14.0	228.1
1957-58	1,845.0	+ 3.7	1,688.0	+ 8.8	157.0
1958-59	1,897.7	+ 2.9	1,779.5	+ 5.4	118.2
1959-60	2,060.8	+ 8.6	1,923.7	+ 8.1	137.1
1960-61	2,221.4	+ 7.8	2,108.8	+ 9.6	112.6
1961-62	2,504.5	+ 12.7	2,325.4	+ 10.3	179.1
1962-63	2,727.7	+ 9.0	2,535.9	+ 9.1	192.8
1963-64	3,081.6	+ 12.9	2,817.7	+ 11.1	263.9
1964-65	3,476.5	+ 12.8	3,059.1	+ 8.6	417.4
1965-66	3,851.5	+ 10.8	3,444.0	+ 12.6	407.5
1966-67	4,197.6	+ 9.0	3,802.4	+ 10.4	395.2

Source: Local Government Financial Statistics, England and Wales.

During the 1930s it was generally held that the very high rates charged in what were called the depressed areas were an important factor in preventing their rehabilitation. In 1933–34, had a non-loan finance system been in operation, the income requirement of local authorities in England and Wales would have been cut by 12%. There can be little doubt that this would have given the necessary relief to those areas which really needed it at that time.

As shown in Table 3, local authorities' capital expenditure does indicate greater irregularities than their revenue expenditure. The conclusion to be drawn from Table 3 is, however, that meeting this expenditure by initial borrowing, and debiting only the annual loan charges and expenses to the revenue account, has done little or nothing during the post-war years to smooth the flow of the annual income requirement. On the other hand, during the depression, while the annual income requirement may have been smoothed, it undoubtedly had a restrictive effect on the economy.

Fourthly, while accepting that the interest charges incurred under the present system increase the cost of items of expenditure covered by loans, it is held that any alternative is the equivalent in practice of levying an interest-free forced loan on the ratepayer.

This contention depends, as does the last, upon whether capital expenditure is a regular or irregular feature in the accounts, and whether in any event this has a significant effect on the annual income requirement. Since, as shown above, the system of loan finance currently operated does not in practice have a significant beneficial effect on the fluctuations of local authorities' annual income requirements, it follows that the policy decision to be made is whether it is right to incur, on behalf of the local ratepayers, the additional expense of interest charges.

Today it is often maintained that the interest charge, as a result of the persistent decline in the purchasing power of sterling, is negligible in real terms, and therefore does not add significantly to the ratepayer's costs. There is perhaps some force in this argument although, if increases in the general level of prices are set against the market rate of interest, one is forced to the conclusion that the real rate of interest has remained positive, and during most of the last 20 years it could not be described as negligible.

Any shift in the general price level covers a wide range of fluctuations in individual prices. A general price index is therefore not a good measure of price changes in local authority expenditure.

In particular, local authority borrowing is on capital account and may be taken as bearing a close relationship to capital formation.

As an indication of price changes in local authorities' capital expenditure, the Central Statistical Office's published data relating to public authorities' gross domestic fixed capital formation has been used as a base for the index illustrated on Chart 4.

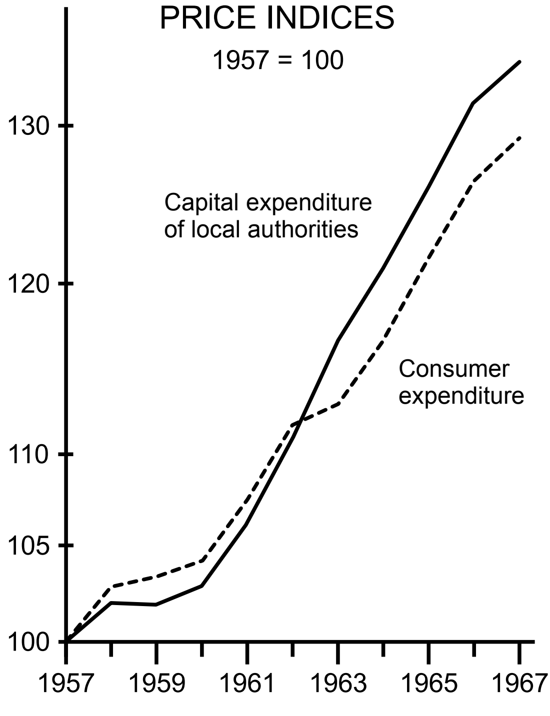

Chart 4

For comparison, the chart also shows the CSO's price index for consumer goods and services. On a financial year basis the rise in the index between 1957–58 and 1966–67 is 31.2%, similar to that stated in Research Appendix 6 of the Redcliffe-Maud Report. (15)

In determining the rate of interest it must be taken into account that it is now the common practice for local authorities to set up consolidated loan funds and to charge their borrowing accounts at an average rate of interest. During periods of rising interest rates the current average loan fund rate will tend to be below, possibly substantially below, the market rate for new loans. It is, however, this current average rate which must be considered as the effective local authority rate so far as their expenditure is concerned, since it is this rate which is used in the costings presented to committees, and upon which these committees make their recommendations to their councils for expenditure decisions.

The annual current rate of interest shown on Chart 5 has been calculated by dividing the interest payments by the mean gross debt during any given financial year in accordance with the figures presented annually to Parliament in the local government financial statistics for England and Wales. The real rate of interest shown on Chart 5 is the current rate of interest deflated by the price index for public authorities' gross domestic capital formation, calculated on a financial year basis. As can be seen from the chart, the real rate of interest charged to the local authorities' borrowing accounts has indeed been negligible in recent years, and was in fact a negative rate for the financial years 1962–63 and 1963–64.

In Chart 6 both the average loan fund rate charged to borrowing accounts, and the real rate, are shown for one council. Although, in this case, at no time does the real rate of interest appear to become negative, during the 1960s it may be considered a negligible rate.

Further, if one takes into account government grants, which during this period have always exceeded 50% of total expenditure, then it would appear that, so far as the ratepayers are concerned, the entire burden of the interest charge has been shifted.

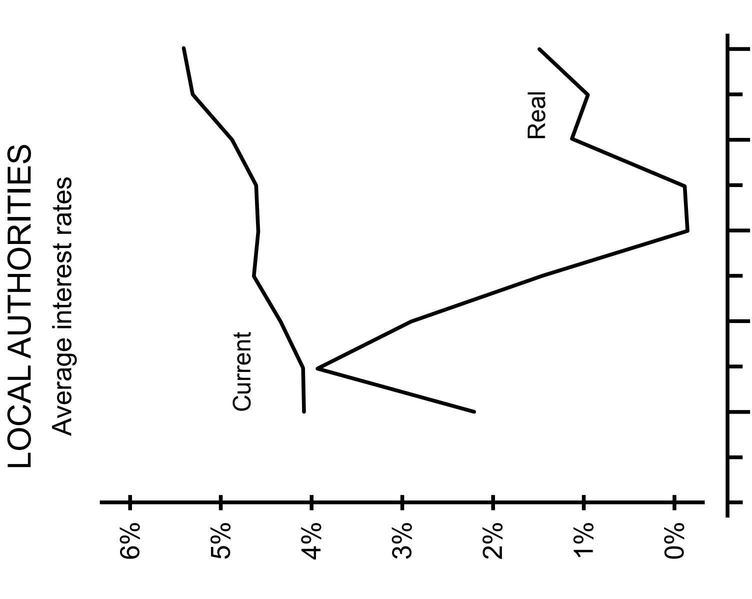

Chart 5

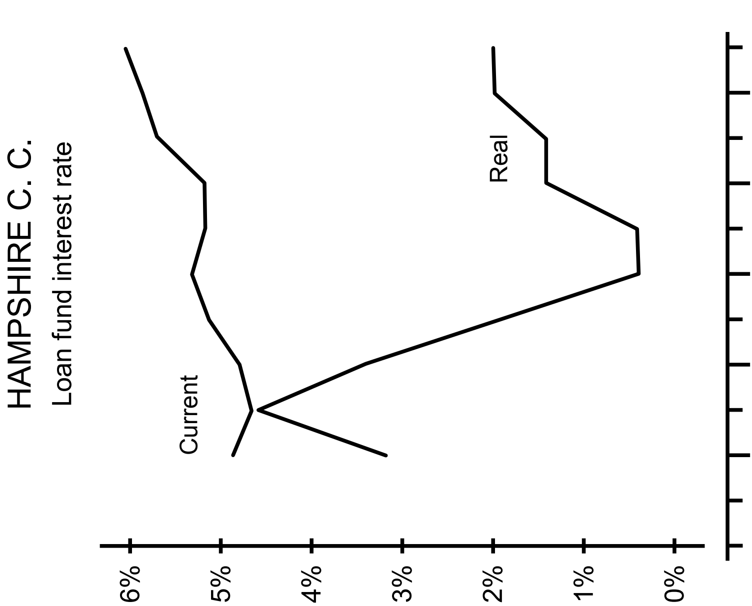

Chart 6

Very clearly, so far as the economy is concerned, if resources have been diverted there must be a corresponding opportunity cost: and if interest charges have been incurred, they must have been met. Local authorities have been able to shift the burden of interest charges off the ratepayer by the operation of a peculiar system of finance during a period of inflation, with a rising price level acting as an arbitrary tax on the community as a whole.

This situation also calls into question the effectiveness of the central authorities' control of the economy by monetary methods. The current market rate of interest for local authorities is around 10%, but in fact this is having little immediate effect in restraining their expenditure. Equally, should the central authorities sharply reduce the current market rate of interest, this will have but little immediate effect on expanding local authorities' expenditure.

One must conclude, therefore, that while under certain specific conditions the local authorities may shift either the whole or part of the interest burden, the result of this will be that they tend to act perversely relative to the interests of the economy as a whole. The central authorities will be forced to rely upon direct controls, with the corollary of local frustration and loss of local independence.

Lastly, it is held that the present system of loan finance is the only method by which a growing authority could meet its statutory responsibility to provide an ever-improving service to ratepayers.

In order to test this contention, in Table 4 the annual accounts of Hampshire County Council have been further analysed using the same method as that used for Table 3. The administrative county of Hampshire covers a rapidly developing area in which, over the past decade, the population has been expanding at about four times the national average rate for England and Wales; while its rateable values since the last revaluation in 1963 have had a rate of growth of more than double the national average. In addition, Hampshire County Council is responsible for such services as education and highways, which over recent years have tended to become an increasing burden on local finance.

Table 4 shows that every year, for the past ten years, the present system of local authority loan finance has reduced the Council's annual income requirement. But as shown in the table, in no year has the difference been greater than 8.7%, while the average over the whole period as analysed is only 4.6%. Bearing in mind that the Chancellor of the Exchequer uses a 10% tax regulator in order to assist him in managing the economy, a difference of 5% in the annual income requirement will not prevent a local authority from performing its statutory responsibilities. Further, since during most of this period it has been official policy to increase central taxes in order to reduce consumer demand, the present loan system of local authority finance appears to be perverse indeed.

Table 4: Annual Income Requirements of Hampshire County Council

Year	Non-loan system	Loan system	Increase
	£1,000s	£1,000s	%
1958-59	16,420	15,099	8.7
1959-60	17,783	17,038	4.4
1960-61	18,971	18,280	3.8
1961-62	22,107	21,567	2.5
1962-63	25,572	24,428	4.7
1963-64	28,030	26,940	4.0
1964-65	31,676	30,377	4.3
1965-66	36,994	36,045	2.6
1966-67	42,587	40,470	5.2
1967-68	48,614	45,773	6.2

Source: Hampshire County Council annual abstract of accounts.

If one assumes that the whole of the additional income shown in Table 4 is to be raised by the present rating system, then the annual precept set by Hampshire County Council would have had to be increased by about 13% over each of the years from 1958–59 to

1967–68 inclusive. Based on the new 1963–64 valuation figures, Hampshire County Council's precept for the year 1963–64 was 6/- whereas to provide for the additional income requirement of a non-loan system a higher precept of 6/8d. would have been necessary. As a comparison, the precept for the year 1938–39 was 7/2d.

Although this would represent a substantial increase in rates it cannot be described as impossible. In such circumstances council members could have inspected cost estimates more vigorously and achieved some reductions. Given Exchequer grants, the Hampshire County Council precept need only have been increased by about 6% or, since revaluation, the product of a little over a 5d. rate.

One must conclude therefore that it would be possible for such a growing local authority to fulfil its functions on the basis of a non-loan system in a way that would have accorded with central government policy, and also, in the particular case of Hampshire, to avoid incurring local authority debt of nearly £21.5m.

Conclusion to Chapter III

As has been shown, the present system of loan finance has serious defects, and makes it possible for local authorities, acting in the best interests of their local ratepayers, to put the community as a whole at great risk. The advantages claimed for the system would appear to have little substance, and many on closer inspection hold inherent dangers. Given that local authorities were provided with an adequate local income, there seems to be no substantial reason why the present system of loan finance should not be abolished, except perhaps for trading accounts. Such a change would not only be to the long-term advantage of ratepayers, but would also make it easier for central government to attend to national affairs, while giving local government full freedom to attend to local affairs.

Before leaving this matter, however, one should perhaps raise what is possibly the more fundamental reason for the adoption of the present system of loan finance by our legislators.

Some sixty years ago Taussig referred to the ‘cynical principle’ of taxation, which he described as “Pluck the goose with as little squawking as possible”. (16)

Some two hundred years ago Henry Fox, speaking in the House of Commons, called attention to the fact that our ever-increasing national debt was only a necessity because Members of Parliament were not prepared to raise the necessary taxation; and much later, Hugh Dalton also called attention to this fact. (17)

Although it is hardly ever stated in so many words, it would appear that the foundation of the present system of local authority loan finance rests on the fact that it enables legislators to carry out schemes incurring heavy public expenditure without appearing to raise the necessary income. As shown in Table 3, however, during the years of the depression the annual income requirements of the local authorities were much higher than they need have been, but for local authority debt; and further, during the post-war years, the wider community has suffered from that most arbitrary of all taxes – the persistent decline in the purchasing power of their money.

Notes and references

1. See for example recent press reports on the reaction of some twenty housing authorities to a letter received from the Minister of Housing during October 1969.
2. *Municipal Finance And Municipal Enterprise*. Annual Address of The Right Hon. Sir Henry Hartley Fowler, President of the Royal Statistical Society, 15th May, 1900. Journal of the Royal Statistical Society, Vol. LXIII, Part III, p.384.
3. See also *Enquiry into Prices and Incomes*, E.S.A. Paper No.1, 1968.
4. At 31.3.63 total debt was £6,980.7m., total rateable value £736.6m.
5. At 31.3.64 total debt was £7,585.4m., total rateable value £2,040m.
6. See also *Enquiry into Prices and Incomes*, E.S.A. Paper No.1, 1968.

7. The London Boroughs, the G.L.C. and Cheshire County Council have had legal powers to raise loans abroad since before the Second World War. Many more have obtained such powers and others are in the process of promoting the necessary Parliamentary Bill.

8. It appears that Treasury thinking is directed towards the immediate boost such borrowing gives to the reserves. Policy dictated by such short term objectives is likely to be short sighted.

9. Hugh Dalton, *Principles of Public Finance*. Routledge & Kegan Paul Ltd., 4th edition, 1954. Part IV, Chapter XXI, footnote p.179.

   "The British National debt was only reduced from £850,000,000 in 1817… to £707,000,000 in 1914… Of the £707,000,000 outstanding in 1914 some £210,000,000 represented new borrowings since 1817. But there remained some £496,000,000 of the debt of 1817 which had not been paid off in 1914. Moreover, if account be taken of the increase in the value of money during this period, both the real value of the annual interest charge in terms of commodities, and the real value of the principal of the debt, were actually greater at the end than at the beginning. This is a very remarkable fact which seems to have escaped the notice of many historians."

10. As can be seen from Chart 2.

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

12. These average figures vary considerably for individual authorities depending particularly on whether they are also housing authorities. Currently about 60% of all interest charged to Rate Fund Services in England and Wales is in respect of housing, while housing also accounts for about half of the total of new loans.

13. Hugh Dalton, *op. cit.* Part IV, Chapter XXII, pp. 184-185.

14. See also Table 3 and the discussion on income requirements.

15. The *Royal Commission on Local Government in England 1966-69.* Cmnd. 4040-II, H.M.S.O., London, 1969. Research Appendix 6, para. 14.

16. F. W. Taussig, *Principles of Economics*, Volume 2, 3rd edition 1921. Book VIII, Taxation, Chapter 68, pp508-509. The same quotation is also attributed to Colbert, Turgot and others. The ‘cynical principle’ is contrasted with the ‘fiscal principle’ of merely raising sufficient money to cover expenditures.
17. Hugh Dalton, *op. cit.* p.184.

Chapter IV – Part 1

Local Taxation

In England and Wales the term ‘rates’ has come to signify a form of property tax used exclusively for local purposes. Broadly, a property is ‘rated’ on the basis of the notional rent that a willing tenant may reasonably be expected to pay a willing landlord given the present use and condition of the land and buildings.

This notional rent is traditionally known as the rateable value, and the corresponding valuations are now carried out by the Inland Revenue. Local authorities have full powers for varying the rates or poundage and are thus enabled to adjust their income to meet estimated expenditure.

Rates have a long tradition as a method of raising revenue for local purposes with a traceable continuity back to the Elizabethan Act of 1601 for the relief of the poor, and isolated examples into the middle ages. (1)

Today they are the only source of tax revenue at the disposal of the local authorities and, although during this century rates have declined in importance as part of the national tax structure, over the past two decades U.K. rate revenue as a percentage of total tax revenue has increased from under 8% to over 11% in 1967. (2)

Contrary to the implication in the majority report of the Royal Commission on Local Government in England, as recently as 1968 only personal income tax and social security taxes yielded more revenue than rates. (3)

Some form of property tax is widely used by all the developed countries as a source of local revenue, and in many it is of some significance in relation to their national tax revenues. In the United States of America, for example, property tax revenues amount to nearly 90% of total local government tax revenue and form some 15% of all tax revenue, Federal, State and local. (4)

In view of the wide use of some form of property tax as a source of local revenue, and since rates in England and Wales have a long tradition, coupled with the fact that the yield has risen sharply over recent years, it is somewhat surprising to find that rates are currently out of favour. Although it may be accepted as self-evident that the present rating system is an inadequate source of local revenue, this does not itself justify the assumption that no rating system will provide an adequate source of local revenue.

Most current enquiries in this country would however seem to start from this latter unfounded assumption, and as a result they are directed towards discovering additional sources of local revenue other than rates. (5)

There can be little question as to the overall feasibility of many supplementary sources of local revenue such as motor duties, local sales taxes, or a local income tax, but whether such supplementary sources are necessary, desirable or good local taxes, is altogether a different question.

The authors of a paper recently published by the Royal Institute of Public Administration (R.I.P.A.) gave the characteristics of a 'good local tax' as follows: (6)

(i) The subject of the tax should be widely distributed throughout the country.
(ii) The rate of tax should be capable of being varied by the local authorities.
(iii) The tax should not be disproportionately expensive to administer and collect.

Superficially these criteria may appear to be generally acceptable, but on closer examination the first is found to be misleading and the second rests on the validity of an unfounded assumption.

It is frequently forgotten that all taxes are paid by persons or corporate bodies and although it is common practice to refer to a tax on property, or a tax on motor fuel sales, what is really being referred to are taxes which persons owning or occupying property, or persons using or dealing in motor fuel, are compelled to pay.

All taxes then are a claim against persons, and any taxes levied for revenue purposes pre-suppose that a person against whom the claim is made has the means to pay. In this sense, for any taxing authority to ignore the 'ability to pay' aspect of taxation is futile.

The R.I.P.A. study notes that the ownership of cars and the consumption of motor fuel is more widely distributed throughout England and Wales than are rateable values, and from this fact concludes, in accordance with the first of their criteria, that a non-commercial motor vehicle tax and a motor fuel tax are "good" additional sources of local revenue. However, it may be observed that relative to the South East other areas have lower population densities and are less well endowed with public transport systems, and in such circumstances private transport over relatively long distances becomes a necessity both for work and pleasure. (7)

It is indeed to be expected that the ownership of cars and the consumption of motor fuel will, area for area, tend to have an inverse relationship to rateable values. It must also be noted that taxes generated by motor vehicles will become a greater burden on the populace given a constant rate of tax as one moves away from the South East, or as one moves from any centre into the more rural and remote areas. From the 'ability to pay' principle, one might reason that motor vehicle and fuel taxes should be levied at a much higher rate in the Metropolitan region than in the more remote areas, but it would perpetuate an injustice to reason the other way around, and to use such local taxes to counterbalance the concentration of rateable values in the South East.

For a good local tax then, both the subject of assessment and the means to pay should be widely distributed.

The second characteristic of a good local tax quoted above is only valid providing it is assumed that a local authority must be empowered to adjust its income to its expenditure. If, however, it is assumed that a local authority should adjust its expenditure to its income, then a good local tax may be one for which the rate may be fixed nationally by a central authority.

As regards the third characteristic stated, cheapness and ease of administration and collection are the *sine qua non* of all taxes both local and national. In this respect the present rating system is very good indeed since, apart from the Inland Revenue contribution, the cost of rate collection is only about 1% of the revenue raised.

A further requirement of any local tax is that it should have both stability and natural buoyancy. This means that a good local tax should not exaggerate changes in national economic conditions, while at the same time it should be responsive to changes in the internal purchasing power of the national currency.

Lastly, it is desirable that a local tax should be local. This means that there should be no doubt as to the location of the subject of assessment, and the yield should be responsive to the individual local authority's policy, actions and expenditure.

The present rating system stands up well to the criteria listed above, better indeed than most of the additional local taxes that have been suggested, and in the circumstances existing in England and Wales today, we would concur with Professor Ilersic's opinion that "it is sheer nonsense to imagine that the local rate can be dispensed with." (8)

In recent times the local rate has been widely condemned and undoubtedly has many defects in practice; it is therefore necessary to consider carefully the main objections and investigate to what extent they may be remedied.

Notes and references

1. Edwin Cannan, *The History of Local Rates in England*. 2nd edition, P. S. King & Son, Westminster, 1912.
2. In 1968 this percentage fell to 10.6% due partly to a sharp increase in central government taxes and partly to the lower rate charged on domestic hereditaments in accordance with the government's short term policy outlined in the White Paper Cmnd. 2923.

3. The *Royal Commission on Local Government in England 1966-69*, Cmnd. 4040, H.M.S.O., London, June 1969, para. 524.

4. Benjamin Bridges Jr., *Past and future growth of the property tax.* Symposium: Property Taxation U.S.A. (ed. Richard W. Lindholm), University of Wisconsin Press, Madison, 1967, Table 2.3, pp.30-31.

5. See for example I.M.T.A. and R.I.P.A. study group reports and the Redcliffe-Maud Report Cmnd. 4040, Chap. XIII and Cmnd. 4040-I, para. 505-530. As noted by Prof. R. W. Lindholm in his *Preface* to the symposium listed above, this may not be the case in the U.S.A.

6. S. H. H. Hildersley and R. Nottage, *Sources of Local Revenue*. Royal Institute of Public Administration, London, 1968. p15.

7. *Ibid.* p.40.

8. A. R. Ilersic, *Rates as a Source of Local Government Finance.* Institute of Municipal Treasurers and Accountants, February 1969, p.12.

Chapter IV – Part 2

Objections to the Present System

The main objections that are raised to the present rating system are as follows, and these will each be addressed in turn:

(i) Rates lack buoyancy.

(ii) Rates are a regressive tax bearing heavily on households.

(iii) The tax base is too narrow.

(iv) Rates are a tax on development.

(v) The twice-yearly demands present payment difficulties, particularly to the lower income groups.

(vi) Rates are the most obnoxious method of taxation to the electorate.

(vii) Rateable values are concentrated in the South East.

It is often implied in statements referring to a lack of buoyancy that the increasing reliance of the local authorities on government grants is the result of a long-term sluggishness in rateable values, which increasingly restricts the income from rates. (1)

Evidence does not support this implication. Local authorities' income requirements from taxation in any given year may be taken as their income from rates, plus income from central government grants. On Chart 7, the growth of this requirement for the financial years from 1930/31 to 1938/39, and from 1946/47 to 1966/67, is shown with the rateable values as at 1st April of each year.

The chart shows clearly that between 1930 and 1963 rateable values had grown at a slightly faster rate than local authorities' income requirements from tax revenue, although in the post-war years up to 1963 this growth was not apparent due to the central government's failure to authorise a full revaluation.

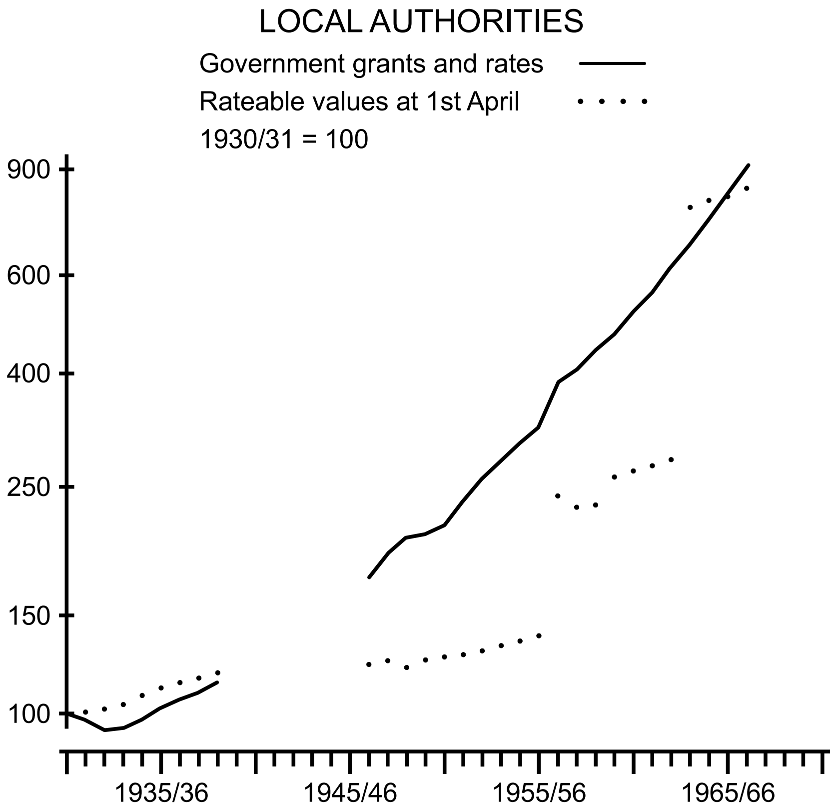

Chart 7

In the White Paper on *Local Government Finance, England and Wales*, it was 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 revaluations 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 revaluation does take place the resulting shifts of burden are resented by the ratepayers who find themselves paying more." (2)

This objection strictly falls into two parts, one relating to the persistent decline in the internal purchasing power of money, and the other relating to the problems of general revaluations.

As a result of the general revaluation in 1963 rateable values in England and Wales were the equivalent of 7.5% of the U.K. Gross National Product. By 1967 they had fallen to 6.6%; if, however, some allowance is then made for the decline in the international purchasing power of money, one finds that in 1967 rateable values would have been the equivalent of not less than 7.3% of U.K. G.N.P. It must also be noted that in 1966 and 1967 the percentage increase of rateable values in England and Wales was greater than the growth of the G.N.P. of the United Kingdom at constant prices.

Assuming therefore that an annual allowance had been made to rateable values for the decline in the purchasing power of money, and that the general revaluation had taken place when due in 1968, the lack of buoyancy would have been marginal and the shift in burdens minimised to the extent that any resentment would have been less than that caused by the sharp increases in national taxes.

The objection that rates lack buoyancy is valid therefore only in respect of the manner in which the system has been operated since the Second World War. Given full revaluations at intervals of not less than five years, it would appear that rateable values do in fact have a buoyancy greater than unity, and that their lack of buoyancy between revaluations would be insignificant providing an annual adjustment was made for changes in the value of money.

The Allen Committee (3) did show conclusively that rates are regressive when related to household incomes, but even so it was not easy to find actual cases of hardship directly attributable to rate demands. It must also be remembered that this particular statistical result may in some cases be the result of deliberate choice, while the general housing shortage and the effects of rent restriction also had a part to play.

The regressive nature of the rating system is greatly accentuated by the present method of valuation. In 1963 this method resulted in domestic rateable values accounting for more than 48% of the total rateable valuation for England and Wales. A further factor which results in rates bearing relatively more heavily on domestic than other classes of ratepayer is that private households pay their rates from taxable income, whereas in other cases rates are treated as an expense for calculating taxable income.

That any particular tax is regressive does not necessarily mean that it is also a ‘bad’ tax, and there is no reason why a particular regressive tax should not have a place in a general tax system that is either proportional or progressive in its incidence.

In the case of rates, however, it does appear that the regressive incidence upon household incomes is accentuated by the present method of valuation, which results in an undue proportion of rate revenue being met by domestic households. Since 1967/68, central government has attempted to redress the balance between the rate liability of domestic hereditaments and that of other hereditaments by directing grants specifically to reduce the rates of householders.

The rate rebate scheme authorised by the Rating Act of 1966 is designed to provide rate relief to householders in the lower income groups. These are however mitigating measures directed at results, and the White Paper has admitted their inadequacy as a long term solution. (4)

The base

The narrowness of the rating system’s base is not inherent in the system. It is simply a result of past and present central government policy. This objection could be met by the following measures:

(a) All property should be given a rateable value.

(b) If particular properties or certain classes of property are de-rated by Statute, then central government should be liable for the payment of the full rate in question to the local authority.

(c) The central government should be liable for the full rate on any property it owns or occupies.

(d) Nationalised industries should be treated in the same way as other ratepayers.

(e) Local authorities should be given clear guidance as to the classes of property (e.g. churches) on which, at their discretion, they may remit part, or all, of the rates due.

Although it may be necessary to have some legislative safeguards against discrimination by local authorities (e.g. different treatment for different religions) in exercising this discretion, there should be no reimbursement from the central government in respect of any property de-rated by local authorities.

Some may wish to press this aspect of a narrow base further, maintaining that in any event rates are only levied on the owners or tenants of real property. While this may be so, it is also true that any tax on expenditure affects only a proportion of the population so far as the formal incidence is concerned; there are, however, very few members of the community who do not at least occupy a simple bed space in a boarding house and the charge that they meet will have taken the rate demand into account.

Rateable values currently depend largely on rental values, and the important factors determining variations in the rent of property on similar sites are the size, quality and general state of repair of the buildings. Given similar sites, the bigger the building and the better its quality and state of repair, the higher the rent, and as a direct consequence, the higher the payment in respect of rates.

If rates are considered as a form of purchase tax levied upon housing services, then in 1963 the rate of tax was approximately 45%, whilst fur coats carried a 25% tax on wholesale prices. (5)

It must be accepted that rates as at present levied are a tax on development and must therefore exercise some deterrent effect on new development, although this is frequently exaggerated.

The twice yearly rate demand comes as a shock to all domestic ratepayers irrespective of their income bracket; but today a nastier shock to those assessed under Schedule D is the Inland Revenue demand. The objection that lower income groups have an added difficulty in payment is more an argument against the method of collection than against rates as such. Many Schedule D payers in relatively high income groups find it impossible to meet the Inland Revenue demand. Many schemes for the ‘easy payment’ of rates are already in operation and could be extended with a small service charge to cover the cost of collection. The addition of a charge for collection may be objected to on the grounds that it would add to the already regressive nature of the system, but as the practice is already accepted on hire purchase payments and private insurance premiums, it also seems appropriate in the case of rate demands.

Today, many if not the majority of the electorate accept taxation as a necessary evil and would no doubt prefer the extraction to be accomplished under complete anaesthetic. Equally, politicians with their eye on votes quietly prefer the ‘cynical principle’ of taxation.

This, however, is a slippery slope, and so far as maintaining a viable system of democracy is concerned, it is good that rates are newsworthy, and that any increase calls forth vociferous objections from ratepayers. The fact that the South East accounts for almost half the rateable value in England and Wales does present difficult problems in respect of local government finance, but we conclude that the most efficient way to improve the geographical dispersion of the local tax base is by reforming rather than by abolishing the present rating system. (6)

From this consideration of the main objections to the current rating system it is clear that even though rates may be a ‘good’ local tax, reform is necessary if they are to be capable of meeting the future needs of local authorities and be equitable in incidence. Many of the reforms required are little more than administrative, and given the necessary political impetus present no difficulty, but other objections require fundamental change to the present system.

In particular, the present system needs reform so that:

1. General revaluations may be carried out at intervals of not more than five years.
2. Annual adjustments may be made that will take into account such factors as changes in the internal purchasing power of the currency.
3. The regressive incidence of rates upon household incomes is minimised.
4. There is a more equitable distribution of the tax as between domestic and other classes of property without the need for direct interference by the central government.
5. There is no element of a tax on development.
6. The geographical dispersion of the tax base is improved.

Notes and references

1. *Royal Commission on Local Government in England 1966-69*, Memorandum of Dissent, Cmnd. 4040-I, para. 505 onwards.
2. *Local Government Finance, England and Wales*. Cmnd. 2923, H.M.S.O., London, February 1966. para. 3.
3. *Report of the Committee of Inquiry into the Impact of Rates on Households*. Cmnd. 2582, H.M.S.O., London, 1965.
4. *Local Government Finance, England and Wales*. Cmnd. 2923, H.M.S.O., London, February 1966.
5. S. J. Prais, *The Impact of Rates*. The Economic Journal, Vol. 76, No. 301, March 1966, pp.172-174.
6. See Chapter VI, *Reforming the Rating System* (p.90).

Chapter V – Part 1

The Location of Industry

Underlying many difficulties of local government in England and Wales is the problem of the location of industry.

Devon County Council has concisely stated part of this problem in its written evidence submitted to the recent *Royal Commission on Local Government*: “The financial problem arises out of the lack of manufacturing industry and the accompanying population and therefore the want of rateable values.” (1)

The other side of the same problem arises in those areas where the expansion of both industry and population results in excessive demands on rate resources.

Industrial location is also important in relation to the possibility of increasing the revenue yield from rates. Since 1966 the central government have found it necessary to limit the householder’s contribution through the medium of the domestic element in the Rate Support Grant, and in these circumstances it follows that any additional revenue from rates must come mainly from other classes of non-domestic ratepayers. In areas lacking in both industry and commerce, therefore, the prospect of an adequate income from a rating system is severely limited.

Hugh Dalton, in the last edition of his book *Principles of Public Finance*, noted that “Diversion may also take place as a result of taxation from one locality to another”. His examples were limited to local taxation applied in the ‘distressed areas’ during the inter-war period, which both the Exchequer Equalisation Grant (devised while he was Chancellor of the Exchequer) and the Distribution of Industry Act 1945 (devised while he was President of the Board of Trade) were designed to rectify. “The whole beneficial change was brought about by a combination of tax changes, subsidies, controls and other administrative arrangements.” (2)

Throughout the last fifteen years successive governments have introduced a further variety of measures designed to affect the location of industry and to induce prosperity into what are now termed the development and intermediate areas. It is observable that many localities in the development areas are benefiting from these measures, and Clark has concluded that central government policies have had some success also in discouraging growth in the congested and more prosperous areas. (3)

It is becoming increasingly apparent however that many central government measures in this sphere are not only self-cancelling and self-defeating, but in the process of reducing the intensity in particular areas have created difficulties in adjacent areas. (4, 5)

Today, after a trial period of some twenty-five years, it must be concluded that, at least so far as local government is concerned, Hugh Dalton's optimism was unfounded. The financial problem mentioned above has grown in its geographical extent, if not in intensity, and many of the government measures designed to assist the less prosperous areas and to alleviate congestion in other areas have in practice eroded local government responsibility and often created other local difficulties.

In addition to the more obvious cases relating to the issue of Industrial Development Certificates and control of office building, the central government has found it necessary to set up a variety of 'ad hoc' bodies, such as the new town development corporations. Such bodies derive their powers directly from central government ministries and are in effect 'local authorities', but are not directly responsible to the local populace or their elected representatives.

Over the years central government has assumed responsibility for local prosperity, but their policies have met with only limited success at the cost of much local frustration. Thus, in view of the importance to local government and local finance in particular of local prosperity, which in turn depends upon the distribution of industry and commerce, it is necessary to digress from the main theme to consider the factors determining industrial location.

The aim of this digression is to investigate whether the rating system may be reformed in a manner that will not only provide local authorities with adequate revenue but also assist the wider geographical distribution of industry and commerce so that many existing central government measures may be eliminated.

For the purposes of location, industry may be divided into three broad classes: material orientated, market orientated and mobile or foot-loose industries.

The material orientated industries are those whose geographical location is mainly determined by their supplies of raw material, e.g. brick making. The public authorities can do little to influence the location of such industries although they may encourage or restrict their operations in suitable locations. For example, since the end of the war the Cornish Mining Development Corporation has maintained that, at current market prices, a very considerable expansion of mining operations in Cornwall is possible given some measure of tax relief and minor changes in the law.

Market orientated industries are those industries that need to be located close to their market, and again as a consequence public authorities can exercise little direct control over their location. It must be noted, however, that the location of market orientated industries may be indirectly influenced, as for example by the creation of new towns. The multiplier effect in a local development scheme is frequently the result of the attraction of such market orientated industry.

Foot-loose industries comprise those firms that can transport either raw materials or their finished products without the loss of competitiveness or profitability. It is only these industries that public authorities can directly control or influence in respect of their location, although it must be noted that an area which is attractive to foot-loose industries will also tend to attract market orientated industries, and that general prosperity in such an area will also tend to encourage production in such material orientated industries as may be located in the area.

Economic potential

The achievement of a significantly wider geographical distribution of the local authorities' tax base, in so far as this is dependent on industrial location, requires that it be known what forces at present render development areas and the remoter regions unattractive to foot-loose industries and what forces make for other areas being attractive. Further, this relative attractiveness must be quantified in a suitable manner.

The Hunt Committee report (5), while highlighting many of the factors which influence location decisions by industrialists, did not in accordance with its terms of reference attempt to quantify them. Some locational factors have, however, been given a quantitative expression in arbitrary units by Colin Clark in his work developing the concept of economic potential (4). Although his calculations for Britain probably understate the differential, economic potential appears to give an approximate quantitative expression to such economic externalities as are represented by distance costs.

It must be remembered that regardless of the particular factors that enter into a particular industrialist's choice as to location, in the ordinary commercial case there are definite limits set by the necessity to operate profitably. Economic potential gives some general indication as to profitability, but a more precise measure, and one that has a market price, is what we term 'situation rent', of which economic potential measures the ground swell.

Notes and references

1. *Royal Commission on Local Government in England 1966-69.* Cmnd. 4040, H.M.S.O. London, July 1968. Written Evidence of County Councils: Devon County Council, p.47.

2. Hugh Dalton, *Principles of Public Finance*. Routledge & Kegan Paul Ltd., 4th edition, London, 1954. Ch. X, para. 13.

3. Colin Clark, *Industrial Location and Economic Potential*. Lloyds Bank Review, No. 82, London, October 1966.

4. A. R. Prest, *Sense and Nonsense in Budgetary Policy*. Presidential Address, Leeds, 1967. The Economic Journal, Vol. 78, Issue 309, March 1968, pp.1-18.

5. *The Intermediate Areas. Report of a Committee under the chairmanship of Sir Joseph Hunt*. Cmnd. 3998, H.M.S.O., London, April 1969, paras. 4, 5 and 6.

Chapter V – Part 2

Definitions

For the purposes of later analysis, we set out the following terms.

During any period of time an enterprise will have made sales to consumers or to other enterprises for a certain sum, A.

The enterprise will also have spent a certain sum on purchasing goods and services from other enterprises, represented by A_1.

The enterprise will have opened the given time period holding a stock of its raw materials, work in progress, unsold finished goods, buildings, machinery and tangible assets which, at the then current market prices, would have had an ascertainable value, B.

At the close of the given time period the enterprise will hold corresponding assets which, at current market prices, will have an ascertainable value, represented by B^1.

The expenditure on purchases from other enterprises A_1 plus the assets inherited from the previous time period B, minus the assets carried over to the next time period B^1 will give, at market prices, the money value of goods and services consumed by the enterprise during the given time period.

We will therefore call $A_1 + B - B^1$ the cost of production.

The cost of production subtracted from the total sales will give a measure of the enterprise's contribution to the national product.

This may be termed its production during the given time period, which we will designate as P.

Therefore:

$$A - (A_1 + B - B^1) = P$$

To any particular enterprise, P represents its disposable income available to meet all the claims to its production which may arise during the time period. It corresponds to the value of sales, less the cost of purchases from other firms and capital assets consumed.

Additionally, the enterprise may have inherited assets from the previous time period *B*, and carried over to the next time period a greater amount, B^2. Therefore, in any given time period, $B^2 - B$ may have a positive value, which will represent its investment, *I* (including stock appreciation), made from current production, *P*.

This additional investment may be represented as $I = B^2 - B$.

Those working within the enterprise will have become entitled, during the given period of time, to a certain sum representing their disposable income from that employment, *W*.

As defined by the current methods for calculating the national income, the aggregate *W* is the equivalent of income from civilian employment and self-employment after current transfers, taxes on income and national insurance contributions. (This definition is not precisely comparable with employees' income as defined in Paper No. 1, as it includes disposable income from self-employment.)

A certain sum, *L* will also have fallen due to the local authority in respect of rates or other local taxes.

Similarly, sums will have become due to the central government for social security taxes, PAYE and other income taxes, profits or corporation tax, SET and possibly customs and excise tariffs. Such payments as the enterprise makes directly to central government, whether or not the tax liability is passed on, we designate as *C*.

Those taxes which the enterprise may have paid out indirectly, for example through the inflated price of purchases included in A_1, are therefore excluded from the definition of *C*.

The enterprise may also have become entitled to cash grants, rebates, premiums or some other form of subsidy from the public authorities, *G*. The net tax liability of the enterprise in the given time period is therefore $L + C - G$.

This overall sum we will designate as *T*.

Other charges on production, apart from those arising from the tenancy of a bare site, may also have been incurred, having a value of *D*. These other charges would include such payments as interest charges and pension contributions, etc. (1).

A certain level of profit is also necessary if an enterprise is to continue in a particular line of production, and it is usual practice for such a margin to be included in costings. The margin will vary from industry to industry and with the type of organisation. Some sole proprietors, for example, may be able to continue production for some time on a negative margin.

This normal profit margin may or may not be realised in any given time period, but there is a definite limit to the period within which it must in fact be realised, if the enterprise is to continue in a particular line of production. This normal profit is designated as N.

If the sum of $I + W + T + D + N$ be written as E, then assuming no charge is payable for site occupancy, the marginal situation for any enterprise arises when $P = E$. Alternatively, we may write:

$$A - (A_1 + B - B^1) = P = E$$

It is highly improbable, in the real world of a developed country such as the United Kingdom, that the marginal situation as defined above will exist, since a charge for site occupancy will in normal circumstances always have to be met. In normal circumstances in a developed country therefore, P will always be greater than E.

It follows that, in any given time period, the extent by which P exceeds E defines the maximum that any particular enterprise will have available from its current production to meet the charges for obtaining access to a particular site.

Thus, for a particular enterprise occupying a particular site, the quantity $P - E$ defines the actual situation rent yielded by that site during the given time period. At any given moment in time, the maximum charge a particular enterprise may be prepared to meet in order to obtain access to a particular site may be greater or less than the actual situation rent depending upon expectations.

The time period during which the payments may exceed $P - E$, if the enterprise is to continue in a particular line of production, is however, limited by the resources available to the enterprise, and the conditions of tenure for obtaining access to the particular site.

For any particular enterprise, *cet. par.*, the actual situation rent as defined above will vary with location.

Marshall noted that location can give rise to what he described as a ‘special situation rent’ or, when capitalised, a special situation value. This he reckoned as the money value of the situation over its ‘mere agricultural value’. It would appear that he considered the mere agricultural value as the money value arising from either the ‘free gifts of nature’, or the ‘inherent and indestructible powers of the soil’ when used for agricultural purposes, such as the inherent fertility of a particular plot of land. (2)

It can be accepted that the free gifts of nature, such as inherent fertility, will have a money value to a farmer, and that, in addition, a particular farm may also have a ‘special situation value’, arising say, from its nearness to a market. From this it follows that while the inherent fertility of the soil may have no money value at all to a building developer he will, if he wishes to gain access to a farm for purposes of building development, have to be prepared to pay a price equal to, or greater than, the mere agricultural value plus the special situation value of the farm to the farmer.

That is, the money value of the situation to a building developer must be equal to or greater than the money value of the situation plus the agricultural value to the farmer.

Free gifts of nature are not, however, exclusive to agriculture. For example, the inherent stability of the subsoil is a free gift of nature and may have a money value to a building developer, and if in a situation suitable for building development, will tend to raise the price to be paid for the site. Since the inherent stability of the subsoil is unlikely to have an agricultural value, it follows that the whole amount by which stability increases the money value of the situation would be considered by Marshall to be special situation value. On grounds of consistency therefore, it is reasonable to drop the concept of agricultural value, since in all other instances ‘free gifts of nature’ or the ‘inherent and indestructible powers of the soil’ are included in ‘special situation value’.

This inconsistency also required Marshall to make a distinction between his ‘special situation value’ and ‘aggregate site value’.

This “aggregate site value”, Marshall concluded, “exceeds the special situation value merely by agricultural value, which is often almost negligible in comparison.” Similarly, Marshall was forced to distinguish between the annual site value and ‘special situation rent’. If, however, the concept of an agricultural value is dropped, then these distinctions are no longer necessary. Since, as Marshall has noted, “annual site value is not a correct form of speaking”, the term situation rent may be used.

Although the maximum charge an enterprise is able to meet for the tenancy of a particular site will be related to the actual situation rent as yielded by the site, the charge that will have to be met will take into account that there may be competing alternative users.

Each of these competing alternative users will have a maximum they are prepared to pay related to the actual situation rent in their own particular case. The minimum charge that an enterprise will have to meet for the tenancy of a particular site, therefore, will be related to the maximum that alternative users are prepared to pay.

The actual charge, or *market price*, will fall between these two extremes. This charge we term situation rent and designate *R*. (3)

The precise relationship of the value of *R* to the actual situation rent in a particular case will depend upon market conditions and the expectations and bargaining skills of the contracting parties.

Frequently, stress is laid on the fact that land is fixed in supply, but this has little bearing on the matter under discussion. (4)

Normally, a number of sites will be on offer, each yielding up a different set of advantages; *R* may be considered as the current market price for the particular set of advantages yielded up by any given site. (5)

Few, if any, of the economic goods making up this set of advantages are effectively in fixed supply, and many can be produced in a relatively short time. However, this is not to say that currently a perfect or free market exists; market conditions, and the expectations and bargaining powers of the contracting parties, are peculiarly affected by such factors as government interference, tax systems, systems of land tenure and general economic conditions.

In many instances, however, P will be greater than $E + R$, and particular enterprises will be able to retain a surplus, which we will designate as S, so that: $S = P - (E + R)$.

This kind of surplus may arise entirely or partly from fortuitous circumstances, but over a period of time such surpluses are likely to be offset by equally fortuitous losses. A surplus may also accrue from the tendency of R to be less than the actual situation rent, the difference being retained by the enterprise currently in occupation.

Alternatively, it may simply arise from an advantage of general efficiency over other enterprises, and in particular from efficiency of the entrepreneurial factor, and S is then akin to pure profit.

Notes and references

1. If an enterprise is tenanting a property at an inclusive rent, the payment for the buildings and for any services rendered would be included in A_1. The balance relates to site occupancy. In the case of a leasehold, the depreciating capital value also amounts to a charge for site occupancy. For the case of an owner-occupied property, the estimated rental value of the site only is considered as a charge for site occupancy. Where a mortgage has been taken out, the interest paid on the capital value of the site is a charge for site occupancy, while the balance is included within D.
2. Alfred Marshall, *Principles of Economics*, Vol 1. Macmillan & Co., London, 1920. Bk. V, Ch. XI, Section 2, pp.441-442.
3. The geographical location of any enterprise is limited in extent by the relationship $P = E + R$.
4. In England, land is not strictly the subject of absolute ownership, but of tenure, and it may therefore be said without exaggeration that, so far as land is concerned, there is no law of ownership but only a law of possession. A person entitled to possession (seisin) owns in fact an abstract entity called an estate, which is interposed between the possessor and the land. As Professor Denman has stated, “the land market is a market that never was.” (Denman, *Land in the Market*, Hobart Paper 30, I.E.A., London, 1964, p.9.)

   That English law has directed its attention, not to ownership but to possession, is instructive. Clearly, the situation rent is yielded directly to the tenant in occupation of the site regardless of legal titles. A person who owns an estate in land, to the extent that this empowers him to control access, may however levy a charge on the tenant in occupation that is related to the situation rent.
5. Mr. H. Mark Wilks, B.Sc., F.R.I.C.S., who conducted the Whitstable survey on the Rating of Site Values, stated in his report that he could not find sufficient evidence of rental values and therefore made use of capital values converted at a rate of 4 per cent, i.e. the capital value of R, divided by 25, leads to the value of R as a tax base.

Chapter V – Part 3

Company Taxation

In addition to what may be described as the natural differentials indicated by economic potential, the relationship of the gross costs of production A_1 to total sales revenue A will also be affected by both public expenditure and the incidence of taxation.

For example, let us assume that a foot-loose industry has a choice of a site in the Bletchley area (economic potential of about 1,400) or an alternative site in the Yarmouth area (with economic potential under 1,000) and that from either location it may expect the same total sales in the U.K. and export markets. (1)

As has been noted, it is to be expected that the gross costs of production A_1 will be lower in the Bletchley area than for a site in East Anglia as a consequence of those factors entering into the calculation of economic potential; but they will be further reduced by the heavy public expenditure represented by the M1 motorway and the efficiency of the London Midland electrified main railway line, both tending to reduce costs by savings in time and effort in travelling and in the transport of goods. In the Yarmouth area there is no counterpart.

The desirability of the Bletchley area is still further enhanced by the proposed public expenditure entailed in the creation of a new town (Milton Keynes). The prospective entrepreneur has not only the reasonable expectation of about a half per cent of the total U.K. market being moved to his doorstep, but also the expectation of greater ease in obtaining the right mix of employees as a result of the massive influx of population. (2)

Many taxes, particularly those on expenditure, tend to inflate the gross costs of production, and in consequence directly affect the relationship between net production and total sales. Clearly, since the gross costs of production will tend to represent a higher proportion of total sales in areas of low economic potential than in areas of high economic potential, the element of tax inflation will tend to be greater in amount in just those areas where the margin for absorption is less.

Further, some of the taxes on expenditure most popular with the Chancellor of the Exchequer will tend to increase the tax inflation element at a faster rate, the lower the economic potential.

From the natural geographical fact of mileage, transport costs will tend to be of greater significance when calculating delivered costs of both inputs and outputs for a firm located in the Yarmouth area than for one located in the Bletchley area. Taxes such as petrol tax, vehicle duty and the Selective Employment Tax, which inflate transport costs, will therefore accentuate the differences between areas of high and low economic potential out of proportion to the amount of aggregate taxation or the percentage increase nationally imposed.

In the comparison between Bletchley and Yarmouth areas taken as an example above, both public expenditure and taxation tend to increase the basic difference indicated when calculating economic potential. That is, both public expenditure and government taxation have tended to intensify the forces making for the concentration of industry in areas of high economic potential.

In such circumstances recourse to direct control, such as refusal to grant Industrial Development Certificates, can only be regarded as a self-cancelling measure doing little to alleviate the plight of outlying areas. Further, since the effect of such direct controls on an individual firm is to increase its gross costs of production, this will tend to reduce its competitiveness internationally.

The kind of relationship often expected in a footloose industry producing goods for consumption is that a firm’s net production represents about 50% of total sales income, and wages and salaries represent about 25% of total sales.

It is observable that throughout the United Kingdom, wages and salaries in manufacturing industries tend to be related to a general level and do not vary in accordance with economic potential. From this it follows that their ratio to production is not constant but will vary with location. As a result, the variations in production arising from local externalities will assume a much greater importance in determining the location of industry than might be expected on first inspection.

Let us assume that a particular firm has a choice of two sites, from either of which it may expect the same total sales per time period; but that, due to different economic externalities (such as those measured by economic potential), the production expectation at one location is 50% of total sales, while at the other it is 55% of total sales: a difference of 10%. Let us further assume that at either location wages and salaries will account for 25% of total sales.

On these assumptions the difference between two such sites, measured in terms of the firm's net income after payment of wages and salaries, becomes one of 20%. Further, any increase in wages and salaries that does not flow from an increase in production (i.e. is not fully covered by a rise in productivity or passed on in higher prices) will widen the difference between the two locations.

It remains a fair statement of fact that, in Dalton's words: "Most serious economists, though not all business men, agree that the usual incidence of income tax is on the income receiver, who is thus quite accurately described as the income tax payer"; and in particular that: "A tax on wages, for example, such as the worker's contribution to social insurance, tends for the most part to be paid by wage earners." This would also appear to be accepted by the Government as a matter of practice. (3, 4)

However, it should be remembered that general income and social security taxes on employees' incomes are largely post-war phenomena. In 1938 such taxes could not be described as general, and in total amounted to less than 4% of gross wages and salaries.

A comparison of post-war wages and salaries with much earlier periods casts doubts upon the still widely held conclusions reached by Dalton, and suggests that the true effective incidence of general taxes assessed on wages and salaries is upon employers, although they may in turn shift some part forward yet again on to prices.

Within this general shift there will undoubtedly be individual variations. An employer does not normally pay an employee a higher wage because of a low PAYE tax code and therefore higher tax deductions; equally an employee is unlikely to accept a lower wage than those alongside him because he has a high PAYE code and lower deductions. In aggregate, however, it does appear that, although the formal incidence of income and social security taxes may be upon the employees, they have during the post-war years shifted these taxes forward on to the employer.

In the Economic Journal for June 1952, E. H. Phelps Brown and P. E. Hart published figures for the factor distribution of the home produced national income of the United Kingdom for most years from 1870 to 1950 inclusive. (5)

In Table 5:1 their figures are recalculated to show wages and salaries as a percentage of the national income from 1870 to 1913, and from 1924 to 1938. The figures are then extended to include 1946 to 1968 on the basis of the latest CSO *Blue Book* tables.

Between 1870 and 1913, although there is some evidence of a cyclical movement, no underlying trend is apparent. This is also true for the period 1924 to 1938, and during these inter-war years, wages and salaries were a much higher proportion of the national income than they were in the period up to 1913: this could indicate that the mean value is related in some way to low unemployment or increased general activity.

During the period following the Second World War, a different picture seems to emerge. Firstly, there is an underlying trend, with wages and salaries representing an ever-increasing proportion of the home produced national income. A possible explanation is that we are seeing the upswing of a long-term cyclical movement, since if the twenty-two years ending in 1893 are taken in isolation, a rising trend is similarly apparent. Secondly, from 1952 onwards the percentages are consistently higher than for any year between

1870 and 1913, and for the past ten years the percentages have been at levels similar to the inter-war years.

Since the post-war years are particularly noted for their low unemployment and high general activity, one would expect, on the basis of a comparison of the period 1870–1913 with 1924–1938, that the mean value for the years 1946–1967 would be lower than before the First World War.

Closer inspection, however, suggests that these differences arise from a change in the basis of the figures; and certainly there is a fundamental difference, statistical errors apart, between what were classed as wages and salaries before 1913, and wages and salaries from 1946 onwards.

Before the First World War, income tax was considered as a tax on the rich and middle classes only, but even then the rates of tax were almost negligible by modern standards. In 1874 income tax was reduced to 2d. in the £, although ten years later, when for the first time central government expenditure exceeded £90m, it was raised from 5d. to 6d. Again, the £90m government expenditure of 1884 equalled only 8% of the home produced national income as compared with about 40% currently.

As noted above, even by 1938 income and social security taxes combined had not reached 4% of wages and salaries, so that it is reasonable to assume that during the period 1870–1913 the direct tax element included in the figures published by Phelps Brown and Hart was nil, or certainly far less than the margin of error.

Current economic theory distinguishes between *gross income*; that is, before the deduction of taxes; and *disposable income*; that is, income after the deduction of all direct taxes. For our purposes ‘disposable wages and salaries’ are arrived at by deducting income tax and employees’ social security contribution from ‘gross wages and salaries’. Since, as has been argued, wages and salaries before the First World War were to all intents and purposes the same as the employee’s disposable income, they should be compared with disposable incomes for the years after the Second World War.

Table 5:1

Wages and salaries as a percentage of the Home Produced National Income

Year	%	Year	%	Year	%	Year	%
1870	54.8	1892	60.5	1924	66.6	1946	61.2
1871	54.2	1893	62.3	1925	66.1	1947	61.1
1872	56.4	1894	61.1	1926	67.7	1948	62.1
1873	55.9	1895	59.7	1927	65.7	1949	62.6
1874	54.6	1896	60.6	1928	64.3	1950	61.2
1875	56.5	1897	59.8	1929	65.2	1951	61.4
1876	55.7	1898	59.3	1930	66.6	1952	64.2
1877	55.5	1899	58.7	1931	69.1	1953	63.9
1878	54.7	1900	58.6	1932	68.7	1954	63.5
1879	56.5	1901	59.8	1933	67.6	1955	63.9
1880	54.6	1902	59.0	1934	67.5	1956	65.5
1881	54.5	1903	60.4	1935	66.5	1957	65.4
1882	55.9	1904	58.5	1936	65.3	1958	65.7
1883	55.4	1905	57.6	1937	64.1	1959	64.8
1884	56.6	1906	56.1	1938	64.4	1960	64.0
1885	57.2	1907	56.4			1961	65.5
1886	56.9	1908	57.9			1962	66.1
1887	58.5	1909	57.3			1963	65.0
1888	58.0	1910	57.0			1964	64.8
1889	58.9	1911	56.7			1965	65.0
1890	58.8	1912	55.7			1966	66.4
1891	59.6	1913	55.1			1967	66.0
						1968	65.6

Sources: For 1870-1938, E. H. Phelps Brown and P. E. Hart, *The Share of Wages in National Income*, Table 1. Economic Journal, June 1952. For the years 1946-1968, the National Income and Expenditure *Blue Books*.

Table 5:2

Wages and salaries net of tax as a percentage of the Home Produced National Income, 1946-68

Year	%	Year	%	Year	%	Year	%
1946	54.4	1952	57.9	1958	58.3	1964	56.4
1947	55.3	1953	58.2	1959	57.6	1965	55.7
1948	56.1	1954	57.8	1960	56.8	1966	56.6
1949	56.2	1955	57.9	1961	57.5	1967	56.1
1950	55.1	1956	59.2	1962	57.6	1968	54.8
1951	55.0	1957	58.8	1963	56.9	-	-

Source: National Income and Expenditure *Blue Books*.

In Table 5:2, wages and salaries net of income and social security taxes are expressed as a percentage of the home produced national income. There is no evidence of an underlying trend in these percentage shares, although a possible long term cyclical movement emerges with a peak in 1956.

On Chart 8 the figures from Table 5:2 are plotted together with those from Table 5:1 for the years 1881 to 1906 inclusive, and the peaks of 1893 and 1956 are aligned. The similarity is startling. In terms of employees' disposable income it appears that the stability described by Keynes as being "a bit of a miracle" has continued over a period of nearly one hundred years and gives reasonable grounds for assuming that a general tax on employees' incomes can be shifted, at least as a first step, to employers. (6)

Such an assumption is in line with the current opinion of many employers and others directly concerned with wage negotiations. It is also noticeable in this respect that today many employees are somewhat doubtful as to their gross income, and when questioned they frequently preface their reply with such a remark as: "Well, I usually take home about…"

SHARE OF WAGES AND SALARIES IN THE NATIONAL INCOME

As a percentage of National Income, 1881-1906 and 1946-1968

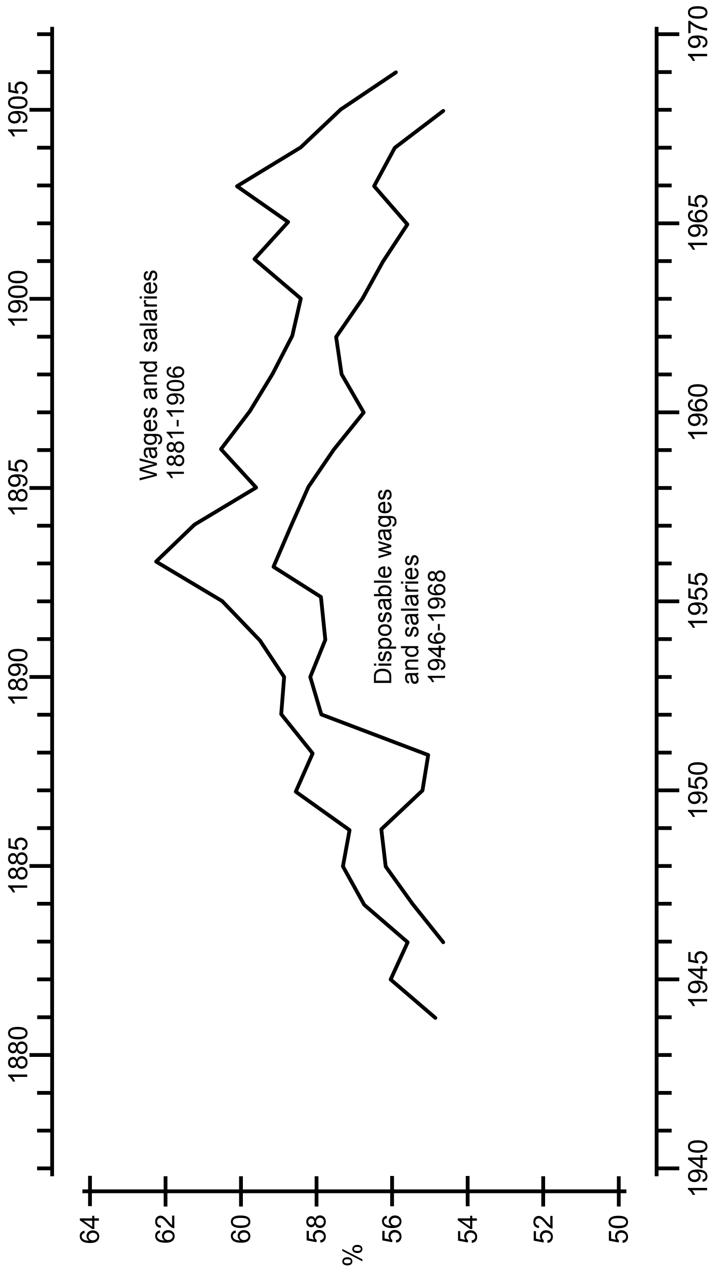

Chart 8

Dalton limited his statements quoted above by admitting that: "Given full employment and strong trade unions, a tax on wages may be shifted forward on to prices", but this limitation misses an important step (7).

In practice, employees lack the ability to shift a tax on their incomes forward on to prices. Their action is limited to a shift to employers, and it is employers who may, under certain conditions, be able to shift the tax forward yet again as increased prices for their products. Now, if a tax which has been shifted by employees on to employers is shifted yet again by the employers on to prices, the tendency would be for employees' gross incomes to remain steady as a proportion, and for their disposable incomes to fall as a proportion of the national income. As shown on Chart 8, however, employees' disposable incomes have remained steady, while gross wages and salaries over the past 20 years show a rising trend.

Chart 8 also shows that employees' disposable income has been consistently lower as a proportion since World War Two when compared with 60 years previously. If the mean is related to some general activity or employment factor then such a result is to be expected, but it would also arise if employers had been able to shift forward on to prices at least some part of the tax; or again, if employees had been unable to shift forward the full tax burden.

It may well be that this shifting of tax from employee on to employer and then forward again on to prices is the element of truth and active force in the cost-push theory; but for the purpose of this paper, it appears reasonable to assume that not only are employees able to shift taxes on wages and salaries forward on to their employers, but also, under the kind of economic conditions that have prevailed during the past 20 years, employees are able to nullify any attempt by employers to shift it back on to employees in their capacity as consumers. This possibly illustrates the element of truth in the concept of the wage-price spiral.

In addition to those income and social security taxes whose formal incidence is on the employee, even though their effective incidence would appear to be on the employer, employers are also assessed directly for social security contributions and SET. The combined effect of the two latter taxes is the equivalent to about a 14% addition on gross wages and salaries. Even in cases where the SET is refunded, there remains to the employer the carrying cost of an interest free loan to the government.

In times of credit restriction when normal banking facilities are not fully available, such carrying costs can be significant. Banks, for example, are not presently allowed to finance import deposits, and although such finance is freely available from other sources, the market price is the equivalent of an interest rate of 15% to 20% per annum, on what amounts to a gilt-edged security. (8)

The burden on industry

"Any tax" wrote Dalton, "imposed on employers, regardless of the amount of business they may be doing, or of the amount of profit or loss they may be making, tends to diminish employment in marginal businesses. The heavier the tax, the wider the margin affected. Local rates, as distinguished from income tax–especially heavy local rates–operate in this fashion, being insensitive to variations in employers' 'ability to pay'. For this reason it is legitimate to regard local rates, and also employers' contributions to social security, as a burden on industry." (9)

At current levels PAYE, social security taxes and SET increase employers' employment costs by about 35% above the employee's disposable income; and even making allowances for the return of SET payments in certain cases, the effective rate of the increase probably approaches 30%.

Accepting that employers' contributions to social security at the rates effective at the time when Dalton was writing, and the heavy local rates adopted during the inter-war period, were "a burden on industry", and "the heavier the tax the wider the margin affected", then the margin affected today must be very wide indeed.

Let us make similar assumptions as before in respect of a firm in a foot-loose industry; that is, that net production will amount to 50% of total sales at one possible location and to 55% of total sales at another possible location of higher economic potential. Let us then further assume that employees' disposable income at either location will account for 25% of total sales, and that taxation on employment is an addition of 30% on the employees' disposable income. On such assumptions, which are not far removed from the situation of today, the original difference of 10% in net production becomes a 30% advantage for the location having higher economic potential. Further, if an appropriate allowance is made for a normal profit before tax of 10% of total sales, then the effective advantage accruing to the location of higher potential has become over 66% and it is indeed doubtful whether the alternative location having lower economic potential is a good business proposition. Clark has noted that areas with an economic potential of less than 1,150 units on his scale show a general lack of industrial progress. In light of the above analysis this is to be expected.

There are two other general taxes on firms: corporation tax and the local rates, both of which have some effect on their location. Corporation tax is a proportional tax assessed on profits. A firm's liability in respect of the tax pre-supposes that a certain profit has in fact arisen over some period of time and the tax therefore does not appear to offend against the 'ability to pay' principle.

Public companies, however, must not only make a profit, but must also declare an acceptable dividend, if they are to continue as independent going concerns. The opportunities for making a pure profit, *S* will be greater in areas of high economic potential while, as has been shown earlier, in areas of low economic potential, firms in foot-loose industries, at least, will encounter difficulties in achieving even a normal profit, *N*.

Since the rate of corporation tax makes no allowance for these variations but reduces at a constant percentage (currently 45%) a firm's ability to declare a dividend, there are undoubtedly many marginal cases where it effectively works to concentrate industry in areas of high economic potential.

Today local rates are rarely a significant burden on industrial firms, but since local variations are marginal, they tend to reduce even further the attractiveness of low economic potential areas. As with corporation tax, local rates will, in marginal cases, tend to concentrate industry in the areas of high economic potential.

As Colin Clark has shown, there are certain natural fundamental economic differences between geographical areas which he has measured in arbitrary units and described as economic potential. It is again entirely natural for firms in foot-loose industries to locate themselves *cet. par.* in areas of higher economic potential, and the results of this drift have been recognised as a political problem for at least a quarter of a century. As we have shown above, however, the present system of taxation, often aided by misplaced public expenditure, accentuates the differences in economic potential and provides powerful forces making for the concentration of foot-loose industries in a few highly desirable areas. The consequences of this spread far beyond the foot-loose industries in question.

Clearly, population will tend to concentrate in the areas where industry is concentrated, and market orientated firms must follow their market, whether that be persons or firms. Material orientated firms may then well find themselves forced to operate in declining areas of low economic potential and faced with rising costs from a variety of causes. In these conditions they too are faced with either ‘running down’ or raising prices, probably both. Such a process will in turn inflate costs generally throughout the community.

An investigation at this point would no doubt be instructive as to some of the factors making for the persistent decline in the internal purchasing power of sterling and the U.K.’s persistent balance of payments difficulties. One must conclude therefore that many of the economic problems which have beset this country during the years after the Second World War have been created by government policy.

Development areas

Under the Distribution of Industry Act 1945 certain parts of the country have been designated ‘development areas’, and over the years much has been done by all levels of government to attract industry to these areas. Government action has not only included the expenditure of public monies, but also measures designed to relieve firms located within the designated areas of the pressures of taxation. Without denying the achievements of this policy, it is still the case that some of the measures (e.g. Regional Employment Premiums) appear to be based on economic concepts that many fondly assumed had become historical, and that even the concept of the development area itself is too crude an instrument to make the necessary allowances for the graduations in economic potential and the desirability of different locations.

Within the development areas the span of economic potentials, for example, are just as wide as in those areas of the country not so designated. According to Colin Clark’s calculations, the Welsh Development Area spans from an economic potential of about 1,200 units down to less than 900 units–as wide as the difference between the Bletchley and Yarmouth locations considered earlier.

Within this wide spectrum the privileges granted by government are approximately the same. Many industrialists in West Wales complain that the marginal advantages received do not compensate for the costs of the extra 200 miles on each round trip, and they are most emphatic that, had they fully appreciated the continuing costs accruing to such a location, they would not have accepted factories in such an outlying part so far west.

Within the development areas precisely the same forces operate as in other areas; and similarly, government policy contains little to redress the balance other than by direct controls. One industrialist who had been in West Wales for some years but still experienced difficulties stated that he would not have moved there, but for the fact that he was refused an Industrial Development Certificate at his previous location some 100 miles to the east. His antipathy to government intervention in the location of industry was confirmed when he discovered that, under subsequent regulations, the new tenant of his old factory had been granted permission to expand.

Notes and references

1. That is, *A* is assumed to be constant.
2. Shortages of labour are not of necessity always resolved by high unemployment rates, and are not limited to shortages of skilled or semi-skilled workers. In South Pembrokeshire, for example, there is a chronic shortage of unskilled women workers.
3. Hugh Dalton, *Principles of Public Finance*. Routledge & Kegan Paul Ltd., 4th edition, London, 1954. p.55-57.
4. See also Frances Cairncross, *Deflation Effect of Pensions Scheme*. Times Business News, 29th January 1967. The assumption being made is that the employees' contributions will reduce employees' income, while only the employers' contributions are likely to be shifted forward on to prices.
5. E. H. Phelps Brown and P. E. Hart, *The Share of Wages in National Income*. The Economic Journal, June 1952.
6. J. M. Keynes, *Relative Movements of Real Wages and Output*. The Economic Journal, Vol. 49, No. 193, March 1939, p.48-49.
7. Dalton, *op. cit*. p.58.
8. These high interest rates may have some importance in relation to the difficulties of Clearing Banks in meeting their liquidity ratios.
9. Dalton, *op.cit*. p.116.

Chapter V – Part 4

Government Policy

The preceding survey indicates that a major force rendering areas of low economic potential, that is most of the development and intermediate areas, not merely unattractive but, without substantial government assistance, impossible for foot-loose industries is the highly regressive effective incidence of the present tax system on an industrialist's income. It has been noted earlier that production, P will vary *cet. par.* with location, tending to be generally lower in areas of low economic potential. E however does not necessarily vary with location and in fact, it tends to be constant. This arises since the major items included in E are disposable earned income, W which tends to a general level throughout the country, and gross taxation $G + L$, which bears a closer relationship to total turnover A and to disposable earned income W than to production. (1)

Since what has been defined as production P represents the total current income available to an industrialist to meet all current claims, and since disposable earned income represents a primary claim, it follows that the incidence of the present methods of taxation is highly regressive in relation to the industrialist's income $P - W$. It would appear that government policy implicitly accepts the situation, since most of the measures designed to influence or control industrial location are either directed towards mitigating the results of the regressiveness, or attempting to defeat the forces that have been generated by means of direct controls.

The present government policy is then both self-defeating and self-cancelling with a built-in spiral effect, as increases in taxation create demand for more assistance; more assistance means heavier public expenditure which can only be met by increases in taxation.

Clearly, a more positive solution to the problem of encouraging prosperity in areas of low economic potential requires a substantial reduction in the regressive incidence of taxation on industrialists' income. At present the Chancellor of the Exchequer's room for manoeuvre in granting any form of tax relief is severely curtailed by the ever-increasing need for revenue to meet an ever-increasing expenditure.

Between 1947 and 1968 central government current expenditure has multiplied four times (the equivalent to about doubling in real terms) while the electorates' demand for more or at least improved public services still appears to be insatiable. It must therefore be accepted as a political requirement that any relief of national taxes must be accompanied by an equal reduction in central government expenditure and that such reductions must not in any way reduce the quality or extent of public services.

These conditions could be met if regressive taxes were replaced by an approximately proportional or progressive tax in relation to an industrialist's income. If, for example, local authorities were provided with an adequate income from such a proportional tax the opportunity would be created for a reduction in central government expenditure through a cut in grants to the local authorities, thus creating room for some reliefs in national taxation. In the United Kingdom as a whole a reduction in central government grants to local authorities by 50% would make about £1,000m available to the Chancellor of the Exchequer for tax relief.

One of the most regressive of all taxes affecting industrial location is the employers' social security contributions, which in 1968 yielded about £1,000m in revenue and therefore could have been remitted in full without affecting the balance of the central government's accounts.

So far as productive enterprises are concerned such a change in local and national taxation would, in 1968, have resulted in the transfer of some £1,500m of taxes that are regressive or restrictive as to location, on to a proportional locationally differential tax.

Transfers of this magnitude would have a very substantial and immediate effect on industry's location decisions.

It must also be noted that those commercial enterprises already existing in areas of low economic potential would immediately benefit from this transfer of taxation since, instead of relying on government support, they would be given the opportunity of becoming, in their own right, commercially viable and prosperous in a competitive world. This aspect also would not be lost on other industrialists when making their location decisions.

Further, so far as government expenditure is concerned there would tend to be a chain reaction effect, since much of the central government's expenditure on regional assistance to industry would become unnecessary, and the conditions would arise in which both Selective Employment Tax (SET) and the Regional Employment Premium (REP) could be phased out without creating difficulties for either the Chancellor of the Exchequer or industry.

Notes and references

1. In 1968 central government tax receipts on current account totalled £13,208m. and of this total taxes on earned incomes, social security taxes and selective employment tax (taxes related to W) accounted for about 42%. Taxes on expenditure, which may be considered as related to turnover A, accounted for over 36% of total tax receipts. Additionally, total U.K. tax payments levied on the total income of companies according to the *Blue Book* definition totalled £2,050m. As noted, even these taxes do not necessarily bear any relation to a company's ability to pay.

Chapter VI

Reforming the Rating System

We may now return to our main theme and close with the pressing question of reforming the present rating system. To be effective it is required that not only should the reform meet the objections listed at the end of Part IV but also that the effective incidence of the rate upon industrialists' incomes should tend to be proportional if not progressive, while at the same time the yield from rates should be sufficient to allow for a substantial reduction in central government expenditure for local purposes.

In 1963 the Rating and Valuation Association conducted a pilot survey in Whitstable Urban District in which the annual values of sites alone were assessed, based on their full development value in accordance with the definition used in the London County Council Rating Bill of 1938–39. The pilot survey was carried out by Mr. H. Mark Wilks, and the report published in February 1964. (1)

The object of the operation was to provide an alternative valuation list that would be directly comparable with the valuation list produced by the Board of Inland Revenue that came into force on 1st April 1963. Although the returns from one urban district in the south-east corner of England cannot be taken as anything more than an indication, the report certainly does indicate that the LCC definition might well meet some of the fundamental objections to the present rating system.

As regards the possibility of producing full revaluations and annual adjustments the surveyor stated in his report: "It is clear to me that the field work involved in valuing site only is very much less than valuing site plus improvements. When the buildings are altered in any way, no alteration takes place to the site value. Once the method is established and the evidence of market transactions is passed to the valuer, the speed of the work in the office is considerably greater than on the orthodox method. Much of the 'valuation' becomes pure arithmetic and the assessment of entries for large developments can be carried out in the office."

Further, the method of producing the unit values is eminently suitable in this computer age for annual adjustments in accordance with changes in the internal purchasing power of money.

The results of the survey showed that the alternative methods of valuation are likely to produce total valuations of the same order of magnitude, but within this there were substantial changes in the apportionment between the various classes of property. (2)

As shown in Table 6, the percentage of the total valuation borne by houses, bungalows, flats and maisonettes reduced from 74.04% to 42.90%, while within this category again, the greatest reduction was in flats and maisonettes, followed by bungalows.

Table 6

Survey results: 1963 rateable values for the Whitstable U.D.C. area

Property type	**Inland Revenue**		**LCC definition**	
	£	%	£	%
Houses	342,850	47.35	180,200	28.06
Bungalows	179,050	24.73	90,200	14.04
Flats and maisonettes	14,200	1.96	5,100	0.80
Total	536,100	74.04	275,500	42.90

Since it appears reasonable to assume that in a town such as Whitstable, most bungalows, flats and maisonettes are likely to be occupied by those whose household income tends to be lower than those living in large houses, then the regressive nature of rates on household incomes would also tend to be reduced by the LCC method of valuation.

Alternatively, the yield of rates in the UDC, given assessments in accordance with the LCC definition, could have been increased by some 50% without increasing the total rates paid by those living in bungalows, while still leaving the total paid by those living in flats and maisonettes at less than the amount payable under the current system.

The conclusion to be drawn from the survey report is that the LCC definition does suggest a method by which the current rating system could be reformed, so that not only would its regressive incidence on household incomes be reduced but at the same time the yield of rates could be increased.

Since, as the valuer points out in the abstract of his report quoted above, the LCC definition involves valuing the site only, it follows that there can be no element of a tax on development in rates levied on such values. On the contrary, given that the sites were assessed at their full development value as was done at Whitstable, there would be an element of tax on underdevelopment that in practice would provide a spur to full development. There can be no doubt that such a tax element would have a beneficial effect in many localities, particularly the intermediate areas that were considered by the Hunt Committee.

As noted earlier, the valuations produced by using the LCC definition at Whitstable were the equivalent of what has been termed situation rents. The effective incidence of a rate levied on situation rents cannot be regressive in relation to industrialists' income and in practice may be found to be slightly progressive.

This follows by definition, since situation rent has been defined as $P - E$ whilst the industrialist's income has been defined as $P–W$, and E includes W. The Whitstable pilot survey therefore leads to the conclusion that a local rate using valuations in accordance with the LCC definition would be a proportional or possibly slightly progressive tax on an industrialist's income.

The adoption of the definition given in the LCC Rating Bill of 1938–39 for the purpose of arriving at rateable values would then meet the main requirements set out at the beginning of this chapter. As the new rate would be a tax on situation rent, and from the very nature of situation rent the yield arising at the centre will always be greater than at the periphery, justice will demand a measure of equalisation.

Equalisation, however, is not a synonym for central government subsidy and there is no reason to assume that a satisfactory outcome could not be achieved within the local government sector, so that local prosperity could become the responsibility of local government.

Notes and references

1. *Rating of Site Values: Report on a Pilot Survey at Whitstable*. H. M. Wilks, The Rating and Valuation Association, London, 1964.
2. In the Whitstable U.D.C. area rateable values produced using the LCC Rating Bill definition totalled 87% of Inland Revenue List.

Chapter VII

Situation Rent

The final question to be considered is whether a tax on situation rent is likely to be sufficient to meet local authority needs, and to answer this question first requires an estimate as to the total of all situation rents in England and Wales as a whole.

The Rating and Valuation Association's pilot survey carried out at Whitstable found that within the Urban District site values were of the same order of magnitude as orthodox rateable values. (1)

This result, however, was very different from the estimate given in the majority report of the Simes Committee in 1952, in which it was suggested that site values would not be less than 20% or more than 50% of rateable values after a full revaluation. (2)

At 1st April 1951, the total of all rateable values for England and Wales was £335.7m and, on an assumption that a revaluation would not increase the total beyond £600m, it was concluded that a site value assessment for England and Wales would result in a figure between £100m and £300m. (3)

Subsequent evidence, however, cast doubts as to the validity of the majority report's assumptions. A partial revaluation increased rateable values as at the 1st April 1956 by some 70% over the previous year, while a full revaluation increased them yet again at 1st April 1963 by some 270% over 1st April 1962. Since rateable values increased sixfold in the twelve years between 1951 and 1963, it seems reasonable to assume that a full revaluation in 1951 would have produced an increase greater than the 79% suggested by the majority report, and that the increase of 280% suggested by the minority report was more accurate. (4)

The majority report had also made an important assumption in respect of present use, which is not implied in the LCC definition, and has no validity when arriving at an estimate of situation rent.

If valuations are based upon present use only, as are orthodox rateable values, then very clearly an inefficient use of the site will reduce the valuations and there will still be an element of tax on development. Further, given the assumption of present use, then orthodox rateable value includes the site value, and the part must necessarily be less than the whole; within 20%, 50% or 70% can be argued. The essence of the LCC definition used at Whitstable is, however, that the valuation should be based on the optimum use within the limits laid down by the planning authorities.

Situation rent is an expression in rental terms of the market price of a site to a developer and the present use has little or no significance. In cases, therefore, where a site is fully developed situation rent is likely to be less than the full rateable value, but in cases where the site is under-developed the situation rent will be greater than the full rateable value.

The relationship of total orthodox rateable values to total situation rent at any given moment of time will then depend on, firstly, the extent to which rateable values represent full valuations, and secondly the extent of the under-development. Such evidence as is available at the present suggests that present rateable values are well below full valuations, while in addition in many areas there is not merely severe under-development but often extensive industrial, commercial and domestic decay. In these circumstances it appears reasonable to accept the only evidence available based on actual valuations and to assume that total situation rents will be of the same order of magnitude as a revaluation of the orthodox rateable values.

The last financial year for which local authority accounts in England and Wales are available is 1966–67, and as at the 1st April 1966 rateable values totalled £2,194.9m. At least 90% of the assessments included in the 1966 list were, however, produced for the 1963 list and during the interval the price index for all goods and services sold on the home market rose by over 10%, while such market evidence as is available indicates that the increase in the selling price of land may have been twice this. On the assumption then that the total situation rents are of the same order of magnitude as total rateable values, and after allowing for the decline in the value of money, it seems likely that total situation rent in England and Wales at the 1st April 1966, would not have been less than £2,400m. We will assume the figure to be £2,400m.

The actual yield of a local tax assessed on situation rent would, of course, be determined by the poundage, as with the present rating system, and political expediency is more likely to restrict the yield than economic factors. The conclusion to be drawn from the Whitstable Survey is that a rate assessed on situation rent could yield an annual revenue some 50% greater than that of the present rating system without increasing the total burden on households and with some reduction in the regressive incidence on household incomes, as described in Chapter VI.

In the year 1966–67 the total rate revenue of local authorities in England and Wales was £1,266m, so that political expediency may indicate a limit of the revenue obtained from a rate based on situation rent in that year to be about £1,900m or the yield of an average rate of just under 16s.

Since by definition situation rent is the current market price of the set of advantages yielded by a particular site to the tenant in occupation, any rate up to 20s. would not offend against the ability to pay principle, at least in so far as hereditaments other than domestic are concerned. A 20s. rate would also demand the full and efficient use of sites within the existing planning permission, and give maximum encouragement to a wide geographical location of industry.

Further, to the extent that a tax assessed on situation rent is effectively a tax on "economic rent", a rate up to 20s. would not tend to restrict production or inflate prices. However, it must be noted that although the advantages a particular site yields to the tenant in occupation depend in large measure on the extent and quality of the local authority services that are made available, other factors also play a part. Bearing this in mind it does not therefore seem justified that a local authority should be allowed to levy a rate of 20s., but that a maximum rate of less than this figure should be fixed nationally. When fixing this maximum rate there does not appear to be any important economic reason why the central government should not differentiate in favour of domestic properties and, say, fix a limit for the domestic poundage rate of 15s. and for other properties of 17s.

Thus, from the economic aspect and from the point of view of political expediency, one is drawn to the conclusion that the product of a rate assessed on situation rent in the year 1966–67 need not have been less than £1,900m, and could possibly have been made to yield over £2,000m.

Under the present system of finance the annual tax revenue requirement of local authorities may be taken as their rate revenue plus the central government grants they receive. In England and Wales for the financial year 1966–67, local authority revenue from rates amounted to £1,266m and from central government grants £1,434m equivalent to a total revenue requirement of £2,800m.

Given no change in the system of finance, a tax on situation rents is then unlikely to yield sufficient for local authorities to be entirely independent of central government grants, although the measure of their dependence could be immediately reduced.

Assuming a total tax revenue in 1966–67 of £1,900m, central government grants to local authorities could have been reduced from £1,434m to £900m, or from just over 113% of their rate revenue to less than 50%. Providing this initial saving to the Chancellor of the Exchequer of some £534m had been passed on by reduction in national taxes, it is reasonable to assume that the maximum yield of a local tax on situation rent would grow on a rate faster than local authority's expenditure, so that within a measurable period of time the need for central government grants would be reduced almost to vanishing point.

Direct grants

However, we have suggested in Chapter II that central government grants to local authorities should be abolished and replaced either by direct grants to persons or by central government payments to local authorities in accordance with the principle that each level of government should be immediately responsible for the financial consequences of its own decisions. Without being given political guidelines it is not possible to quantify the effect of replacing the present grant system by such a principle.

If, however, it is assumed that a central government payment under the proposed system would be approximately 50% of current total grants, then in 1966–67 local authorities' accounts in England and Wales would have benefited by between £600m and £650m, either by way of direct receipts or by reduction in expenditure. There is, of course, no reason to assume that the benefit accruing to local authorities would not equal the £900m mentioned in the previous paragraph, but bearing in mind the nature of this guesswork we may assume a figure between the two of £750m.

We have also concluded in Chapter III that there would be advantages in abolishing the present system of loan finance and introducing a new system under which local authorities were not empowered to borrow (except on their trading accounts) other than for normal overdraft requirements. Very obviously, at the present time such a change would increase a local authority's income requirements, although the extent of this increase would depend upon what items were included in trading accounts.

If local authorities are to be allowed to raise loans in respect of trading services it follows that they should be required to run these services as a commercially viable venture. In practice this would mean that no local authority service for which trading account status is claimed would qualify for regular contributions from the rate fund in order to meet deficiencies. Further, given a change in local authority structure and their financial system, it may be found that some of the present trading services should in fact become rate fund services and vice versa. One important item which cannot be considered here is houses and land to which the Housing Revenue Account relates.

So far as local authorities are concerned there appears to be a case for housing to be given trading account status. The financial cost of any need for subsidised housing should be met by central government, preferably by means of direct grants to persons. The whole matter of considering what services should or should not be included in trading accounts does, however, require a separate study, and for the purposes of this paper we have assumed that trading services, corporation estates and housing revenue accounts are operated in such a manner that they do not place a regular burden on the rate fund.

After making allowances for trading services, corporation estates, housing revenue accounts, and payments from the central government, local authorities in England and Wales, on the basis of the 1966–67 accounts, would have required under a non-loan system a local tax revenue of between £1,900m and £2,000m. (5)

There is, then, every indication that given a new system of local authority finance as outlined, the yield of a local tax on situation rent would be sufficient in total to meet local authorities' tax revenue requirements.

In order to establish such a system of local authority finance it would be necessary for the central authorities to take over the liability for the current local authority loan charges that otherwise would remain chargeable to the rate fund. In England and Wales for the year 1966–67 these loan charges totalled £407m and must be set against the savings of about £700m that would accrue to the Exchequer from the abolition of central government grants, giving a net saving of about £300m.

Finally, the fact that the immediate net saving to the Chancellor of the Exchequer following an increase in local tax revenue would be reduced by a change to a non-loan finance system may be considered as an argument for the retention of the present loan system. If the objective is limited to providing scope for national tax reduction this argument must be admitted. However, in the longer term, since local authorities' loan charges include an item for the repayment of debt, it follows that given no new borrowings, the charge to the Chancellor of the Exchequer will be reduced each year. Probably in the space of a single Parliament the net saving to the Exchequer under a non-loan system would be greater than had the loan system been continued. Much more important in this context is the fact that if local authorities are to be allowed to incur debts in respect of rate fund services then it is essential in the interests of the national economy that the central authorities exercise a reasonably detailed control over any expenditure to be met from loans. (6)

It may be concluded from history that the British people have a much greater care for the liberty of the subject than for what is today described as democracy, and there is certainly considerable evidence to suggest that much of the present clamour for national independence, provincial government and the like, is caused by personal and local frustrations resulting from central controls.

If, however, a non-loan system of finance is operated in respect of all rate fund expenditure, then most of these central controls which tend to produce local frustrations and resentment would become unnecessary.

The only control that would be necessary for the central government to exercise is to fix a maximum limit to the poundage, the contribution to an equalisation fund, together with enacting the regulations for the distribution of such a fund, and to ensure that any trading services were operated in such a way as to incur no regular liability to the rate fund. The advantages that would accrue to the individual, given such local independence, seem far to outweigh the passing advantage of a possible immediate reduction in national taxes of less than £150m, or some 1½% of the national tax revenue.

Notes and references

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

2. *The Rating of Site Values, Report of the Committee of Enquiry under the chairmanship of Erskine Simes Esq., Q.C.,* Ministry of Housing and Local Government, Scottish Home Department. H.M.S.O. 1952.

3. *Ibid*. para. 127.

4. *Ibid*. Minority Report, para. 40.

5. A rough estimate of local authorities' income requirements under a non-loan system, based on Table 1 of *Local Government Financial Statistics–England and Wales, 1966-67* gives the following results:

	£m	£m
Revenue account expenditure	3,216	
Capital	1,392	
Total		4,608
Deduction for:-		
Housing	996	
Loan charges	408	
Trading services deficit	24	
Other income	432	
Central government payments or other reductions in expenditure	750	
Total		2,610
Local authorities tax revenue requirements		1,998

6. In the financial year 1966-67 rate fund services were debited with £176,622,000 for debt redemption.

VIII

Conclusions

In February 1966, government published a White Paper in which it admitted the need for reform of local government finance. (1)

No proposals were made, but the hope was expressed that the new structure expected to emerge from the keen deliberations of a forthcoming Royal Commission would at last provide a promising context for a drastic reform of local government finance.

The Royal Commission was appointed in May 1966, under the Chairmanship of the Right Honourable Lord Redcliffe-Maud, "To consider the structure of local government in England outside Greater London in relation to its existing functions and to make recommendations for Authorities and Boundaries and for functions and their division having regard to the size and character of areas in which these can most effectively be exercised and the need to sustain a viable system of local democracy." After a long process, the Commission's report was published in June 1969. (2)

Although the Royal Commission of 1966 was not precluded by its Terms of Reference from considering finance, and ten out of the fifteen proposals put forward in the Commission's majority report related to finance, in total its findings amounted to little more than a further expression of hope. It may now be assumed that central government has no immediate proposal for "any immediate reform of local government finance" from the fact that they have recently introduced to Parliament the General Rate Bill 1969, designed to assist the general revaluation due to be completed by 1973. (3)

As has already been stated in this research paper, the present local rating system is inadequate for local authority needs and this has been admitted by the Government. (4)

Revaluation by the present method will not alter this situation, and the financial requirements of local authorities are not likely to be reduced by a reorganisation of their structure and boundaries. It would therefore seem entirely irresponsible for central government to do violence to the established present structure and organisation of local government, unless the drastic reform of local government finance is put in hand at the same time.

The reform of local government finance must provide as a basic minimum, firstly a local revenue that is adequate for local needs, and secondly for a substantial reduction in central control.

These two requirements would be met along the lines of the following proposals:

(i) Central government grants to individual local authorities to be replaced by central government grants to persons and by the central government discharging by direct payments its financial liability to particular local authorities.

(ii) The central government to assume full responsibility for all outstanding local authority debts relating to the provision of rate fund services.

(iii) Local authorities should no longer be empowered to borrow (other than normal overdraft requirements) to cover their expenditure on rate fund services.

(iv) Any other local authority services requiring loan finance to be operated according to normal commercial principles and to have no regular recourse to the rate fund.

(v) Rateable values should be assessed on the situation rents of all sites in accordance with the definition specified in the LCC's London Rating (Site Values) Bill, 1939.

(vi) A maximum rate of poundage should be fixed by the central government.

(vii) All local authorities to be empowered to levy the maximum rate on all sites.

(viii) An equalisation fund to be set up within the local authority sector but under central government regulations.

(ix) The central government to fix the poundage rate for local authorities' contributions to the equalisation fund.

(x) Since local situation rents are largely determined by local prosperity, local authorities should have full responsibility in matters affecting local prosperity.

Finally, it must be noted that local government finance has a bearing on the required structure, organisation and boundaries. For example, much of the case for new provincial councils rests on the concentration of power at the centre, but this concentration itself is grounded on financial dependence.

We conclude, therefore, that financial reform is a necessary part of local government reform, and that finance cannot be considered separately from structure and organisation if the objective is strong local government in this country.

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3. Cmnd. 2923, para. 5.
4. *Ibid*. para. 3.

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