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LOCAL GOVERNMENT FINANCE STUDIES: DRAFT GREEN PAPER

Memorandum by the Secretary of State for the Environment

During the last year, the Local Government Finance Studies have carried out a fundamental reappraisal of the local government finance system in Great Britain. In the light of that work, the attached draft Green Paper has been prepared in collaboration with the Secretaries of State for Scotland and Wales.

2. The Green Paper - which I propose should be entitled "Paying for Local Government" - sets out proposals for reforming local non-domestic and domestic taxation and the system of Government grants to local authorities. The substance of the draft has been approved by the Sub-Committee on Local Government Finance of the Ministerial Steering Committee on Economic Strategy (E(LF)). For publication I intend to include a brief Ministerial foreword and I will circulate to colleagues shortly a draft of what I propose to say.

3. The main thrust of the proposed reforms is to provide authorities with a much greater incentive to restrain their expenditure and to utilise their resources more effectively by radically enhancing the accountability of local authorities to their electors. The main proposals for England and Wales are as folows:

a. there should be a uniform national non-domestic rate in each country, the proceeds of which would be pooled and redistributed among all authorities as a flat-rate amount per adult; this would be accompanied by a revaluation of non-domestic properties, coming into effect in 1990-91;

b. domestic rates should be phased out over a ten-year period, and replaced by a flat-rate community charge, payable by all adults;

c. a power to limit selectively the community charges levied by individual authorities should be held in reserve;

d. the existing block grant system should be replaced by a grant to equalise differences in authorities' assessed expenditure needs and a standard grant, which would pay a flat-rate amount per adult across the country as a whole; all grant allocations would be determined at the start of the year and would not alter subsequently.

4. The proposals would protect non-domestic ratepayers; spread the burden of local domestic taxation much more equitably among all local electors; and reduce significantly the instability and complexity of the rate support grant system. And in combination they would ensure that the full costs or benefits of increases or savings in a local authority's expenditure would accrue solely and entirely to its local domestic taxpayers; with the widening of the tax base and the much clearer relationship between expenditure and tax demands, local accountability should be substantially improved.

5. Comparable reforms are proposed for Scotland, taking account of existing differences in the local government finance system in that country. The proposals do not, however, apply to Northern Ireland, where the arrangements for local government and its financing are markedly different.

PUBLICATION AND TIMETABLE FOR CONSULTATION

6. Subject to colleagues' views, I propose the Green Paper should be published on 28 January. I would intend to make an oral statement to the House of Commons on that day, in which I would also announce the timetable for a non-domestic revaluation.

7. Since we are proposing radical reform of the local government finance system, I believe we must allow a reasonable period for consultation. I therefore propose in respect of England and Wales that we should invite comments on the bulk of the proposals by 1 October 1986. Following the conclusion of the consultation period, I would envisage publication of a White Paper at about this time next year. It is too early at this stage to say when legislation might follow, but this timetable would allow us to introduce legislation in the summer of 1987 if we wished to do so.

8. The exception to this would be the proposals for reforming the capital expenditure control system, which can be considered separately from the rest of the package. Although we have yet to reach a view on this, we may wish to legislate for reform in this area in advance of the other proposals. I therefore intend to invite comments on the proposed capital reforms by mid-April 1986.

9. The Secretary of State for Scotland wishes to keep open the possibility of legislation to reform local government finance in Scotland in the 1986-87 Parliamentary Session, and accordingly proposes to seek views on his proposals by the end of April 1986.

CONCLUSION

10. Subject to detailed drafting amendments, I seek colleagues' agreement to publication of the Green Paper on the basis I have proposed.

K B

Department of the Environment

3 January 1986

cmo Untill Publication

PAYING FOR LOCAL GOVERNMENT

Contents

Chapter 1: Why change local government finance?

1.1 In some ways, the debate about local government finance is unchanging. Many of the arguments that are considered in this Green Paper are as old as local government itself. But, in other ways, change in recent years has been very rapid, and has introduced important new factors into the debate.

1.2 Local government has become a business so big that it has nearly 2 million full-time, and one million part-time, employees. It accounts for over a quarter of all public expenditure, and 11% of GDP. In 1984/85, the services provided by local government in Great Britain cost £39 billion. There has been a shift in the nature of these services, with a particularly significant increase in welfare services – help for groups such as the elderly and children at risk. Local government has also become much more strongly influenced by national and party politics.

1.3 This Green Paper looks at how local government is paid for and sets out the Government's proposals for reform. Because of markedly different arrangements regarding provision of the relevant services and levying of rates, it does not apply to Northern Ireland.

A historical perspective

1.4 In the United Kingdom, all the powers of local authorities derive from Parliamentary legislation. The structure of local government, the services it provides, and the way in which it finances those services are all subject to statutes passed by Parliament.

1.5 There has been a succession of reforms of the structure of local government, from that of 1888, which ended the system of appointed county government, to the changes introduced in 1974 in England and Wales and 1975 in Scotland, and the winding up of the GLC and the metropolitan county councils. Parliament has imposed new duties on local authorities, ranging from the provision of police and education in the nineteenth century to more recent examples such as the responsibility to house homeless families. There have also been occasions when Parliament has decided that certain responsibilities which local government had been carrying out could be better discharged in other ways. Local authorities ceased to be responsible for prisons in the 1870s, trunk roads in the 1930s, gas and electricity in the 1940s and water and sewerage – in England and Wales – in 1974.

1.6 Parliament has also exercised control over the financing of local government, in terms both of the nature of local government's own sources of revenue, and of the extent of Government grants and the method of allocating them. The rates as we know them – a unified local tax – did not exist until at least the end of the nineteenth century. Before that, there were several different 'rates' for different purposes. These included highway rates, improvement rates, poor rates and school rates. Not all of them were assessed in the same way. Parliament has also experimented with other methods of funding local services – such as a system of assigned central revenues, used for a time at the end of the nineteenth century.

Central and local government services

1.7 Until the nineteenth century, there was scarcely any overlap at all between the responsibilities of central and local government. Central Government's energies were directed towards foreign policy and defence. Local government was responsible for other services which it was felt should be carried out by the state – primarily the relief of poverty. Individual authorities were left to interpret the needs of their areas as they judged them, and cater for those needs as they saw fit.

1.8 Even in the nineteenth century, as Parliament gradually became more interested in domestic affairs, it proceeded slowly in imposing new duties on local government in the fields of law and order, public health and, in due course, education. It tended first to encourage, then to provide enabling legislation, and only after that to impose duties.

1.9 There were no regular grants from central Government to local authorities before 1835. Even by 1879, grants amounted to less than 10% of local authority revenue. Parliament was, of course, also concerned with the level of local taxation. This is not surprising as revenue from rates exceeded that from income tax every year until after the First World War. But the narrow range of local authority services still meant that rate bills were relatively small: in 1870, local authorities were spending only about £● for every person in England – roughly £● at today's values – compared with £● today.

1.10 Gradually the picture changed, in two main ways. The first was that Parliament began to concern itself much more with the services that local authorities were providing, feeling that some were of such importance that they should be provided to a reasonable standard throughout the country. The second factor was that central Government itself began to be involved in assistance for the unemployed and other disadvantaged groups. In doing this, it began to concern itself in matters which, for earlier generations, had been the concern solely of local government.

1.11 Even though central Government was gradually taking over local authorities' Poor Law responsibilities, local government spending grew steadily in the first half of the twentieth century. In real terms it increased by nearly 350% in the sixty years between 1890 and 1950. It was also taking up an increasing share of the nation's wealth, rising from ●% of GDP in 1890 to about ●% in 1950.

1.12 After 1950, local authority spending continued to grow, as part of a general expansion of public services. Only 25 years later, in 1975, it had increased by almost a further 300% in real terms. And it was still increasing at a faster rate than the nation's wealth – so much so that it accounted for ●% of GDP by 1975. The full costs of this increase in spending were hidden from ratepayers by a steady increase in the central Government grants for local authority services. By 1975 65% of all local authority revenue expenditure in England was paid for out of central taxation, through Government grants. Annex A shows these trends in more detail.

1.13 This growth in spending could not continue indefinitely. In 1975 Mr Anthony Crosland, then Secretary of State for the Environment, declared that "the party's over". Under pressure from the IMF, the Labour Government asked for, and got, a substantial reduction in local authority current expenditure in 1977/78. And it also sought cuts in capital expenditure: between 1974/75 and 1978/79, local authority capital expenditure almost halved in real terms. In addition, the Labour Government reduced the rate of grant from the Exchequer. In England and Wales it fell from 65% in 1975 to 61% by 1978/79. Nevertheless, current expenditure began to grow again in 1978/79. This was the situation which confronted the incoming Conservative Government in 1979.

Local authority spending and economic policy

1.14 Because Governments are responsible for the overall management of the economy, they have to be concerned with the amount of local authority expenditure, borrowing and taxation. Local authority borrowing has implications for the public sector borrowing requirement (PSBR), the rate of monetary growth, and interest rates. Local authority current expenditure, whether it is financed by local or national taxation, affects the overall burden of taxation in the economy and the balance between public and private sector output.

1.15 Since 1979 the Government has been committed to reducing inflation and setting the foundation for sustained economic growth. The rate of monetary expansion had to be curbed, and public borrowing reduced, so that interest rates could be kept down. Higher local authority borrowing would have made it harder for the Government to achieve these objectives.

1.16 The Government also sought to reduce the size of the public sector. This would, in turn, allow reductions in levels of taxation and more freedom for individuals and firms to choose which goods and services they wished to consume.

1.17 Few would question central Government's right to control the level of local authority borrowing, which accounted for £2.4bn out of the PSBR total of £10.2bn in 1984/85. Since local authority expenditure is financed largely by borrowing, this is one of the main reasons why central Government has taken a close interest in the level of local authority capital expenditure.

1.18 Central Government's concern with the level of local authority revenue expenditure – current spending and capital spending financed by revenue – is not always so readily accepted. Some commentators argue that local authorities have independent tax raising powers – the rates – and that, if they choose to finance extra spending from this source, that need not concern central Government. On this argument, central Government should confine its interest to the overall contribution through national taxation to the cost of local services. But, as Figure 1 shows, local government accounts for more than a quarter of the total tax burden in the United Kingdom. Rates account for 10% of all taxes levied; and another 16% of taxes are used to finance local authority expenditure through Government grants. The arguments against high levels of taxation apply just as much to local taxes – domestic and non-domestic rates – as to national taxation. Only central Government is in a position to assess the competing claims on national resources. There can thus be no question of the Government's abdicating its interest in the levels of local authority spending or taxation.

Figure 1: Local authorities' claim on the total tax burden (United Kingdom)

1.19 Since the war there has been sustained growth in local authority current expenditure to the point where, in 1979/80, it constituted ●% of public expenditure. It was inevitable that the success of policies to reduce public expenditure generally would depend to a significant extent on a reversal of post war trends in local authority expenditure.

Policy since 1979

1.20 The Government's policies on local government finance since 1979 have had three main strands.

- A concern to contain local government expenditure at affordable levels. A new method of allocating the main unhypothecated grant towards local authority expenditure - block grant - was introduced in 1981/82. At the same time a new system of controlling capital spending, rather than just borrowing, came into effect. The Government subsequently abolished supplementary rates, which had previously made it possible for authorities to begin a financial year with one rate, and then to increase it in the course of the same year.
- Encouragement to authorities to carry out services more efficiently, and to introduce private sector competition where possible. The Goverment established the Audit Commission, one of whose major tasks is to advise local authorities in England and Wales on value for money. It also established new rules governing local authority direct labour organisations, which include public tendering for most sizeable contracts.
- A reduction in detailed controls over local government. The Local Goverment Planning and Land Act 1980 abolished or simplified ● detailed controls over local government such as ●.

In each of these cases the legislation referred to England and Wales, though the block grant and capital controls systems are administered separately in the two countries. There is separate legislation in Scotland.

1.21 The Government remains committed to all three of the objectives set out above. But any reduction in detailed controls can only take place in the context of a system where the government can be satisfied that its overall public expenditure policies are being met.

1.22 Since the Government had no direct means of controlling local authority current expenditure, it introduced a series of measures designed to achieve expenditure restraint through pressure from ratepayers. Under the block grant system, introduced in 1980, the proportion of an authority's overall expenditure met by grant was less if it spent significantly more than was needed to provide a standard level of service (see Annex B). The Government also started progressively to reduce the overall percentage of local authority expenditure met by grant, so that all authorities had to consider more carefully whether the cost of extra spending, with a lower contribution from central Government, was justified. In England grant fell in stages from 60% in 1980/81 to 49% in 1985/86. Qver the same period it fell from 74% to ●% in Wales, and from 68.5% to 57.7% in Scotland.

1.23 It quickly became apparent, however, that these measures alone were unlikely to bring about the reductions in local authority spending that the Government thought necessary. The local government finance system worked in such a way that the effect of the block grant pressures was greatly reduced by the time they reached local domestic ratepayers. Why this should be so is considered in more detail in paragraphs 1.35 to 1.43 below. This made it easier for some authorities to decide that they would not contribute to the expenditure reductions asked for by the Government. Indeed, in 1981/82, faced with a general request for revised budgets, a handful of authorities responded by proposing *increases* in the spending they planned to undertake. With great reluctance, the Government saw that, if it was to succeed in controlling local authority expenditure, it would have to take stronger measures.

1.24 The Government decided to supplement the expenditure pressures of the block grant system with a system of expenditure targets for every authority, based on its actual spending in earlier years. Any authority which exceeded its target had its block grant entitlement reduced so that it had to raise a much higher contribution from its local taxpayers. Expenditure targets were set from 1981/82 to 1985/86 and the penalties for exceeding them were increased year by year.

1.25 For 1986/87 the Government is discontinuing the system of individual targets in England and Wales. However, it is increasing the incentives within the block grant system for authorities to exercise expenditure restraint.

1.26 Throughout, the Government has faced particular problems in dealing with a handful of the highest spending authorities in England and Scotland. In 1983/84 English local authorities' budgeted revenue expenditure exceeded the Government's targets by £770m. 75% of this was accounted for by 16 overspending authorities. A similar pattern occurred in 1984/85 when 75% of the overspend of £850m was attributable to just 12 authorities. Many of these were still increasing their expenditure. In 1984 Parliament passed the Rates Act, which gave the Government powers to set limits to the rates which English and Welsh high-spending authorities could levy. These powers were used for the first time in 1985/86 in England. Similar powers have been in use in Scotland since 1983/84.

Success and failure

1.27 These financial pressures have had some success. As Figure 2 shows:

— the annual rate of growth in the volume of local authority current expenditure in England has fallen from 3% or more in the sixties and seventies to under 1%;

— after continuous growth in the sixties and seventies, English local authorities' manpower has fallen since 1979.

Figure 2: Trends in local authority expenditure and manpower (England 1960-198●)

1.28 By comparison with the trends of the sixties and seventies these results represent a considerable achievement. Even so they mean that, in Great Britain as a whole, current expenditure is still growing and now represents a higher proportion of GDP than it did in 1979. Local government has achieved some reductions in manpower, but the fall of 5% since 1979 is modest compared with achievements elsewhere in the public sector. And the manpower total has not fallen significantly further since the end of 1983.

1.29 Large elements of central Government spending cannot be curtailed in the short term. For example, defence expenditure is affected by international commitments; unemployment benefit has inexorably risen at a time of world economic recession. So it is difficult to make room for extra local government spending within the public expenditure total. But every year since 1979 the Government has been forced to increase the amount allowed for local authority current expenditure in its public expenditure plans.

1.30 The modest success in holding back spending has been accompanied by a worsening of the relationship between central Government and even the moderate and responsible local authorities. To secure any significant reduction in the total of local authority spending under the target system, the Government needed to ask for expenditure savings based on previous years' spending levels. Councils which had a long tradition of careful husbandry and efficiently-provided services found it increasingly painful to make further savings from a low base.

1.31 The measures that have been taken have also tended to make the grant system more complicated and more unstable. One by-product of the system of targets and penalties has been the growth of "creative accounting". Authorities have become adept at manipulating expenditure between financial years to minimise grant losses. The effect has been to weaken further the link between changes in spending and changes in local tax bills.

1.32 All these measures rested on the assumption that, faced with the increasing cost of expenditure growth, local ratepayers would bring pressure to bear on local councils for lower spending. But in fact only modest savings were achieved. For some authorities, the pressures of local accountability failed to work at all, and their spending was restrained only through rate capping.

Why have these problems arisen?

1.33 The Government's concern to restrain local authority expenditure and taxation has revealed that the existing financial framework has serious shortcomings which significantly weaken local accountability. These problems have not been *caused* by what has happened since 1979. The flaws have been inherent in successive systems over many years. But the inevitable tensions that have arisen – in a period when a Government, for the first time since the war, has been seeking to exercise significant continuing restraint over local authority spending – have highlighted their importance.

1.34 Shortcomings arise as a result of problems in three main areas:

i. the extent to which local authorities' marginal spending is funded by non-domestic ratepayers;

ii. the mismatch between those who are entitled to vote in local elections, those who benefit from local authority services, and those who pay domestic rates;

iii. the operation of the grant system.

(i) The contribution from non-domestic rates

1.35 Over half the total rate income of local authorities in England comes from the non-domestic sector. This includes commerce, industry, public utilities and public sector institutions such as schools and hospitals. Under 40% comes from domestic ratepayers' own pockets and rebates meet the remaining 10% (see Figure 3). In Wales, non-domestic ratepayers account for ●% of rate income, and in Scotland 62%.

Figure 3: Sources of rate income (England 1984/85)

1.36 The significance of this contribution by the non-domestic sector lies in its impact on the contribution which domestic ratepayers make to expenditure increases at the margin; for on average it means that, after Government grants are taken into account, domestic ratepayers are meeting less than half the cost of any increases in their council's spending. In some rating authorities the non-domestic ratepayer provides as much as 70% of income raised locally. Authorities therefore find themselves in a position to increase spending on services for voting domestic ratepayers largely at the expense of non-voting, non-domestic ratepayers. This provides little incentive to economy.

(ii) Those who vote and those who pay

1.37 The poor linkage between those who vote and those who pay has been further weakened by the fact that many of those who are entitled to vote for higher standards of local authority services either do not pay rates at all, or do not pay full rates. As Figure 3 showed over a fifth of the domestic rate bill is met by rebates.

1.38 There are about 35m electors in England. Of these about 18m are liable to pay rates. Of course, many of the remaining 17m will be spouses of ratepayers; but they are not billed direct, nor do they personally make any payment to their local authority; and other adult members of ratepayers' families may have even less appreciation of the cost of local services. Of the 18m who are liable to pay rates, only about 12m actually pay their rates in full. 3m receive partial assistance with their rates and the remaining 3m receive full relief from their rates bill. For those who receive only partial help, the rebates damp the effect of increased local authority spending. Those who receive full relief know that, under the present arrangements, they can vote for higher services without having to pay anything towards them. In Wales and Scotland ●% and 49% respectively of electors are liable to pay rates. ●% of ratepayers in Wales, and 20% in Scotland, receive partial rebates. ●% and 20% respectively receive full rebates. Figure 4 shows the proportions of the English electorate liable to pay rates and those in receipt of full or partial rebates.

Figure 4: Proportions of the electorate paying full or partial rates (England, 198[redacted])

1.39 The picture varies from authority to authority. Some urban councils have large concentrations of industrial and commercial development and a high proportion of voters also receive rebates. In the some cases, domestic ratepayers meet, after rebates, as little as [redacted]% of the rate bill from their own pockets.

1.40 Rates are currently the only form of local taxation. Domestic rates have many technical advantages. But they do not take any account of the composition of households or their consumption of local government services. This was less relevant in the past when, as noted earlier, local government was responsible for services such as gas, electricity and water, where the basic provision was related to property ownership and consumption was charged for. But today most local authority services are provided for people, rather than property. Education alone accounts for 46% of local authority current expenditure.

(iii) The grant system

1.41 Accountability is also impaired by the way in which grants are paid to local authorities. Authorities' grant entitlements are linked to actual spending – not only their own spending, but also that of every other authority. The result is that no authority can be certain how much grant it will receive until after the year for which the grant is paid is over. Grant entitlements also vary betweeen years. To some extent this is unavoidable, since the total amount of grant to be made available has to be considered afresh each year as one element in the Government's annual budget decisions. But grant can also be affected by changes to the various components of the grant system, such as the method of assessing the cost of providing a reasonable standard of service in different areas. This can have a powerful impact on the grant of the individual authorities that are most affected, producing significant changes in the amounts which they need to raise from rates which are unrelated to changes in their expenditure.

1.42 Successive governments have also paid grant to compensate authorities for variations in rateable value. This is known as "resources equalisation". Some method of equalising non-domestic resources is obviously needed. Shops, offices, and factories tend to be concentrated in particular areas, and so is the revenue from non-domestic rates. Without some equalisation arrangement to even out this effect, there would be very large differences in the amounts domestic ratepayers had to pay for their services. But the system also compensates for variations in domestic rateable values, by ensuring that different authorities can charge the same rate *poundage* for equivalent spending levels. This means, however, that rate *bills* in different areas vary for the same standard of services. There is no obvious justice in saying that a household living in an area where houses are expensive should pay more for their services than if they lived in the same house in an area where housing was cheap. But that is what happens. It means that, to pay for a similar increase in spending, authorities in areas where rateable values are low need to increase their rate bills by a smaller amount than high-rateable value authorities.

1.43 The effect of this is that rate bills faced by households are lower in some high-spending authorities than in other areas where spending is less. The individual ratepayer in Carlisle, for example, faced with an average bill of under £234 a year in 1984/85, might have assumed that his authority's spending was modest compared with that of Luton where the average bill was £366. But, in fact, Luton was the lower-spending area. As Figure 5 shows, if both authorities had spent at the level of their grant-related expenditure – the Government's assessment of their need to spend – the difference in rate bills would have been even greater. Yet differences in household income between Carlisle and Luton are likely to be much smaller than the differences in average rate bills.

Figure 5: Rate poundages and rate bills in Luton and Carlisle (1984/85)

The direction of reform

1.44 Local government finance is at a crossroads. The Government needs to be able to influence the total of local authority expenditure, as part of its overall economic policies. Yet its attempts to do so are frustrated by a local tax and grant regime which depresses and distorts the cost of marginal increases in expenditure. As a result electors are often either indifferent to the level of expenditure adopted by their local council or are encouraged to vote for higher service standards than they would be prepared to finance if they bore the full marginal cost themselves. To achieve even modest success in restraining expenditure, the Government has therefore had to bring steadily increased direct pressure to bear on the highest spending authorities.

1.45 Some improvements are possible within the context of the existing arrangements. The Government is already proposing, in the White Paper on the Reform of Social Security (Cmnd 9691), to make one important change. It envisages that, in future, all domestic ratepayers should be required to pay at least 20% of the rate bill they face. This will re-establish a financial link between the 3 million households who receive full relief from their rates bill and the local authorities in whose areas they live. But it will still leave many problems unresolved. The need for fundamental reform will still exist.

1.46 There are three main possibilities for reform:

— changing the structure of local government;

— imposing much greater central control over local authorities;

— financial reform designed to improve local accountability.

(i) Changing the structure of local government

1.47 There are some who will argue for a further upheaval in local government structure. One model the advocates of this approach have in mind amounts to a federal structure: provincial councils taking major economic and planning decisions with, below them, single-tier authorities responsible for all day-to-day services. It is true that there could in theory be some gain in accountability if we were to have all-purpose local authorities throughout the country. Ratepayers would then know that the spending decisions of one authority lay behind their bills. But this gain would be achieved at the cost of the enormous disruption which a further large-scale local government reorganisation would cause. And, in the course of that reorganisation, we should be forced, yet again, to face up to the fact that different local government services can best be provided by authorities of different sizes.

1.48 Moreover, any proposals which include a regional tier of government will have to consider what the role of those provincial authorities should be. The issues have been extensively discussed in the last 20 years following the proposals of the Royal Commissions chaired by Lord Redcliffe-Maud and Lord Wheatley. The debate about devolution showed that there is little support for the major constitutional change that would be needed to move to a federal structure.

1.49 Nor would changes to the structure of local government deal with the underlying financial problems set out in this chapter. Tackling those means facing up to the choice between increasing central control and improving local accountability.

(ii) Increasing central control

1.50 Increased central control of local government spending may at first sight appear an easy answer to the problem, at its results could be substantial and guaranteed. There are a number of possible models for a centralised system. One would simply be to impose a general limit on rates. Another would be to fund one or more of the main local government services from general taxation, with the budget for each set by central Government. Or a substantial slice of spending on a particular service or services could be taken to the centre.

1.51 But any system based on more extensive central control of local authority spending would have major drawbacks.

— Introducing a general limit on rates would mean extending rate-capping to most, if not all, authorities. Setting limits which brought about reductions in expenditure where appropriate, but also took account of the different circumstances of individual local authorities, would require Government departments to get drawn into the detailed financial affairs of every authority.

— Introducing central funding of a major service, such as education, would enable the Government to control about [redacted] of local authority spending. But the Government would have to become responsible for setting each local authority's budget for education and for determining the policies necessary to implement them. Local authorities would not be spending any of their own money on the service; they would act merely as agents with no incentive to manage them efficiently. A big increase in central Government manpower would be needed.

— Central funding of teachers' and lecturers' salaries alone would provide control of over half of education spending, or a fifth of all local government expenditure. But it would mean that the Government had to take responsibility for the number and grading of teachers in each authority, and their conditions of service. There would be duplication with local authority responsibility; perpetual argument about the division of powers; dilution of local accountability to parents and the community; and no guarantees of improvements in standards of performance, administrative cost, or expenditure control. This, too, would require a significant increase in central Government manpower.

(iii) Improving local accountability

1.52 The Government has a responsibility to ensure that what the public sector spends is consistent with what the country can afford. It cannot abandon its concern with the level of local government expenditure. But neither structural reform nor increased central control offers an attractive way of fulfilling that responsibility. The alternative is to make local authorities more accountable to their electors within the present structure of local government. This is more attractive on several counts. It guarantees the continued existence of a healthy, democratic system of local government. It should reduce the tension between central Government and local authorities. In the longer term it should help to ensure that services are provided more efficiently. And it strengthens the link between the local authority and those who live in its area. For the vast majority of people, this is the preferable way forward. But it can only work if we are able to deal with the shortcomings which this chapter has identified.

1.53 Local accountability depends crucially on the relationship between paying for local services and voting in local elections. At the moment there are worrying gaps. 60% of total rate income in England comes from non-domestic ratepayers with no vote. Of the 35 million local electors in England, only about 18 million are liable to pay rates, and about a third of those receive full or partial rebates.

1.54 These problems are accentuated by the arrangements for paying Government grants to local authorities. Grants will continue to be needed. It would be unacceptable for the full costs of services to be borne locally, particularly in the poorest parts of the country. But the existing grant system makes it impossible for ratepayers to see a clear relationship between the spending behaviour of the authorities in whose area they live, and changes in their rate bills.

1.55 This suggests that there will be three main elements in a new finance system based on improved local accountability:

— better arrangements for the taxation of non-domestic ratepayers so that their contribution to local services does not conceal from local voters the true costs of increased spending;

— a more direct and fairer link between voting and paying, with more local voters contributing towards the cost of providing local authority services;

— clearer grant arrangements, so that the consequences of increases or reductions in spending are felt directly and straightforwardly by local domestic taxpayers.

1.56 This central issue of improved local accountability is discussed in detail in the chapters that follow. The first three deal separately with local non-domestic taxes (Chapter 2), local domestic taxes (Chapter 3) and grants to local authorities (Chapter 4). The assumption in all three chapters is that the present overall financial balance between the contributions of national taxpayers, local domestic taxpayers, and local non-domestic taxpayers to local spending will be broadly maintained. Each chapter considers the shortcomings of the existing arrangements and sets out possible alternatives. Chapter 5 discusses the effects for households and local authorities of the improvements to local accountability proposed in the previous three chapters.

Capital expenditure

1.57 These chapters are concerned with reforms which bear primarily on local authority revenue expenditure. The Government also sees a need, however, for reform in the field of capital expenditure. The system of control over capital expenditure that came into operation in 1981/82 is based on centrally determined capital expenditure allocations. These are permissions to spend accompanied by borrowing approvals issued each year to local authorities. Authorities may supplement the allocations in various ways, the most important of which is that they may spend a proportion of their capital receipts from the sale of council houses and other assets and from repayments of grants and advances.

1.58 In the first two years of the capital control system there was considerable underspending. In the subsequent three years the main cash limits have been overspent by large amounts. The Government has had to take various corrective measures, which have inevitably increased the uncertainty and instability for individual authorities in carrying out their capital programmes. To some extent the early underspending was the result of local authorities having to adjust to a new system and to the large capital receipts achieved from the sale of council houses. But a fundamental problem is the mismatch between the elements of control at national as compared with local level: individual authorities may increase their spending by a proportion of both in-year and accumulated capital receipts, whereas at national level the total of in-year receipts only is netted off gross expenditure. Other local flexibilities have no counterpart in the national system and have allowed more leeway for local authority expenditure than was originally envisaged.

1.59 Chapter 6 considers further the problems posed by the operation of the capital control system and discusses proposals for reform designed to give greater certainty and stability whilst preventing overspending of the national cash limits.

1.60 Chapter 7 discusses further opportunities for reinforcing local accountability by extending the use of fees and charges to fund local authority services, and by strengthening the framework governing the preparation and implementation of authorities' budgets.

1.61 To avoid over-complicating the presentation of the main issues, each of these chapters focuses primarily on experience in England. Chapters 8 and 9 set the review in the rather different circumstances of Scotland and Wales. The conclusions of the review are set out in Chapter 10.

Chapter 2: Local non-domestic taxes

2.1 In Great Britain, non-domestic rates in 1984/85 contributed £7.9bn towards a total local authority revenue expenditure of £29.1bn – over one quarter of the total.

The pattern of non-domestic rates

2.2 The bulk of non-domestic rate payments comes from industry and commerce, including shops. But there are also very large contributions from the nationalised industries and from public sector bodies. Local authorities pay rates to themselves and to each other for the schools and other premises they occupy. Central Government, regional health authorities and universities are also large contributors. Figure 6 shows the breakdown of non-domestic rate revenue by sector.

Figure 6: Non-domestic rates by sector (England and Wales 198[illegible]/8[illegible]

2.3 Non-domestic rateable values are heavily concentrated in areas of commercial and industrial activity. Typically, urban centres have a much higher concentration of non-domestic property than rural areas. But there are many exceptions – for example, the contribution from a single power station can make up a very large proportion of the total rate income of a non-metropolitan district council. London is an extreme example of the degree to which non-domestic rates are concentrated in particular areas. The London area alone accounts for about one third of the total non-domestic rateable value of England. And within London, over half of the rateable resources are concentrated in the central boroughs of Westminster, Kensington and Chelsea, Camden and the City of London.

2.4 The poundages charged by local authorities also vary greatly – from 291.8p in the £ in Newcastle-upon-Tyne to 137p in the £ in Croydon in 1984/85. This means that similar businesses in premises with identical rateable values can face rate bills that differ by as much as 113% just because they are located in different authorities.

2.5 The characteristics of non-domestic rates have damaging implications – discussed below – both for the effective operation of businesses and for local accountability. These defects make non-domestic rates unsuitable as a locally variable tax.

Non-domestic rates and business

2.6 Non-domestic rates are one of the largest taxes paid by business. Figure 7 compares the yield of non-domestic rates on industry and commerce in Great Britain since 1975 with the yield of corporation tax and the national insurance surcharge. Although the yields are not directly comparable, the overall trends are clear. Since corporation tax is directly linked to the profitability of businesses, its yield fluctuates. National insurance surcharge declined in importance in line with Government policies until its final abolition in 1984. But the yield of non-domestic rates increased throughout the period. There is no correlation between the growth in non-domestic rates and the increase in costs in the economy generally.

Figure 7: Taxes on business (Great Britain, 1975/85)

2.7 Business representatives have expressed concern that this element of their overhead costs can vary erratically from year to year and from place to place. The impact of changes in and levels of non-domestic rates for businesses is less straightforward than that of other business costs. Normally if the price of an input – such as the cost of a particular type of material – rises, the first reaction of a firm would be to reduce its consumption of that input by switching to a substitute material or looking for another supplier. But with a change in the cost of occupying property that entails very drastic measures indeed. There are considerable costs in relocation. Until the Rates Act 1984 even "mothballing" empty industrial property carried no guarantee of reducing the rates bill.

2.8 Businesses therefore have to deal with increases in rate bills in different ways from increases in the cost of other inputs. In the medium to long term they will pass at least some of the cost back to the property market in the form of lower rents or capital values. In the shorter term – between rent reviews or the transfer of ownership – all of the variations in rate bills must be carried as an overhead cost. Where businesses are able to pass these costs on they will do so, in the form of higher prices charged to the consumers of their goods. Where the market will not allow price rises, increases in rates must be met by reducing investment, or the level of activity, which means fewer jobs. In extreme cases it can put a firm out of business.

2.9 Hard evidence of the effects of rates on business is scarce. A recent study commissioned by the Department of the Environment concluded that during the period 1974 to 1981 rates could not be shown to have had a significant overall influence on manufacturing employment, although high rate burdens in London were correlated with relocation of offices outside London. At the aggregated level at which the study was conducted, and over the particular period considered, these results are plausible. But they do not provide a good indication of detailed effects at a local level. Moreover, in the period studied, non-domestic rate poundages fell in real terms in all the regions considered except London, and in London itself there was very little manufacturing employment to provide an evidential base. The 1974 starting point also excluded the significant rate increases associated with the 1974 local government reorganisation and the effects of the implementation of the 1973 revaluation, which would have overshadowed subsequent movements in non-domestic rates.

2.10 How far business rate increases do affect the location and viability of businesses in particular areas must therefore still to a large degree be a matter of conjecture. For most firms, the burden of rates is not so significant that a change in its level would be likely to have a major impact on location decisions. But employers' organisations, both in the private and public sector, report that their members *have* been influenced by rates in making decisions on employment.

2.11 A more general concern is the impact which high and variable rate poundages have on the overall competitiveness of industry. If rates are passed on in higher prices they will damage the ability of British industry to compete with foreign businesses. If rates are absorbed by reduced investment that will, in the longer term, reduce productivity and again undermine the competitiveness of industry. If rates are passed back to the landlord there will be less incentive to develop land for business expansion – particularly in areas like the inner cities where other factors may make it difficult to secure an adequate rate of return.

2.12 Most costs that businesses face are fairly uniform across the country. But the rate burden can vary considerably even between neighbouring authorities. If this arises because of differences in rateable value, it is a reflection of the relative benefits of occupying different types of property in different localities and so is not a distorting factor—except to the extent that rateable values themselves are out of date and distorted. But differences in rate poundages are a different matter. These are a reflection of the spending policies of local authorities and have no connection with the resources being used by the business. Nor do differing poundages reflect different levels of benefit to non-domestic ratepayers. So rate poundages which differ sharply between different parts of the country will damage economic efficiency as businesses face differing cost structures which are unrelated to their real competitive strengths and weaknesses. Figure 8 shows the variation in non-domestic rate poundages, both nationally and for neighbouring authorities in Greater Manchester.

Figure 8: Variation in non-domestic rate poundages (1984/85)

2.13 On grounds of economic efficiency alone there is a case for setting non-domestic rates on a basis that does not distort the competitiveness of businesses simply as a result of the chance factor that they were located in one authority rather than another. And they have other defects in the context of local authorities' accountability to their electors for their financial decisions.

The effect of non-domestic rates on local authorities' financial decisions

2.14 The Government introduced a new consultation requirement in the 1984 Rates Act to promote discussion between local authorities and their non-domestic ratepayers. In some authorities such links were already well established. In others, the new arrangements represent a considerable improvement. But they still do not overcome the problem that local authorities, at the end of the day, are not directly accountable to their non-domestic ratepayers.

2.15 There is no voting right attached to the payment of non-domestic rates. However much a business might contribute to the income of a local authority, it cannot exercise any direct electoral influence over local taxation decisions that can have a profound effect on its competitiveness and on its scope for investment. Although an influential employer can put his views across to a local authority in many ways, and the relationships between many local authorities and local businessmen are excellent, the fact remains that local authorities are not *answerable* to the business ratepayers who provide a large proportion of their income. Local authorities can find themselves under extreme pressure to spend more on services for their electors largely at the expense of the non-voting non-domestic ratepayer.

2.16 The 1983 Rates White Paper argued in favour of domestic rates as a local tax that:

> "They are highly perceptible to ratepayers, and they promote accountability".

Neither argument is true of the non-domestic rate. Although non-domestic ratepayers actually write the cheques payable to the local authority, businesses do not ultimately bear the bill. As paragraph 2.8 above indicated, the final burden of the tax will rest elsewhere: with the consumers of the goods produced, the owners of the property occupied, the shareholders of the company, the workforce (either through lower wages or lower job creation), or the taxpayers who will pick up the bill for public sector bodies. These people will not perceive any link with the rating behaviour of the local authority. They are very likely to live outside the local authority's area altogether. So non-domestic rates fail the normal criteria for any local tax: that it should be perceptible to those who pay it as a tax imposed by the authority concerned, and that the taxpayers should be able to influence the behaviour of those who levy the tax.

2.17 In fact, non-domestic rates not only fail the test of accountability in terms of those who pay them and those who impose them. They also severely distort the link between the cost of providing local services and the costs faced by the local *domestic* taxpayers of an authority.

2.18 On average for every £1 raised locally from domestic taxpayers £1.50 is paid by the non-domestic sector. So the marginal cost of services to domestic taxpayers is reduced by a 60% contribution from non-domestic ratepayers. In a few authorities where there are particularly high non-domestic rateable values the marginal subsidy from non-domestic ratepayers is even greater. In Camden, for example, for every £1 contributed by the domestic ratepayer the non-domestic ratepayer contributes £4.55.

2.19 The extreme variations in non-domestic rateable values make it inevitable that there will be complicated grant arrangements to even out these differences in resources. Those arrangements in themselves make the connection between spending increases and changes in tax bills hard for local electors to understand. They may know that the expenditure of their authority and the grant it receives are in some way connected. But it is difficult to see how they are connected when the relationship depends simultaneously on the level of the authority's spending in relation to its assessed needs *and* the level of the authority's rateable values in relation to that of other authorities. The effect of "resource equalisation" within the grant structure is discussed more fully in Chapter 4.

Options for reform

2.20 To summarise, on grounds of both economic efficiency and local accountability, non-domestic rates are not a satisfactory local tax.

- They have an arbitrary and erratic effect over time and in different areas on the competitiveness of businesses.
- They fall immediately on those who have no vote to influence local spending decisions.
- They are ultimately borne by people who are unaware of how these extra costs arise and may not live in the area of the authority imposing the rate.
- They conceal the true costs of local services, and of marginal increases in spending, from domestic ratepayers.
- They make complicated grant arrangements—which further distort the impact of changes in expenditure—inevitable.

2.21 There are three possible ways forward in dealing with these problems. The Government could consider the complete abolition of non-domestic rates, making up the lost revenue from some other source. It could seek ways of making local authorities genuinely answerable to their business ratepayers. Or it could look for ways of eliminating the damaging variability of non-domestic rates.

2.22 There are few taxes that could be substituted for the non-domestic rate and so make it possible to abolish it altogether. The only business tax with a similar coverage to non-domestic rates and capable of producing a broadly equivalent yield would be some form of payroll tax. The Government has no intention of introducing such a tax on jobs. The yield of non-domestic rates could alternatively be replaced by increasing a national tax not levied on business: for example, by adding [redacted] percentage points to VAT or increasing basic rate income tax by 6½p. The Government is not prepared however to damage work incentives by increasing income tax. Nor would an increase in the rate of VAT be acceptable as a means of replacing the yield of non-domestic rates.

2.23 Those who argue that the problems of non-domestic rates are best tackled by making local authorities answerable to their non-domestic ratepayers often advocate reintroducing a business vote or establishing a separate class of membership of local authorities for representatives of business. But this approach looks to be unworkable. The previous business vote fell into disuse and was eventually withdrawn in 1969 because it was available only to sole traders or partners in businesses operating in the area. A large proportion of businesses are now limited companies, many of which are trading in more than one local authority area. It would not be practicable to devise satisfactory arrangements for voting by limited companies. For example, who would exercise the vote of the large retail chains with branches in most shopping centres? Establishing a separate class of local authority membership for businesses would not resolve the conflicts in accountability which exist at the local level and would be regarded by many as an infringement of basic democratic principles.

2.24 If these approaches – abolition of non-domestic rates, or making local authorities directly answerable to business ratepayers – have to be ruled out, the unsatisfactory characteristics of non-domestic rates as a local tax will have to be tackled by retaining non-domestic rates but directly restraining their variability. This means transferring to central Government the power to determine the non-domestic rate poundage, although the proceeds of the non-domestic rate would continue to be applied in support of local government spending. Inevitably, this will mean some reduction in local government's control of its revenues.

Setting the non-domestic rate

2.25 In deciding how to set the non-domestic rate central government could choose broadly one of two starting points. The existing pattern of rate poundages could be frozen. Or central Government could set a national rate poundage that would apply in all local authority areas. Starting from existing rate poundage levels would ensure that individual rate bills did not change as a result of the move to the new system. But it would do nothing to remove the inefficiency inherent in the present arbitrary distribution of rate poundages in different parts of the country. Nor would it redress the disincentives to investment, job creation and new development in high spending local authority areas which presently exist because of the existence there of high rate poundages. Many of these are older urban areas which can ill afford to deter business in this way. As Annex D shows there is a strong correlation between the areas which would derive most benefit from a national rate and those which presently suffer the highest rates of unemployment. For these reasons the Government's preference is for a uniform national business rate.

2.26 Whichever approach is adopted, several questions have to be addressed. Both local government and businesses would require assurances about the way in which any new arrangements would be operated. Businesses will be concerned to ensure that the new arrangements do not lead to an increase in the proportion of local government spending financed by their rates. Local authorities will want to be sure that the contribution from businesses does not fall, leaving them to find more of the money to support their spending from local domestic taxpayers. The intention would be that the yield of the non-domestic rate should remain broadly unchanged in real terms as a result of the new arrangements.

2.27 This entails setting a starting level that corresponds with the present level of support from non-domestic ratepayers, and subsequently raising that level in line with inflation. On the Government's preferred option the initial level would be achieved by setting a uniform poundage equivalent to the average of the individual poundages, in real terms, set in the preceding year (but see paragraph 2.34 below). Otherwise a poundage for each authority would be set corresponding to the real value of the poundage in that area in the preceding year. The best way of ensuring that business rates continued to meet a fair share of local spending in future years, and that increases were predictable and allowed businesses and local authorities to plan ahead with confidence, would be to index the initial poundages. The indexation should be provided for in primary legislation so that the arrangements could not be overturned without fresh consideration by Parliament.

2.28 There is a choice of possible indices. Some social security benefits are linked to rises in the Retail Price Index and are uprated once a year in the light of increases over the previous period. The alternative would be to use a forecast measure of inflation for the year to come. The Government publish such a forecast each year in the Chancellor's Autumn Statement as required by the Industry Act 1975.

2.29 Nationally the total of non-domestic rateable value continues to grow at an average rate of between 1 and 2 per cent per annum as net additions are made to the stock of properties. Indexation of the poundage without an allowance for such growth would result in a more rapid rise in the aggregate yield than in the rate of inflation. It would be for consideration whether, in specifying the arrangements for indexation, it would be appropriate to make an offset for this effect.

Distributing the proceeds

2.30 Whatever the basis on which the non-domestic rate were set, the total yield of the tax would be hypothecated to local government expenditure. The proceeds would be pooled and redistributed to authorities in such a way as to lower the rate of the local domestic tax by the same amount per adult in all authorities. It would be necessary to moderate the distributional impact of this change on local authorities' income. Possible measures for doing so through a "safety net" arrangement are discussed in Chapters 4 and 5.

2.31 This simple process of pooling and redistribution would replace the complicated equalisation of non-domestic rateable values which presently takes place within the block grant arrangements. It would do so in a simple, straightforward and understandable way which would not lead to instability in grant entitlements within years and would not obscure the basic relationship between expenditure and local taxes. This transparency is a major benefit which will make this method of distributing the non-domestic rate an essential element in the new local government finance system.

Local dialogue

2.32 In the 1984 Rates Act the Government for the first time required local authorities to consult with representatives of non-domestic ratepayers before setting their rate or precept. That legislation was a response to the failure by certain local authorities to enter into any serious dialogue with businesses in their areas about the services which were needed and the level of rates which businesses could reasonably afford to pay. Early experience of the first round of statutory consultation has shown that in some areas these provisions have proved extremely helpful in bringing together councils and their local employers. In other areas businesses continue to complain that their authorities are merely going through the motions. Although there are many reasons why councils and their local businesses should consult, there is a risk that removing from local government the right to determine the level of the non-domestic rate will reduce the incentive for such discussions to take place. We need to consider further ways of encouraging a fruitful dialogue between local authorities and businesses in all areas.

2.33 Many commentators in recent years have also pointed out that the existing grant arrangements give local authorities no incentive to encourage development of their rateable value base. The complete compensation for variation in rateable values through "resources equalisation" ensures that, after a short time lag, authorities neither gain nor lose from changes in their rateable value. There is little or no incentive to encourage development and redevelopment.

2.34 One approach to meeting both objectives would be to allow local authorities to retain the discretion to levy a small rate on their non-domestic rate base, after consultation with their non-domestic ratepayers, and to retain in full the proceeds of such a rate. This could be limited to a poundage equivalent to, say, 5% of the national non-domestic rate (or 5% of the national average rate if the capped poundage method were adopted). The required national non-domestic rate yield would be set 5% lower to reflect this headroom.

Administrative arrangements

2.35 The non-domestic rate would continue to be collected by local authorities under the existing well-established arrangements. Of the amount collected they would be entitled to retain a sum equal to their entitlement from the redistribution of the national pool together with any entitlement to rate support grant. Any remaining surplus would be remitted to the Department of the Environment (or Welsh or Scottish Offices as appropriate) for redistribution. Where the yield of the non-domestic rate was less than an authority's entitlement to its share of non-domestic rates or rate support grant, it would receive payment of the balance. As at present, upper tier authorities would not collect rates. They would receive rate support grant and payments from the non-domestic pool.

2.36 Non-domestic ratepayers would continue to have the right to pay rates in instalments. The schedule of payments by local authorities to or from central Government would take account of that.

2.37 If, in the light of consultation, the Government decided to proceed with the proposal for a small discretionary local non-domestic rate with a maximum limit, upper and lower tier authorities would share the proceeds and rate demands would make it clear whether, and the extent to which, each tier was making use of its discretion.

2.38 With separate arrangements for non-domestic and domestic local taxes it would be necessary to re-draw and clarify the borderline between domestic and non-domestic property. The dividing line would fall between residential property which is occupied as a main or only residence and residential property which is not occupied on that basis. Hotels and boarding houses, therefore, would continue to be regarded as non-domestic property, like other businesses, and liable to the non-domestic rate except where the predominant use of the property is as a main or only residence for those who live there. Detailed discussions would be required to establish the boundary line. It would be a matter for the Inland Revenue Valuation Office to decide, on the facts, whether a property should be subject to a non-domestic rate. Existing arrangements also provide for a category of "mixed hereditaments" where there are both non-domestic and domestic uses. These arrangments would also require some alteration and in determining both the non-domestic and mixed categories it would be necessary to provide for an appeal procedure. Separate arrangements are proposed for second homes. These are set out in Annex G.

Rates on Government Property

2.39 Crown Property is not liable for rates. The Treasury, however, through the Rating of Government Property Department, makes contributions in lieu of rates on the basis of a rateable value equivalent negotiated between that Department, the Inland Revenue Valuation Office, and the local authority concerned. There may be more efficient ways of achieving this under new non-domestic rate arrangements — for example by a direct payment into the national non-domestic rate pool. There would, however, be a case for contributions to continue to be made in respect of local domestic taxes where the Crown Property concerned is residential in nature. The Government would wish to consult with the local authority associations about such arrangements and about which Crown Properties should be covered by them. Would it, for example, be appropriate for prisons to be treated in this way?

Non-domestic revaluation

2.40 Since non-domestic rates are to continue as a major source of tax revenue it is important to ensure that they are levied on as firm and consistent a base as possible. Since the 1973 revaluation, values have become badly out of line in some areas. The Inland Revenue Valuation Office has therefore been asked to start work on a revaluation of non-domestic properties with a view to preparing a new list in time for introduction on 1 April 1990. The revaluation will be based as before on evidence of rental values.

2.41 For the longer term, after the initial non-domestic revaluation has been completed, the Government believes it is essential to return to regular revaluations for the non-domestic sector. These could be at five yearly intervals as previously provided for. An alternative might be to introduce a process of "rolling revaluation" for the non-domestic sector. For example, one-fifth of all properties might be revalued each year. The information obtained might then be used to develop indices which could be applied to the properties which were not to be revalued that year. Such an approach could reduce substantially the degree of turbulence associated with a quinquennial revaluation of all properties.

2.42 If a satisfactory system of rolling revaluations could be devised, it would be possible, instead of indexing the nationally-determined non-domestic rate poundage to the rate of inflation as discussed in paragraphs 2.27-2.29 above, to freeze the poundage, but instead allow the buoyancy of rateable values to cause the yield to rise in line with the increase in non-domestic property values. The Government will issue a separate consultation paper on the practical issues arising from a system of rolling revaluations.

Transition

2.43 The national non-domestic rate poundage should be introduced at the same time as the new non-domestic rateable values. Both sets of changes would affect rate bills for businesses. This impact is considered more fully in Annex D. In many cases the two sets of changes would be offsetting. In other cases the effects of the two changes would combine to give substantial overall changes in rate liability. There would therefore be a good case for phasing in the combined effects over several years.

2.44 If existing rate poundages were simply capped, the new rating liabilities would reflect only changes in the value of the properties occupied, not changes in the method of setting poundages. There would still be a case for phasing in those changes, but a shorter transition period would be appropriate.

Conclusion

2.45 The proposals in this chapter on the future of the non-domestic rate are central to the Government's proposals for the reform of local government finance as a whole. By substantially removing the discretion of local authorities to vary the non-domestic rate and by the arrangements for pooling and redistributing the yield described above it will be possible simultaneously to introduce a radical simplification of the grant arrangements and close the gaps which exist between those who vote for and those who pay for local services.

2.46 For businesses these proposals offer certainty about the overall speed with which non-domestic rates can be expected to grow and an ending of arbitrary variations in the sums demanded of them. This should aid those making investment decisions to plan with greater confidence. The commitment to regular revaluations or a rolling revaluation will reinforce this certainty.

2.47 Local authorities, for their part, will continue collectively to enjoy the full benefits of the non-domestic business rate. But it will no longer be open to individual authorities to require businesses in their area to pay a disproportionate share of additional spending.

Chapter 3: Local domestic taxes

3.1 It is often said that domestic rates have existed for nearly 400 years and have stood the test of time. As mentioned in Chapter 1, however, rates in their present form appeared only at the end of the last century. Between their inception and their final emergence in their modern form, the rates underwent major changes in response to changes in social and economic conditions and in local government responsibilities.

The history of rates

3.2 In earlier times rates were levied on the basis of two separate principles. There was the "redistributive principle", under which rates were levied generally to pay for services — like the Poor Relief dating from Elizabethan times — which benefited poorer members or the community. And there was the "beneficial principle", under which rates were levied on particular groups to share out the cost of providing an amenity from which they all benefited. Rates which were redistributive initially took as their base the value of land: in a largely agrarian economy the occupation of land was a reasonable measure of ability to pay and the ownership of land was linked to the right to vote. For services which provided a direct benefit the basis for dividing the cost varied according to the service provided. For example, the cost of sea defences might be shared between landowners according to the relative amounts of their land that would be protected by the works.

3.3 The transition to an industrial society, and the growth of the towns, brought with it the need for more communal services and new forms of local government. The existence of many separate rates for different purposes then became unwieldy. A process of consolidation started. In the absence of arrangements to reduce the cost of these new services to those with low incomes the "redistributive principle" gained the ascendancy over the "beneficial principle" in levying rates. By [illegible] the present system of elected local authorities largely financed by a single property rate was firmly established. Until after the First World War this local tax raised more than income tax and was the major source of tax revenue with any element of progressivity.

3.4 Since that time there have been many refinements to the rating system, including the standardisation of valuation procedures. But, with the exception of agricultural derating in 1929, there has been only one major change in its operation. In 1965 the Allen Committee investigated the imperfect relationship between the value of property occupied and the taxable capacity of the occupants. As a result of their findings a system of rebates to mitigate the impact of rates on those with the lowest incomes was introduced. These rebates are now incorporated in housing benefit.

3.5 But while during this century rates have remained largely unchanged, much else concerned with local government has not. Many new responsibilities, in education, in public health and in housing have been placed on local authorities. Central Government has taken a role in promoting more uniform standards of key servicces. And it has taken complete responsibility for several of the services originally provided locally, most importantly the relief of poverty. Over the same period Exchequer grants to local authorities have become much more significant so that a large part of local spending is now effectively paid for by central taxation. The period has also seen the rapid extension of the franchise. Today, after progressive extensions, the local vote is available to any resident Commonwealth citizen or citizen of the Irish Republic over the age of 18.

Criteria for a local tax

3.6 In the light of these important changes in the franchise and in the scope of local authority services, it is appropriate to look again at the suitability of domestic rates as a local tax. There are three main tests that a local tax should satisfy:

- is it technically adequate?
- is it fair?
- does it encourage local democratic accountability?

(i) Technical adequacy

3.7 The 1981 Green Paper "Alternatives to Domestic Rates" (Cmnd 8449) discussed the technical adequacy of local taxes under a number of separate headings. In particular it argued the importance of cost-effective administration and the need for any local tax system to fit in with the overall national tax system. A further requirement was that a new local tax had to be compatible with sensible and tight budgeting — "proper financial control". The yield had to be predictable and not lumpy so that local authorities could plan ahead and make small discrete changes in the tax rates. The Green Paper pointed out that a local tax which increased imperceptibly would be less effective in securing proper financial control. The final technical criterion was that the local tax had to be suitable for all tiers of local government, taking account of the varying responsibilities of the tiers and differences between the non-metropolitan and metropolitan areas.

(ii) Fairness

3.8 As the brief historical outline earlier in this chapter showed, a consideration of the fairness of local taxes needs to take account of both the "beneficial principle" and the "redistributive principle". The present local tax — domestic rates — is accused of inadequacy in both respects.

3.9 Domestic rates do not properly reflect the use of local services by a household. The single person does not make the same demands as a large family in identical property, yet will face the same rate bill. At the turn of the century many more local services offered a particular benefit to owners of property: water, gas and electricity were all provided by local government as well as the police and fire services. But the balance has now swung heavily to more personal services. Education, personal social services and libraries, for example, now account for [redacted]% of local authority expenditure. A tax based on the value of properties obviously will not be closely or consistently related to the use of such services.

3.10 Rates are also said to be unfair in relation to the "redistributive principle". Figure 9 sets out the present relationship between rateable values and incomes in England. Those with the lowest incomes are liable to much higher rates in relation to their income. The rate rebate scheme was introduced to offset this effect. The more detailed analysis in Annex F shows the very wide variations concealed by the averages. 10% of households with net weekly incomes above £300 per week live in properties with a rateable value below £150 (78% of the average rateable value), while at the other end of the income scale 19% of those with net weekly incomes of less than £50 per week live in above average rateable value properties. So for many households there is no relationship between their income and the rateable value of the property they live in.

Figure 9: The relationship between rateable values and incomes (England 198[redacted])

(iii) Local democratic accountability

3.11 Consistent with the approach outlined in Chapter 1, the Government considers that the third test — whether a tax is conducive to proper local democratic accountability — is now of crucial importance. It is the key to an approach to local government finance that rests on responsible local spending decisions and a reduction in central Government intervention.

3.12 To meet the central criterion of the accountability of local authorities to their electorates a local tax must have the following features:

— the tax base should be wide so that the burden is not unfairly concentrated on too few shoulders and a substantial proportion of electors have a direct financial interest in the decisions of their authority;

— there should be a clear link between changes in expenditure and changes in the local tax bill; at present rate bills are a poor indicator of what is happening to a local authority's spending.

These are essential if local voters are to have a direct stake in their local authority's spending decisions and to understand how those decisions will affect them.

Possible forms of local tax

3.13 Although domestic rates account for only ●% of local spending, their total net yield is still a substantial figure—£4.5bn in 1984/85. There are only four broad categories of taxation that would be technically capable of raising such a figure. These are taxes on property (like the rates themselves); sales taxes; income taxes; and residence taxes. There are examples of the use of all of these at local level in various developed countries. A brief description of the arrangements in other OECD countries is given in Annex K. The suitability of the different taxes in a particular case depends very much on the constitutional and structural framework of local government in the country concerned, as well as on the inherent strengths and weaknesses of the tax.

3.14 All of these alternative forms of tax were extensively discussed in the 1981 Green Paper "Alternatives to Domestic Rates" and in the subsequent White Paper. The following sections re-examine the case for and against their use at local level in the light of the technical issues and criteria covered in that Green Paper, but also with particular regard to the crucial local accountability criteria set out in paragraph 3.12 above.

Domestic Rates

3.15 The 1983 rates White Paper recognised the technical strengths of domestic rates, while acknowledging that rates were not an ideal or popular tax. It put forward the following advantages for rates:

> "They are highly perceptible to ratepayers and they promote accountability. They are well understood, cheap to collect and very difficult to evade. They act as an incentive to the most efficient use of property."

The White Paper recognised that a property tax would not relate directly to ability to pay, and hence accepted the need for rebates at the lower end of the income scale.

3.16 Domestic rates thus score well on the technical criteria set out in the 1981 Green Paper. And they retain some links—though much attenuated—with the original "beneficial" and "redistributive" principles. Some local authority services—such as the fire service, land drainage, flood protection, development control—still provide a greater benefit to property owners than to other local residents. And it is probably true as a broad generalisation that those people living in the more valuable houses in an area can more easily afford to pay local taxes, although there are many exceptions to this rule. But how do rates fare against the criteria for a local domestic tax which will promote accountability?

3.17 The 1981 Green Paper argued that rates did promote accountability since they were highly perceptible to ratepayers. But while that is true, it does not take adequate account of the relatively small numbers of electors who are ratepayers. While rates are highly perceptible to those who actually pay them, they are much less so to those who are not directly liable for rates such as spouses and adult children living at home, and to those who benefit from the rebate system. The proposals in the recent "Reform of Social Security White Paper" (Cmnd 9691) will mean that the three million households in England who presently pay no rates at all because they receive full rate rebates will in future meet at least 20% of their rates bill. Even this reform will leave some 17m adults who are not *directly* liable to local taxes yet who can vote in local elections. This is inevitable if the local tax is levied on a household, not an individual, basis. So domestic rates fail the first test of a suitable local tax. They fall on too few shoulders.

3.18 Rates also fail the test of giving clear signals to those who pay. Unlike income taxes, which are based on actual income, or sales taxes which are levied on actual transactions, rates have to be levied on a constructed tax base which does not automatically update itself. Rateable values therefore have to be periodically revised. If there is a long period between valuations there will be large changes in relative values and consequently large shifts in the tax burden. These large changes are one of the main reasons for the unpopularity of rates. Smaller changes would occur if revaluations took place over relatively short periods. But then domestic rate bills would be constantly changing for reasons quite unconnected with changes in local expenditure. That is bad for local accountability. A further difficulty with rateable values is that they are very unevenly distributed between areas so that there are large differences between local authorities in rateable value per head. This has required complex compensation arrangements through central grants which again lead to variations in rate bills which are not easily related to local decisions on expenditure.

Local sales tax

3.19 A local sales tax, levied on top of VAT and with the same coverage, could replace the yield of domestic rates if it were levied at a rate of 6%. So a local sales tax certainly could bear the weight of replacing rates. It would also be paid by all consumers, which would meet the criterion of wide coverage. But it has few other advantages, and was dismissed summarily in the 1983 White Paper.

3.20 That conclusion remains valid. A local sales tax would not be perceived directly by those able to vote in local elections. It thus fails one of the key tests for a new local tax. It would also entail considerable additional administrative complexity. The yield would be lumpy and would fall very unevenly indeed. Regional shopping centres would benefit at the expense of their neighbours. For example, shopping floorspace per adult in Newcastle is over twice that of neighbouring Gateshead. Gateshead would probably need to levy at least twice as high a local sales tax as Newcastle for the same revenue per adult, which would drive its shoppers to the neighbouring authority. So Government grant would continue to be necessary to compensate for the differences. This would mean that Gateshead residents would pay for a lot of Newcastle's services, and national taxpayers would pay for the bulk of Gateshead's. In addition, there would be problems in apportioning the yield of local sales tax on services and there would undoubtedly be an additional burden on business.

Figure 10: Distribution of shopping floorspace per adult in North East England

3.21 Local excise duties—road fuel duty, alcohol duties and vehicle excise duty—were also considered in "Alternatives to Domestic rates" as possible replacement taxes for rates.

3.22 All such taxes however fail the first test for a new local tax—that it should be paid by all those able to vote in local elections. Local alcohol and vehicle excise duty would naturally fall on particular groups of consumers. Local road fuel duty would be passed on to a wider range of people in the form of higher costs of goods and services but the impact in this form would be imperceptible and would not be closely identified with the locality in which it was levied.

3.23 A local vehicle excise duty might be more feasible as a supplement to another local tax. The drawback with this however is the very uneven distribution of car ownership between authorities. According to the 1981 census the number of cars varies from 0.41 per head in Hertfordshire to 0.20 per head in Tyne and Wear. So a locally variable vehicle excise duty used as a supplement would require complicated equalisation arrangements which would destroy the link between spending and the main local tax.

Local Income Tax

3.24 A local income tax at an average rate of 4½p in the pound would be capable of replacing the present net yield of domestic rates. The introduction of a local income tax would represent the final shift away from the "beneficial principle" of local taxation towards the "redistributive principle". It would remove the need for a separately administered rebate scheme. But it would be necessary to have a system of equalising grant to iron out differences in the taxable incomes of different authorities. Otherwise authorities with large numbers of residents with low incomes would have to levy higher taxes to finance similar levels of spending. Unless there were special provisions to limit the total revenue authorities could raise, local income tax would provide local authorities with a more buoyant tax than they have had hitherto.

3.25 There are three main objections to the replacement of domestic rates by a local income tax:

— an extension of taxation of incomes would run counter to the Government's commitment to reducing the burden of tax on incomes;

— a local income tax would not underpin local accountability;

— it would not be appropriate to rely too heavily on a redistributive tax to fund local authority services.

3.26 The reduction of income tax is a major objective of Government policy. The replacement of domestic rates by a local income tax would require an increase in the average basic rate of income tax from 30p to 34½p. In some authorities the rate would be lower – but in other authorities it could be considerably higher. Simply converting present average rate bills into average local income tax rates would produce a range of local income tax rates from [redacted]p to [redacted]p, so that in some authorities basic rate taxpayers would face a combined marginal rate of income tax of [redacted]p.

3.27 Local income tax does not adequately meet the criteria set out in paragraph 3.12 for a local tax which would underpin local accountability. There are 20m income taxpayers in England, compared to 18m householders and 35m voters. So while the introduction of a local income tax would widen the tax base, there would still be only 57% of the electorate who were paying local tax, and some households would not be liable for any local tax.

3.28 A local income tax could be collected nationally at the same time as national income tax. This would require the Inland Revenue to identify the residence of all income tax payers. It would add to the compliance costs of businesses, which would have to cope with a range of different local income tax rates to be deducted from employees' salaries, and thus run counter to the Government's objective of reducing bureaucratic burdens on industry. A national collection scheme would make local tax payments largely imperceptible to local taxpayers. That would undermine accountability.

3.29 To overcome this the tax might be administered by local authorities themselves. But this would require either separate declarations of income to local authorities or the passing of confidential information about individuals' taxable income from the Inland Revenue to authorities. The additional administrative cost entailed in local collection is likely to be very high.

3.30 The third objection to a local income tax is rather different – that local income tax is not an appropriate tax for local authorities. There is a broad distinction to be drawn between the roles of central Government and local authorities. Local authorities' essential role is to provide services – some "beneficial", some "redistributive". Local councillors are judged on their performance in delivering these services. Local government has no responsibility for the performance of the economy. That is solely the responsibility of central Government. This division of responsibilities should be reflected in the taxes that the different levels of government levy.

3.31 The ideal local tax should fit in with local authorities' role as a service provider and promote the efficient provision of services to the levels desired by most members of the community. That argues in favour of a form of taxation which has at least some of the characteristics of a charge. It argues against a redistributive tax. Furthermore, since local authorities are held accountable for services but are not held accountable for national economic performance, they would naturally be inclined to use a buoyant tax such as income tax, which rises imperceptibly, to finance an expansion of services without considering the economic benefits of reducing income tax rates or raising allowances. This would weaken the Government's capacity to manage the economy as a whole and cut across broader fiscal policy objectives.

3.32 For all these reasons the Government is not prepared to introduce a local income tax.

The way forward: a community charge

3.33 Of the alternatives considered so far, only a local sales tax would meet the first condition specified in paragraph 3.12 – that a tax to promote accountability should be paid by all those who are eligible to vote in local elections. But sales tax fails the second test – of bringing home to voters the cost of local authority spending. The other options considered fail both tests.

3.34 The search for the best local tax has been an attempt to reconcile conflicting objectives – the "redistributive principle" and the "beneficial principle". It is clear that *no* tax could satisfy both aims simultaneously, and that, with the structure of local government in this country, only rates or a tax on residence are technically capable of being applied at the local level in a way that has regard to local accountability. Of the two, rates are far less satisfactory. They are no better related to ability to pay than a flat-rate charge would be, as Annex F shows, and they are less well related to use of local authority services which now more closely reflects the number of people in a household than the value of the property occupied. Furthermore they fall on a narrow section of the local voting population.

3.35 The Government therefore proposes to introduce a new flat rate charge – a community charge – for local services, payable at the same rate by all the adult residents of a local authority. Such a charge would be more perceptible than rates. Each local authority would determine the level of its own community charge. All adult residents would be liable to pay, not just householders. If each local authority is to be accountable to those who have to pay for its expenditure, clear and comprehensible price signals must be given to all local taxpayers. A community charge will achieve this, for all local residents will face similar bills.

3.36 Moving from rates to a flat-rate community charge would mark a major change in the direction of local government finance back to the notion of *charging* for local authority services. Chapter 7 outlines the Government's approach to increasing income from charges for those services where it is possible to levy specific charges, and where people have a genuine choice of whether to use the service or not. But although there is scope for extending user charging, most local authority spending will inevitably not be financed by such charges. For this large element of local spending, a community charge would provide a closer reflection of the benefit from modern people-based services than a property tax. Like the rates, it would of course need to be rebated for those with low incomes.

3.37 As Figure 11 shows, the community charge performs no worse than rates in relation to ability to pay. At the very lowest income levels, poor people would face lower average bills with a full community charge than with domestic rates.

Figure 11: [title]

Moreover, the bulk of local authority services will continue to be funded from national taxes or the non-domestic rate. In aggregate, therefore, people with high incomes will be paying for a much larger share of local services than those on low incomes.

3.38 "Alternatives to Domestic Rates" concluded that a flat-rate charge payable by all adults would meet all the technical criteria descibed in paragraph 3.7. It would be capable of producing a yield equivalent to that of rates, would be suitable for all tiers of local government, and would be conducive to proper financial control. But in the White Paper, the option of introducing such a tax was rejected. The major objections put forward were operational:

> "... the tax would be hard to enforce. If the electoral register were used as the basis for liability it could be seen as a tax on the right to vote. A new register would therefore be needed. but this would make the tax expensive to run and complicated, particularly if it incorporated a rebate scheme."

Operational issues are considered briefly below and in more detail in Annex G. They are not insuperable. In view of the overriding importance of increasing local accountability through the introduction of a community charge these problems must now be tackled.

Transition

3.39 The move from rates to a community charge will inevitably affect the personal finances of households since single-adult households gain at the expense of multi-adult households. The Government considers that the change should be made gradually by introducing the community charge initially at a low level. In the first year of the new scheme rates would be reduced – by, say, an amount equivalent to the yield of a £50 per adult community charge. That would mean that the overall position of the average two-adult household would be broadly unaffected: their rates would go down by about £100, but they would have to pay an additional £100 – £50 per adult – in community charges. In some authorities where rate bills are low, a £100 reduction in rates would be a large proportionate reduction. In other authorities, mainly in London and South East England where some authorities have domestic rate bills in excess of £500 per adult – over £1000 a year for a two-adult household – it would be a much smaller proportionate cut and rates would continue to meet a large part of the local tax bill. All those paying local taxes for the first time would however face a similar bill, and there would be a similar *cash* reductions in rate bills across the country. And in all areas single householders would pay less, and households with more than two adults would pay more, towards the cost of local services.

3.40 In subsequent years any additional local revenue would be raised through the community charge. That would ensure that the cost of extra spending would be met in full by all local residents. There would remain, however, in all authorities some residual rate burden. It would be possible to freeze this sum, and leave it frozen until it constituted a sufficiently small proportion of the total local tax bill to be wound up. But that would mean that rates would continue well in to the 21st century. The Government's objective is to replace domestic rates entirely within a reasonable timescale.

3.41 But people will need time to adjust. It is reasonable to expect domestic rates to have been phased out completely within 10 years of the introduction of the new system. In order to achieve this it will be necessary to require periodic transfers from rates to the community charge. In Scotland and Wales, and in parts of England where rate bills are not high it will be possible to move relatively quickly. But in parts of England where there are higher rate bills a longer period of adjustment will be necessary. This will mean that rates will disappear in some areas before others. Separate arrangements could be made for the transition in Scotland and Wales.

Operational issues

3.42 As paragraph 3.40 made clear, the previous examination of alternative local taxes concluded that the major objections to a new flat-rate charge were operational. The Government recognises that there would be problems in any move away from a tax on property to a personal tax. This would of course apply just as much to local income tax, for example, as to the community charge. Residence would have to be defined and people would have to be registered for the tax. Since the tax is not a tax on the right to vote – and would be paid by people such as foreigners who do not have the right to vote in UK elections but who would benefit from local services – the Government proposes that there should be a separate register for this purpose. A separate register would also be necessary because, unlike the electoral register, the new community charge register would be a "rolling register" – people would register or deregister when they changed their main or only residence. The additional administrative and enforcement costs of the new tax would be to some extent offset as the costs of running the domestic rating system, in particular the operations of the Valuation Office, were reduced. There would be no need for complex revaluations if rates in many authorities were to disappear within a relatively short period of years. An outline of the basis on which the community charge might be administered is given in Annex G.

3.43 There would inevitably be less than 100% compliance with the community charge, as with all taxes. However local authorities would have a variety of resources at their disposal. They would be able to draw on local records including the electoral register for names and addresses of residents, and to supplement this information with a personal canvass of households in order to compile the new register. These measures could be backed up by checks on those using local services. Local authorities would have every incentive to compile an accurate register to maximise the yield of the community charge. It would probably be necessary to make the deliberate failure by a head of household to register someone resident in his house a criminal offence (as is the case already for the electoral register); but it should be necessary to prosecute only in extreme cases. Once a person is registered his liability to pay the charge will be enforced in the same way as rates are now.

3.44 Domestic rates can bear harshly on households with low incomes, in particular single householders occupying a family home. Rates rebates, now part of housing benefit, were introduced to help such households. The Government considers that it would be better for there to be an explicit income support scheme operated through the social security system than to obscure the true cost of the local contribution to services by, for example, having a lower level of charge for those with low incomes. Either approach would require a test of income. Direct income support would be the most efficient way of helping the poor without distorting the signals to the majority of taxpayers who do not require special assistance.

3.45 The community charge would have a different impact from domestic rates because it would reflect the size of the household. The Government would therefore have to consider how best to provide support for those on low incomes. The new housing benefit scheme set out in the White Paper on social security provides help with domestic rates to low income householders but requires every household to make a minimum contribution towards them. One option would be to modify the present scheme to apply to the non-householders who will be liable to the community charge. This is discussed in Annex G. Other options might be based on modifications of the main income related social security benefits – income support and family credit. Whatever method may be adopted, the provision of help to low income households should not impair the key objective of the new community charge – to enhance the accountability of local authorities to their electors.

3.46 In conjunction with the new treatment of non-domestic rates and the new grant arrangements discussed in Chapter 4, the community charge would introduce new pressures for financial responsibility which are absent under existing domestic tax arrangements and lead to a healthier climate for local accountability.

Chapter 4: Grants to local authorities

4.1 Chapters 2 and 3 set out proposals for major changes to the way in which non-domestic rates are paid, and for a new system of local domestic taxation designed to increase local accountability. In 1984/85 about 28% of the cost of providing local authority services in England was met by non-domestic ratepayers. A further 23% came from domestic rates. But the largest contribution to local government expenditure, 49%, or £11.9bn was provided by national taxpayers as central Government grants. The bulk of this – £8.4bn in 1984/85 – takes the form of a block grant in support of local government expenditure generally. Of the remainder, £2.8bn in 1984/85 was accounted by grants in aid of specific services and £0.7bn by domestic rate relief grant (see Annex B). Grants are administered separately in Wales and Scotland, where respectively 67% and 54% of expenditure was met by grant in 1984/85.

Grants and local accountability

4.2 The Government intends that grants should continue to play an important part in the local government finance system. It is essential, therefore, that they should contribute towards the Government's overall objective of increasing local accountability which is central to the proposals in this Green Paper. The present grant arrangements do not meet this requirement.

4.3 Under the local taxation proposals set out in Chapter 3, all adults living in an area will be helping to pay for the services that are being provided, as well as having the chance to vote for them. In addition to bringing the tax base more closely into line with the electorate, however, the new arangements must also ensure that taxpayers can see a clear link between changes in their authority's expenditure and the corresponding changes in local tax bills. The grant system must operate in a way that enables local residents to see the extent of the support that is being provided. In addition, it must not obscure the spending behaviour of their authority by distorting the relationship between expenditure and taxes at the margin. And it must be stable; otherwise changes in grant entitlements within and between years will prevent local residents from seeing the link between their authority's spending and their local tax bills.

4.4 This chapter examines the development of Government grants and their place in the local government finance system and sets out proposals for reforming the grant arrangements to meet the objective of improved accountability.

Why do we have grant?

4.5 Grant systems for local authorities have grown up because, although it is important for the proper functioning of local government for it to have its own sources of income, successive Governments have taken the view that it would not be appropriate to expect the whole cost of providing local authority services in each area to be met solely by the local taxpayers of that area. This reflects a continuing policy that services that are national in character, such as education, or of national importance, such as the police, should be provided to an acceptable standard country-wide whether or not the taxpayers of particular areas can afford to pay for them. Over the last 20 to 30 years, Government grant systems have sought to achieve this objective by three different means: compensating for differences in *expenditure needs* between local authorities; compensating for variations in local authorities' *taxable resources* and ensuring that a substantial proportion of local authority expenditure is paid for out of *national taxation.*

(i) Equalising needs

4.6 Some authorities inevitably face much greater calls on their services than others. The proportion of the population which is of school age, for example, varies widely across the country: primary and secondary schoolchildren make up 17% of the population in Knowsley but only 9% in Richmond. At the other end of the age scale, the proportion of pensioners living alone ranges from 46% in Westminster to 28% in Harrow.

4.7 It also costs more to educate a child or provide support for an old person in some parts of the country than in others. One reason is the nature of the area. Thinly populated areas face higher transport costs, for example. And other factors can also have a big impact – like the extra cost of educating children whose first language is not English. Authorities in London face higher wage bills as a result of the need to pay their staff London Weighting.

4.8 Where an authority has a concentration of needy people, or is faced with higher costs, it would be unreasonable to leave the entire financial burden to be met locally. To do so would mean that local residents would have to pay higher levels of local taxation than those in other authorities for an acceptable standard of service.

(ii) Equalising resources

4.9 Under the present local government finance arrangements, the taxable capacity of local authorities is measured in terms of rateable value per head of population. This varies greatly from authority to authority, largely as a result of the concentrations of industrial and commercial property in particular areas. Block grant is used to compensate authorities with low rateable values in relation to their populations. If they had to finance their services wholly from local taxation, such authorities would have to levy much higher tax *rates* than other authorities.

(iii) National taxation

4.10 In principle, the combined effect of equalising both needs and resources is to enable all authorities to finance a comparable level of service for the same rate in the £. But, in addition, to the equalisation process, successive Governments have also provided general grant support for local authority expenditure. This is because they have taken the view that the burden of such expenditure should not be borne by local taxpayers alone. This view rests on two considerations: first, the wider "national dimension" of some of the main services which local authorities provide; and, second, the fact that domestic rates are not a tax which can bear the full weight of local authority expenditure, since they are not related to ability to pay. In these circumstances, if local services were met entirely out of local taxation, those on low incomes would bear a much heavier burden than was justified and this could inhibit the provision of satisfactory standards of service in some authorities. Providing Exchequer grants to local authorities avoids this problem. The same considerations will apply to the proposed community charge which is also not related to ability to pay.

The origin of grants to local government

4.11 Sizeable grants began to be paid in the latter part of the nineteenth century to encourage different areas to provide services of a consistent standard. At first this was achieved largely through specific grants. Some specific grants remain: these are considered separately in paragraphs 4.44 to 4.49 below. But gradually the main form of Exchequer support began to take the form of unhypothecated grants, paid towards local authority spending generally. This chapter is concerned mainly with those grants.

4.12 Since 1958, all unhypothecated grant systems have contained elements designed to equalise local authorities' needs and resources. Until 1981/82 the two tasks were carried out by separate elements of the grant; since then, in England and Wales, they have been undertaken as part of the single calculation of block grant.

Before block grant

4.13 The grant system in force in England and Wales between 1974/75 and 1980/81 had a number of serious drawbacks. Two in particular warrant discussion. The first concerns the method used to equalise resources: that is, to ensure that authorities could operate as if they had the same rateable value per head on which to raise their local contribution to expenditure. This involved the Exchequer in effect standing in as an extra ratepayer in authorities with rateable resources below a given level, and paying whatever rate in the £ the authority levied on a fictional property with a rateable value equal to the shortfall in the total rateable value of the authority. This meant that the amount of resources grant an authority received rose in line with the rate poundage it levied. The more an authority chose to spend, the more grant it received from its central Government "ratepayer". And because the grant pool was fixed, authorities, by increasing their own entitlements, pre-empted grant from other authorities.

4.14 The second problem concerned the calculation of needs grant to compensate authorities for unavoidable differences in their spending per head (see paragraphs 4.6-4.8 above). This involved using the statistical technique of multiple regression analysis to select and weight social and economic indicators which correlated with the broad pattern of actual local authority expenditure. It is true that under this arrangement individual authorities could not influence the amount of needs grant they received by their spending behaviour. But the calculation could be affected if a group of authorities with similar characteristics spent more. For example, if the majority of urban authorities chose to increase their spending, this would be interpreted by the regression analysis as evidence of greater need to spend in these authorities whether or not their real underlying spending needs were correctly reflected in their actual expenditure levels.

Block grant

4.15 Block grant, introduced in England and Wales in 1981/82, was an attempt to devise a system that would be fairer and more accessible in these respects than the arrangements it replaced. It shares the objective of its predecessor of equalising authorities' expenditure needs and rateable resources so as to enable all authorities to provide a comparable level of service for the same rate in the £. But it succeeds in offering a system for supporting local authority spending which is conceptually much more logical and defensible than any previous arrangements. Annex B explains in more detail how it works in England. It also applies in Wales, where there are some operational differences. Despite the improvements of block grant, its basic structure still reflects earlier arrangements, so that it shares some of their defects. These are discussed below.

(i) Calculating block grant

4.16 An authority's entitlement to block grant depends on its needs, as measured by its grant related expenditure assessment (GRE), its resources, as measured by rateable value, and its actual spending. The calculation, which is described in detail in Annex B, is complicated and difficult for non-experts to understand. Moreover, the method of calculation means that grant entitlements can change both between and within years. This volatility in grant entitlements weakens the link between changes in spending and local taxes levied.

4.17 Between years, individual authorities' share of the total of block grant can alter as a result of changes in their needs assessments, their rateable resources, or their spending. However, expenditure changes are under the authority's control and movements in rateable value are generally predictable. The main source of volatility in practice has been GREs. Although it was hoped that GREs would be more stable than the previous system of needs assessment, this hope has not been realised in practice. Annual changes in methodology and data, as well as changes in the overall distribution between services, have resulted in sharp changes in the GREs of individual authorities. This has led to uncertainty over grant income and has tended to mask the impact of changes in actual expenditure.

4.18 An authority's grant entitlement can also vary within a year. This is an inevitable consequence of a system where grant is based on actual expenditure and where the overall grant provision is cash limited. Individual authorities' grant claims – based upon their spending decisions – have to be adjusted so that in total they correspond to the total amount of grant available for distribution. This means that an authority's grant will change not only because of its own spending, but also because of the combined effects of the spending decisions of all other authorities. Grant entitlements will also change as better estimates of spending become available. Final grant determinations cannot be made until audited outturn expenditure for the year is known – at least 18 months after the end of the financial year. Mid-year GRE changes have been a further cause of within-year grant volatility. GREs have been re-determined during the course of the year to correct data errors and to revise certain estimated items in the light of later information. All this means that an authority's grant entitlement could change as much as 4 times between provisional notification in the December preceding the financial year and the final closing of the books 3 years later.

(ii) Resources equalisation

4.19 The way in which resources equalisation is undertaken within block grant also reflects earlier arrangements, although differences in rateable resources are now equalised more fully through the grant system. Grant, which would otherwise go to authorities with high rateable values per head of population is, in effect, transferred to those with low rateable values. This means that between different parts of the country there are substantial transfers of resources which are concealed within the grant system. Fig 11 shows, as an example, estimates of the scale of transfers involved between the various English regions: in total, some £1030m is being transferred through the grant system from Southern and Eastern England to the rest of the country, and the relative scale of transfers to and from individual authorities is even greater. Such transfers are justified within the terms of the existing system. But what cannot be justified is that substantial transfers – which directly increase or decrease the cost to ratepayers of local authority services – are hidden from view in the complexities of the grant system.

Figure 12: Inter-regional transfers through resources equalisation (England 1984/85).

4.20 In addition, the present system of resources equalisation is providing a subsidy to individual domestic ratepayers in different parts of the country in a way which bears no consistent relationship with ability to pay.

4.21 At present local authorities have the power to raise taxes from both the domestic sector and the non-domestic sector. Resources equalisation attempts to compensate for differences in the combined resources of both sectors measured in terms of the rateable value per head of population. Differences in authorities' rateable resources may reflect differences in the size and composition of the property base (for example, an authority with a major concentration of commercial property in an urban area is likely to have higher rateable resources per head of population than a sparsely-populated rural area) or the general level of rateable values of property in each area, or a combination of the two. The biggest cause of variations in rateable resources is differences in the size of the non-domestic sector.

4.22 The effect of equalising rate poundages is that in those authorities where average domestic rateable values are low, the tax bills on individual properties are lower than the tax bills on comparable properties in authorities with high average rateable values. This might not be considered unreasonable if rateable values bore a reasonable relationship to the ability of householders to pay. But the problems involved in assessing rateable values mean that it is unlikely that even within local authorities they will correctly reflect differences in the value of individual properties. Moreover, between different local authorities, the rateable values of comparable properties vary much more than the ability of their occupants to pay. Annex F demonstrates for any level of household income the wide range of rateable values which exist both within and between authorities. The rateable value of a good quality detached 4 bedroomed house in a good area in Carlisle is likely to be in the region of £330, while in Luton it is likely to be £580.

4.23 Figure 13 which compares average rateable values and average incomes for each of the English regions, gives an indication of the extent to which variations in rateable values between areas greatly exaggerate variations in ability to pay. The problem is even greater for individual households where rateable values may vary by a factor of up to 8 for households with similar incomes.

Figure 13: Average domestic rateable values and average incomes in English regions

4.24 Resources equalisation therefore heavily subsidises the cost of local authority services to all domestic ratepayers in authorities where domestic rateable values are low. This is the logical consequence of rate poundage equalisation with a property tax. But in terms of what people pay and the services they get it makes little sense. For a comparable standard of service, the occupant of the 4 bedroomed detached house in Carlisle would pay £550 a year, while his counterpart in Luton would pay £970.

4.25 Not only is the justification for this situation weak in terms of ability to pay, but people whose bills for local authority services are being substantially subsidised, especially at the margin, have less incentive to be concerned about how much their local authority spends and whether services are provided efficiently. This may explain the prevalence of higher spending in low rateable value areas.

(iii) Grant related expenditure assessments

4.26 Block grant's method of equalising needs is based on grant-related expenditure assessments (GREs). These use objective factors to assess the relative cost of providing a similar standard of service in different parts of the country. Instead of relying, as the previous system had, on general social and economic indicators to measure differences in what local authorities need to spend, the GREs are built up on a service-by-service basis using a client group/unit cost approach. For example, the main factor which determines the need for education spending is the number of schoolchildren; spending on road maintenance is assessed largely according to the length of roads in each area. Where necessary, these main indicators for each service are then adjusted to take account of factors which affect the cost of provision in different areas – factors such as the number of children entitled to free school meals, and the amount of traffic carried by different types of road.

4.27 This approach makes it possible to see how GREs are made up. This was impossible with the purely statistical needs assessments used under the previous system. But the system does encourage complexity. There is a temptation to make GREs over-complicated by introducing new factors and by continual refinement. This leads to instability.

Objectives and principles of a new grant system

4.28 The earlier part of this chapter has explained why grants to local authorities have developed, and the form they have taken. It has shown that block grant is an advance on the systems that went before, but that shortcomings still exist: it is still highly complex and difficult to understand, both for authorities and ratepayers; it is unstable; and it distorts and obscures the relationship between changes in expenditure and changes in local taxes.

4.29 It is clear that the grant system must be reformed if it is to contribute towards improved local accountability.

— It should be as simple as possible in its manner of operation, so that it can be understood by residents as well as local authority experts.

— It should be stable. Local authorities should have greater certainty in their grant entitlements, both within and between years.

— It should enable local taxpayers to see a direct link between changes in authorities' spending and increases or reductions in local tax bills.

4.30 The Government also remains committed to the principle of evening out the amount which authorities need to spend to provide a reasonable standard of service. Whatever form of local taxation is in force, it would be unreasonable to leave people in high need areas to bear a heavier burden than people in low need areas in order to provide the same standard of service.

4.31 The proposed changes in the non-domestic and domestic tax arrangements do, however, have a bearing on the approach to be adopted in equalising authorities' taxable resources. The main cause of present variations in authorities' resources is the uneven distribution of non-domestic rateable values across the country. This would be eliminated by the proposal in Chapter 2 to pool the proceeds of the non-domestic rate and redistribute them to all authorities as a common amount per adult. The proposal to replace domestic rates with a flat-rate community charge levied on all adults similarly removes the variations in authorities' domestic taxable resources. As indicated in Chapter 3, an element of domestic rates would still be present during the transitional period introducing the new community charge. But its significance would be much smaller than at present and would steadily decline. These issues are discussed in more detail in Annex H.

4.32 The Government has therefore concluded that under the proposed new taxation arrangements resources equalisation through the grant system would no longer be necessary. Ending resources equalisation would achieve two important objectives when combined with the equalisation of spending needs and the replacement of rates with a community charge:

— it would ensure that domestic taxpayers throughout the country would pay the same *bill* for spending at the level of assessed need;

— it would remove a major distorting factor in the relationship between marginal changes in expenditure and local tax bills, and thus further enhance accountability.

4.33 The new tax arrangements would, in addition, mean that the domestic rate relief grant would no longer be required. The proposal that non-domestic and domestic taxpayers should be taxed on quite separate and different bases means that a special discount for domestic ratepayers becomes unnecessary.

The Government's proposals

4.34 The Government therefore proposes a grant system with just two main elements:

i. needs grant, to compensate authorities for differences in the cost of providing a standard level of service to meet local needs;

ii. standard grant, to provide an additional contribution from national taxation towards the cost of local services.

The sum of needs and standard grant would be determined annually as a matter of policy by the Government as is the case now.

4.35 The needs grant would represent the first call on the total amount of grant available after deduction of specific grants. It would be distributed so as to compensate fully for differences between authorities in the assessed cost per adult of providing a reasonable standard of service—its expenditure needs assessment. The amount of needs grant payable to each authority would be fixed before the start of the financial year and would not be affected by what the authority actually spent.

4.36 Each authority's expenditure needs assessment—which would correspond to the grant-related expenditure assessment in the present system—would be derived from a formula based primarily on the unit costs of providing services to different client groups, adjusted as necessary to take account of factors which legitimately cause variations in the need for and cost of providing services. This is the basis of the present GREs; but in view of their increasing complexity and instability, the Government intends to review the existing formula before the grant system comes into operation, with a view to making it less complex and more stable. The detailed operation of the needs grant and the basis on which GREs might be reformed is set out in Annex H.

4.37 The remainder of the grant total after deduction of the needs grants would be distributed as standard grant. This would be paid as a common amount per adult to all authorities, so as to produce an equal reduction in the size of the community charge authorities need to levy to finance their spending. Like needs grant allocations, the amount of standard grant payable to each authority would be fixed at the start of the year and would not alter subsequently.

The operational principles of the new grant system

4.38 Under the proposals described in this Chapter and in Chapters 2 and 3 local authorities would receive income to finance their revenue expenditure (aside from any specific grants) from four main sources:

— the non-domestic rate pool
— standard grant
— needs grant
— the community charge.

Authorities would all receive the same amount of non-domestic rate income and standard grant per adult. Each authority's needs grant would vary, depending upon the level of its assessed expenditure need per adult in relation to that of the authority with the lowest assessed need. But an authority's income from each of these sources would be fixed at the start of the grant year and would not alter subsequently to reflect what it spent. Accordingly, the community charge would bear the full weight of any variations in an authority's expenditure from the level of its assessed needs. In this way, local taxpayers would either carry the full cost of any increase in spending above the authority's assessed needs or reap the full benefit of any expenditure savings. The consequences of their authority's expenditure decisions would be clear.

4.39 Figure 13 shows how the grant system so far described would work. The three illustrative authorities all receive the same amount of standard grant and non-domestic rates per adult living in their areas. Authorities A and B, each of which is spending at the level of its assessed need, levy the same average tax bills. The difference in the amount it costs the two authorities to provide a standard level of service is met entirely by additional needs grant. Authority C can provide a standard level of service for the same cost as Authority B, and therefore receives the same amount of needs grant. But, in this example, it chooses to spend considerably more. The whole cost of this additional spending falls on local domestic taxpayers.

Figure 14: The grant system and local taxation

The effect on local tax bills

4.40 The Government's proposals:

— that there should be a grant under which all marginal changes in spending are met by local domestic taxpayers;

— that the proceeds of non-domestic rates should be pooled and allocated as a constant amount per adult to all authorities;

— that there should be no other form of resources equalisation

would mean that some authorities would have to finance more of their spending from their domestic taxpayers than at present. In other areas the burden of domestic taxation would be less than it is now. Low spending authorities with high domestic rateable values would gain most. High spending authorities would lose, and so would authorities with low domestic rateable values.

4.41 The size of the changes would generally be small—for 90% of areas average local tax bills would change by less than £1 a week. But, in a minority of cases, losses would be greater. And, of course, these effects would be superimposed on changes in the pattern of household bills *within* areas resulting from the gradual introduction of a community charge.

4.42 Allowing the effects of the grant and non-domestic rate proposals to feed through immediately, or within a very few years, would end the confusing situation that exists at present where domestic tax bills are lower in some high-spending areas than they are in authorities that spend much less. But the Government is mindful of the fact that householders have taken on commitments on the basis of the present patterns of local taxation. It would be unreasonable to disrupt that pattern too severely or too quickly.

4.43 The Government therefore envisages that special arrangements would be introduced to avoid any significant shifts in the burden of local taxation *between* local authorities which would arise as a result of the reform of the grant arrangements and the pooling of the non-domestic rate. Changes in the balance of local taxation *within* a local authority, arising from the widening of the local tax base by the introduction of the community charge, would begin to feed through immediately. So would the effects of any *increases* in spending. But for the same level of spending under the new system the average level of an authority's local tax bills would be virtually unchanged.

4.44 A more detailed account of the impact of the new system and of the design of the special arrangements is given in the next Chapter. Chapters 8 and 9 discuss the position in Scotland and Wales.

Specific Grants

4.45 So far this chapter has been about the main system of unhypothecated grants towards local authority expenditure. But a significant proportion of Exchequer support is paid in the form of specific grants. These make up about 20% of the grant total, amounting to about £2.8 billion in 1984/85. Police grant alone, which meets 50% of spending on the police service, cost about £●m in England in 1984/85. Contributions towards local authority spending on home improvement grants in England amounted to about £●m. At the other end of the scale, ● grant was worth only £●m, and that for ● only £●.

4.46 Specific grants take a number of forms. Some are paid towards capital expenditure, some towards current expenditures and some, like slum clearance subsidy, towards a combination of the two. Grant rates vary from ●% in the case of ● to ●% for ●. Some, like police grant, are paid towards actual expenditure on a complete service. Others, like the new education support grants, offer help towards service expenditure of particular types up to a total approved in advance. Specific grants can be either for programmes of expenditure or, as with transport infrastructure grant, for particular projects.

4.47 There will remain a role for certain existing specific grants, such as that for police expenditure. There may also be a case for some new grants, in the education field, for example, in support of the Government's objective of raising standards at all levels of ability. But, equally, extensive use of such grants could run counter to the approach set out in this Green Paper of local accountability and choice. And it is several years since there was a thorough appraisal of the role of specific grants. It is not clear that the existing pattern of grants can easily be justified in terms of the policy objectives of the 1980s and 1990s.

4.48 The Government is therefore undertaking a separate review of the role of specific grants in the new system. In its view, specific grants may be justified where they are intended:

- to assist the delivery by local authorities of central Government policies of continuing national importance;
- to give special encouragement for a limited period to expenditure on activities or services which fulfil a specific central Government objective;
- to recompense local authorities for expenditure on activities carried out by them or other authorities at the request of central Government where there is limited or no local discretion over the expenditure incurred;
- to assist in the financing of activities that are not adequately covered by the proposed needs assessments.

4.49 In the Government's view, any existing or new specific grant must satisfy at least one of these criteria. But that would not, in itself, be sufficient to justify the continuation or introduction of a particular grant. It must be demonstrated, in addition, that the grant will provide good value for money for both the Government and local authorities, and that its administration will be purposeful and effective.

4.50 The Government would welcome comments on the principles set out above and, in the context of such principles, on particular specific grants which now exist or might usefully be introduced.

Summary

4.51 Paragraphs 4.28 to 4.33 above set out the objectives and principles which a new grant system should satisfy. The system outlined in this chapter would meet those requirements.

- It would be inherently simpler than block grant or previous systems.
- It would be stable. Authorities would know, before the year in question started, exactly how much grant they were going to receive. That figure would be fixed. And grant entitlements should not vary so much between years.
- Grant would fully compensate authorities for variations in need. But the cost of increases in spending or, the benefit of reduced spending, would fall entirely on local domestic taxpayers.

4.52 Ideally, the Government's aim would be a system where tax bills could be the same in different parts of the country for a standard level of service. Adopted without amendment, however, such a system would mean sudden and substantial shifts between areas in the burden of local domestic taxation. The Government considers that such shifts are unacceptable, and evisages that special arrangements would be necessary to avoid excessive changes in average domestic tax bills for each local authority on introduction of the new system. This would mean that average tax bills in different authorities would continue to vary for a standard level of service. But it would still enable the change to the fairer distribution of domestic taxation *within* authorities resulting from the move to the community charge to take place. And it would still ensure that every £1 increase in local authority spending would be met entirely from the domestic taxpayers of the authority and every £1 saved would reduce the local tax burden by the same amount. The aim of ensuring that the grant system contributes to local accountability would be met.

Chapter 5: The combined effects of changes to local taxation and grant

5.1 Chapter 1 explained how the present Government's efforts to constrain local government expenditure had revealed some serious underlying flaws in the present system of local government finance. These flaws weaken the accountability of authorities to local people, with the result that many electors are indifferent to how much their local council spends or are encouraged to vote for ever higher expenditure on services.

5.2 The Government intends to tackle the problem not by increased central control of local authority expenditure but by taking action to remedy the weaknesses in the present system which undermine local accountability. Accordingly, *Chapter 2* set out proposals for limiting local authorities' access to non-domestic rate poundages, by setting a uniform national non-domestic rate poundage, and redistributing the yield among all authorities as a common amount per adult. *Chapter 3* described proposals for transferring the burden of local domestic taxation from rates to a flat-rate community charge levied on all adults resident in an authority's area. *Chapter 4* set out proposals for a new simplified grant system, consisting of a "lump sum" needs grant to compensate for differences in authorities' assessed expenditure needs and a standard grant, which would be distributed as a common amount per adult to all authorities. In addition, there would be special arrangements to ensure that in the first year of the new system authorities' income from grant and non-domestic rates would broadly be the same as under the old system.

5.3 These proposals are inter-related and together provide a comprehensive reform of the local government finance system, the main features of which are as follows:

— the non-domestic ratepayer would still make the same overall contribution to aggregate local authority expenditure, but individual authorities would no longer be able to increase the rates paid by non-domestic ratepayers in their area so as to finance marginal increases in expenditure;

— the local domestic tax arrangements would be fairer; all electors would make some contribution to the expenditure of their local authority and this contribution would be more closely related to their use of local services;

— the grant system would be more stable and more conprehensible; the grant an authority received would no longer depend upon how much it spent and there would be no grant support for marginal spending; and the grant system — in combination with the new tax arrangements — would be designed to equalise tax bills for comparable levels of service rather than rate poundages, which at present cause significant disparities between tax bills between areas;

— the combined effect of the tax and grant reforms would be to ensure that the full costs or benefits of increases or savings in expenditure accrued to local domestic taxpayers; with the widening of the tax base and the much more understandable relationship between spending and tax demands, this would greatly improve the accountabilty of local authorities to their electors.

5.4 These reforms will have important distributional consequences, affecting the finances both of local authorities and of households and individuals. This chapter explains in general terms what those are likely to be and describes how the reforms might be phased in over a transitional period so as to keep their distributional effects within reasonable and tolerable limits. It is chiefly concerned with England; Scotland and Wales are discussed in Chapter 8 and Chapter 9. Annex J describes the distributional effects in greater detail.

5.5 This Chapter and Annex J describe the pattern of changes arising from the proposed reforms for local authorities and for households. The modelling assumptions include actual local authority spending in 1984/85; Family Expenditure Survey data for 1980 to 1983 combined and repriced to a common 1984/85 level; full implementation of the proposals contained in the White Paper "Reform of Social Security" (Cmnd 9691) before the new arrangements come into operation; and an unchanged overall contribution from national taxpayers, non-domestic ratepayers, and local domestic taxpayers towards local authority spending. The assumptions are purely illustrative and simply show the effects of the measures proposed in the Green Paper, had they been in place in 1984/85.

The effects on local authorities

5.6 Local authority income would be affected by two aspects of the proposals: the national pooling and redistribution on a per adult basis of the income from non-domestic rates; and the ending of resources equalisation. The effects of these proposals on individual local authorities would be determined by the level of their expenditure in relation to their grant-related expenditure and the size of their rateable values per head of population.

5.7 Two types of local authority would gain extra income from the non-domestic rate and grant proposals.

i. *Low-spending authorities.* Authorities spending at a low level in relation to their GREs will be levying non-domestic rates below the national average and will thus get a below-average yield from their non-domestic ratepayers. National redistribution of the total yield of non-domestic rates as a common amount per adult (as proposed in Chapter 2) would increase the amount of non-domestic rate income going to these authorities.

ii. *Authorities with high domestic rateable values.* At present, the block grant system equalises differences in the rateable resources of authorities; grant is in effect transferred from authorities with high rateable values to those with low rateable values. The discontinuation of this process means that authorities with high rateable resources — which generally have high rate bills at present — would retain a larger proportion of their grant than hitherto. Since non-domestic rates will now be dealt with separately, this effect will depend on the level of an authority's *domestic* rateable values.

In practice most gaining authorities would tend to fall into both categories. They would be those which have fared worst under the present system, facing disproportionately high rate bills for a relatively low level of spending.

5.8 Conversely, two types of local authority would experience a reduction in their non-domestic rate and grant income as a result of the proposed reforms.

i. *High spending authorities.* The limitation of non-domestic rate poundages and the pooling and redistribution of non-domestic rate income would mean a reduction in revenue to authorities spending above the level of their GRE and currently levying an above-average non-domestic rate poundage.

ii. *Authorities with low domestic rateable values.* Just as authorities with high domestic rateable values gain from the discontinuation of resource equalisation, so authorities with low domestic rateable values lose.

As with the gaining authorities, most of those losing would tend to lose on both counts. They would be those which have fared best under the present system, with disproportionately low rate bills for relatively high levels of spending.

5.9 On the basis of 1984/85 data, the number of authorities in England likely to gain extra income from the grant and non-domestic rate proposals would be in the region of ●, some ●% of all authorities. Most of these authorities would be in southern, eastern and central England, where spending in relation to GRE is generally low and rateable values relatively high. Authorities which stand to lose grant and non-domestic rate income number some ●, ●% of the total. Most of these would be in northern England where spending in relation to GRE tends to be high and rateable values are relatively low.

5.10 The effects of the proposals in London are different. Total rateable values per head of population in many London authorities are substantially above rateable values elsewhere. This advantage would normally be offset by a reduction in grant under the "resource equalisation" principle. Successive grant regimes have however protected London from the consequences of full resource equalisation by allowing its authorities to retain a significant proportion of its resource advantage over other authorities, primarily to moderate the very high rate bills which would otherwise occur. Because resource equalisation has always been limited for London, its high resource authorities stand to gain relatively little in grant terms from the complete abolition of domestic resource equalisation. But many London authorities, particularly in inner London, are spending very significantly above the level of their GREs. They therefore stand to lose substantial amounts of revenue from the proposal to pool and redistribute non-domestic rate income. The combined effect would be significant reductions in non-domestic rate income for many London authorities which are only partially offset by grant.

5.11 The proposal to move the burden of local domestic taxation from rates to community charge means that domestic tax bills in London would no longer be inflated by high rateable values. There would therefore in principle no longer be any case for affording London any special resource advantage over other authorities. In the case of non-domestic rates, the proposed revaluation will ensure fair treatment for all non-domestic ratepayers across the country, although the need for some transitional arrangements in introducing both the new values and the new non-domestic rating system is recognised.

Moderating the effects on local authority areas

5.12 Changes in the non-local income — i.e. non-domestic rate income and grant — of local authorities would inevitably affect the burden falling on their local domestic taxpayers. If an authority's total income from grants and non-domestic rates goes down average domestic tax bills would have to be higher to finance any given level of expenditure, and vice versa. In a number of authorities these changes would be likely to be significant.

5.13 The Government believes that such changes are too disruptive in their likely effects on the personal finances of local taxpayers. It therefore proposes that there should be a "safety net" system of adjustments to the grant and non-domestic rate income of authorities, so as to preserve their income from these sources after the introduction of the new system at broadly the same level as under the present grant and taxation arrangements. This would amount to a self-financing pooling arrangement.

5.14 The arrangement would generally provide local domestic taxpayers with full protection from the distributional effects of the grant and non-domestic rate proposals in the first year of the new system. After the first year of the new system the adjustments would be frozen in cash terms for subsequent years.

5.15 In preserving the initial entitlement to grant and non-domestic rate income, the Government has no intention of validating excessive rate increases or any increases in expenditure which are not compatible with its public expenditure plans which occur between the publication of this Green Paper and the introduction of the new system. In determing the level at which grant and non-domestic rate income is to be preserved by the pooling adjustments, the Government would take account of authorities' expenditure and rating behaviour in the remaining years of the existing system.

The effects on households and tax units

5.16 If the level of local authorities' grant and non-domestic rate income is held constant in the changeover from the present local government finance system to a new system, the position of households and individuals will initially depend solely on the change in the domestic taxation arrangements described in Chapter 3. Since an authority's grant and non-domestic rate income will be preserved, the total amount of revenue to be raised from its domestic taxpayers will remain unchanged for any given level of expenditure. But the *distribution* of that burden between the authority's taxpayers will change as a result of the new domestic taxation arrangements.

5.17 Since the key objectives of the new arrangements include broadening the local tax base to include all adults and moving towards a situation where all local taxpayers pay a flat-rate charge for local services, the effects of this redistribution of the local domestic tax burden would affect both households and tax units — that is couples or single people.

5.18 Within a local authority area the proposals would affect households in two different ways.

— *According to the size and composition of the household.* In general, single person households would benefit from the replacement of a tax on property by a tax on people, and households with three or more adults would lose.

— *According to the rateable value of the household property relative to that of other domestic properties in the authority's area.* For any given household type relatively high rateable value households would benefit more from the gradual move away from using property values as the basis of local taxation, while those in low rateable value properties would take a bigger share of the financing of local services. This effect would occur both across precepting authority areas and within rating authorities.

5.19 Among tax units, the principal redistributive effect would be between householder tax units and non-householder tax units, ie between those who are currently liable to pay rates and those who are not. The main beneficiaries would tend to be single-person householders and the main losers would be young single adults who at present are not householders and are not liable to pay rates.

5.20 Chapter 3, however, made it clear that the Government recognises that people would need time to adjust their personal finances to cope with the new community charge. It therefore proposed (paragraphs 3.39 to 3.41) that there should be a ten-year transitional period during which rates would be phased out and progressively replaced by the community charge. The distributional effects of this process on households and tax units can therefore be considered at two stages:

i. the effects in the first year of transition, with the community charge introduced at £50 per adult and the rest of local domestic tax revenue raised from rates;

ii. the effects when rates have been completely replaced by the community charge.

These effects are shown in detail in Annex J; the main points are summarised below.

(i) Effects in the first year of transition

5.21 A modest move towards the community charge of £50 per adult in the first year would produce very small distributive effects in the total local tax burden. The typical two-adult household would on average tend to face no significant change in their total local tax bill. Over 80% of households would gain or lose less than £1 a week and for 94% the changes would represent less than 1% of net household income.

5.22 The picture would be much the same for tax units. Almost 90% of them would gain or lose less than £1 a week and for 98% the changes would represent less than 2% of net income. The main losers would be non-householder tax units who would become liable to pay local taxes for the first time, the majority of whom are single adults in the 18-24 age group. This is the expected and proper consequence of widening the tax base to include all adults.

(ii) Effects of the complete replacement of rates by a community charge

5.23 The distributional effects of completely replacing rates by a community charge accentuate the scale of changes which would occur in first year of transition. Nevertheless, the changes would still be relatively small for most people.

5.24 Just over half of all households would be better off with a community charge instead of rates, but three quarters of all household gains and losses would be less than £1 a week. Among tax units, the main effect would be a shift in the burden from householder tax units to non-householder tax units. The main gainers would be single adult households, primarily one-parent families and pensioners, while the main losers would again be young single adults because they would become liable to pay local tax for the first time. Overall, 52% of tax units would lose and 48% would gain; but over 70% of gains and losses would be less than £2 a week.

Interaction with the social security system

5.25 The proposals for replacing rates with a community charge interact with the social security system in two different ways.

— Because the local domestic tax base will be widened beyond householders, more people will become eligible for housing benefit although the scale of support needed for existing ratepayers will be reduced. This will have cost implications, both in terms of additional benefit paid and increased workload for local authorities administering the benefit scheme.

— The effect on householders in receipt of housing benefit needs to be seen in the context of the proposal in "Reform of Social Security" (Cmnd 9691) that all benefit recipients should pay at least 20% of their local domestic tax bill.

5.26 The full replacement of domestic rates by the community charge would lead to an estimated increase in housing benefit caseload in Great Britain of about 17% but an increase in cost of only 4%. However, with the proposed transition over a number of years, these increases would build up gradually. Otherwise, the interaction between the two sets of proposals is very limited. The proposals in Cmnd 9691 redistribute income support among low income households, generally in favour of families with children. The local taxation proposals described in this Green Paper involve a switch in local tax burden from householders to non-householders and affect all income groups. The effects are discussed in more detail in Annex J.

Limitation of local domestic tax bills

5.27 The new grant and taxation proposals should considerably improve the accountability of local authorities to their electors for their expenditure and taxation decisions. The reasons for increases in local taxes will be clearer. At the same time, if all local electors have to bear the full cost of marginal increases in their local authority's expenditure, they will have a strong incentive to take a much keener interest in the levels of such expenditure and may be less inclined to tolerate large increases.

5.28 This increased accountability will only be fully achieved, however, once rates have been completely replaced by the community charge. In the early years of the transitional period the impact of the community charge on electors who are brought into the local tax net for the first time (on average such electors account for almost half of the electorate) would be modest. In order to ensure that local authorities do not take advantage of this situation by increasing their expenditure excessively during the transitional period, the Government proposes to retain a panel, similar to the selective rate-capping panel, to prevent irresponsible authorities from imposing excessive burdens on their taxpayers.

Summary

5.29 The proposals for reforming the non-domestic and domestic local taxation arrangements and the system of Government grants to local authorities are radical and far-reaching. Yet with the system of pooling adjustments for grant and non-domestic rate income described in this Chapter there would be no dramatic shifts of resources between local authority areas; and the proposed transitional mechanism for transferring the burden of domestic taxation from rates to a community charge would ensure no drastic effects on the income of households or individuals. The introduction of the new arrangements would therefore be neither sudden nor disruptive in its effects. Despite that they will ensure that the local tax burden will be more equitably shared between domestic taxpayers than at present and that local electors will have to bear the full cost of any increases in expenditure for which they vote. In short, they will close the gap between those who pay, use and vote for local services.

Chapter 6: Capital expenditure

6.1 This Green Paper has focussed so far on local authority revenue expenditure — spending financed out of current income. But local authorities also spent more than £6bn in 1984/85 in England and Wales, some £120 per person, on capital expenditure. This includes the purchase and construction of new buildings, roads and other structures; major renovation and improvement works; the acquisition of land, vehicles, plant and equipment; and the making of grants and advances for similar purposes including mortgages. Figure 15 shows the capital expenditure of local authorities in England and Wales by service, by economic category, and by method of finance for the latest available year.

Figure 15: Local authority gross capital expenditure (England and Wales: 1984/85)

6.2 This chapter deals with the main system for controlling capital expenditure in England and Wales. There are separate systems for Scotland and for law and order services in England and Wales; there are no plans for major changes in those cases. The chapter looks at the Government's objectives in controlling local authority capital expenditure and borrowing, and discusses why the main system now operating in England and Wales, like its predecessor, has failed to achieve those objectives. A number of options for a new system are then reviewed.

The Government's objectives

6.3 Because capital expenditure offers future as well as immediate benefits, local authorities are not necessarily expected to finance it, as they are revenue expenditure, from income in the year. A large part of capital expenditure has always been financed out of borrowing. The maximum period within which local authorities are allowed to complete repayment of the loans is related to the expected life of the new asset. In this way, capital projects are paid for through their lifetime by those who benefit from them.

6.4 Any system of control has to take into account the financing practice of local authorities. Each authority operates a number of separate accounts, reflecting the various services for which it has responsibility. But it would be inefficient to manage the cash for each account separately, because that would mean that money was lying idle in one account while another account was having to pay interest on loans from outside the authority. So an authority manages its cash through a consolidated loans fund (CLF). Accounts with spare cash lend it to the CLF. Accounts in need of cash go to the CLF to borrow. The treasurer, who runs the CLF, will make loans using cash lent internally to the CLF as far as possible. If there is insufficient internal cash, he will look outside the authority, either to the Public Works Loan Board (PWLB), a Government-funded but independent body which lends only to local authorities, or to the money market. When money which has been internally lent to the CLF is required for its original purpose by the account which lent it, the CLF may at that stage have to borrow externally to replace it. So the term "borrowing" can mean variously internal borrowing by service accounts from the CLF, or external borrowing by the CLF from the PWLB and the market.

6.5 Since such a large part of capital spending is financed by external borrowing, either initially or when internal loans are later converted, the Government has to be concerned not only with the level of spending, but also with the implications for the overall public sector borrowing requirement (PSBR).

6.6 Total gross capital expenditure by local authorities in a given year, their net capital expenditure after deducting receipts, and changes in their total indebtedness as measured by the local authority borrowing requirement (LABR) are all important to national economic management. Between a quarter and a third of all public sector capital expenditure is incurred by local authorities. The Government's commitment to the firm control of public expenditure has been emphasised repeatedly, for example in the 1985 Financial Statement and Budget Report.

There are two reasons why this is vitally important.

— The Government is committed to holding down interest rates and eliminating inflation. Achieving these goals entails continuing downward pressure on monetary growth and public borrowing as a share of GDP.

— Lower taxation is an essential ingredient in improving incentives and efficiency and thus in increasing employment. Tight control of public spending is vital to provide the scope for a lower tax burden.

The Government is therefore concerned with both borrowing for capital purposes and the capital expenditure itself.

6.7 Whatever form of control is adopted, it must be effective. This is essential for the national economy. But it is also essential if local government is to have the stability required for sensible capital planning. With an ineffective system there are bound to be constant changes to bring spending and borrowing back on course.

6.8 Against this background, the Government considers that there are three objectives which any control system must satisfy.

— It should provide effective Government influence over aggregate levels of local authority capital expenditure and borrowing.

— It should promote the Government's aim of reducing the size of the public sector by encouraging asset sales.

— It should provide a sound basis for local authorities to plan their capital programmes. The Government should allocate resources in accordance with national policies and focus them on areas of need, but local authorities should have freedom, within their overall spending ceiling, to have regard to local priorities. The system should also be stable enough for local authorities to be able to plan ahead with confidence.

The past and present systems

6.9 During the latter part of the 1970s it became increasingly clear that the form of borrowing control operated by the Government of the day offered too little influence over either capital expenditure or borrowing. Local authorities were free to spend any amount of non-loan finance over and above their borrowing limits. The control of borrowing applied to all borrowing for capital purposes by service accounts from the CLF, regardless of whether the money was initially found from external borrowing or by the temporary use of surplus funds from elsewhere within the local authority. Borrowing approvals were mostly given for particular projects, and the initial borrowing from the CLF could take place either immediately the approval was given or in any subsequent year, depending on how fast the project progressed. Where the CLF initially used surplus internal money to make the loan, external finance could be substituted at any later date. In practice, therefore, the time at which the initial borrowing approvals would make themselves felt as demands in the market was unpredictable.

6.10 There was a further complication. Although local authorities are not allowed to borrow long-term for revenue expenditure, they may borrow short-term while they wait for money which is due to come in — for example payments of rates. Such borrowing was outside the specific controls and varied considerably in amount from year to year.

6.11 Taking these points together, the Government could have little confidence in forecasting the annual level of the LABR, which measures changes in the level of local authorities' external borrowing.

6.12 The present Government introduced for the first time a system of direct controls over the level of capital expenditure. The system was embodied in the Local Government, Planning and Land Act 1980, and came into force from the financial year 1981/82.

6.13 At the national level, cash limits are set on the total of local authorities' net capital expenditure. The level of net expenditure in a given year is measured by taking the overall gross level of expenditure for that year and subtracting the capital receipts accruing in the year from the sale of council houses, surplus land and other assets, and from the repayment to authorities of mortgages and other advances.

6.14 At local level, each local authority is given capital expenditure allocations by the Government each year. In England, local authorities receive a number of such allocations, each covering a particular block of services. In Wales, a single block allocation is given. In each case, separate allocations are given for some types of scheme. Allocations constitute permission to incur a stated level of capital expenditure. Each local authority may aggregate all its allocations and add to them in various ways, most importantly by adding a specified proportion of its capital receipts — including both those arising in the year and those remaining unspent from earlier years. In this way, an individual authority's expenditure ceiling can be considerably greater than the level of its allocations. Once the ceiling is set, it is a ceiling on all capital spending — except for a few exempt categories — not just on borrowing. Contributions from revenue may be used instead of borrowing to finance spending up to the ceiling if an authority chooses to do so. But spending above the ceiling is not permitted however it is financed.

6.15 The system has not achieved the first of the objectives set out in paragraph 6.8. The setting of direct expenditure ceilings for individual local authorities for the first time was designed to keep national spending within the cash limits. The simplified form of borrowing control which has been retained, with approvals broadly equal to each authority's expenditure allocations and exercisable only in the year to which they relate, was designed to remove one of the elements of uncertainty inherent in forecasting the LABR. But the very success of the "right to buy" policy for council houses and other moves to secure the sale of assets has left local authorities with a large store of accumulated capital receipts which enhance their spending power. It is primarily the problem of capital receipts which has made it impossible to control expenditure accurately on an annual basis.

6.16 In the first two years of the new system, as receipts started to come in fast and local authorities were adjusting to the new arrangements, there was considerable underspending of the national cash limits. But in the three years starting with 1983/84 there has been persistent overspending. Figure 16 compares actual expenditure with the levels envisaged in the public expenditure plans.

Figure 16: Planned and actual gross and net capital expenditure on services covered by the main cash limit in England, 1981/82 to 1986/87

6.17 The system has been changed to deal with the problem of overspending, but these changes have made the other objectives set out in paragraph 6.8 more difficult to achieve. The proportion of receipts which authorities can add to their allocations has been reduced, and the national total of allocations has been cut back, to offset the growing spending power from the stock of accumulated receipts. But this has also reduced the incentive to dispose of surplus assets and the scope for directing allocations to areas of greatest need.

6.18 This and other corrective action has left local authorities uncertain about the way the controls will be applied for future years. Forward planning has suffered despite advance indications of minimum allocation levels for some service blocks. The problem has been more acute in England than in Wales, where the use of allocations which are largely formula-based and the issuing of advance indications across all services has helped to maintain greater stability.

Towards a new system

6.19 In the autumn of 1984 the Government undertook to review the capital control system in consultation with the local authority associations. The Government has considered their comments and others received over the last year, including those of the Audit Commission.

6.20 The local authority associations have argued that it should be enough for the Government to rely on constraints on revenue expenditure, without separate controls on capital expenditure or borrowing. Failing that, they maintain that if controls have to be retained, they should, as before 1981, be over new borrowing — internal or external — for capital purposes. In their view, the degree of control under such a system, which proved inadequate before 1981, could be sufficiently improved by giving approvals on an annual basis, rather than allowing them to be exercised at any time. The associations have also argued for greater ease of capital planning by local authorities through further reductions in Government control over the detail of local authority projects.

6.21 A large part of the complicated paraphernalia of project controls which the Government inherited in 1979 has in fact already been swept away. The question of the scope for further simplification has not been separately considered in the present review, because the need for controls is in any case under constant re-examination and further improvements are in hand. A recent instance of change is in the coverage of housing project control in England, which was further reduced in April 1985. Most categories of expenditure by local authorities which are no longer in receipt of housing subsidy are now exempt from even a simplified form of scrutiny. Plans are also being made to reduce control over education projects following a review in the Department of Education and Science. In Wales, housing project control still applies to all local authorities but is presently under review; there is no detailed control of education projects.

6.22 The Government does not, however, accept that there is no need for controls over capital expenditure or borrowing. Even apart from the wider national considerations discussed in paragraph 6.6, borrowing controls are needed as part of the prudential regime which helps to safeguard the creditworthiness of local authorities. Governments have exercised control over local authority borrowing for at least 150 years, and the present system of control goes back more than half a century. Local authorities do not need specific consent to borrow temporarily pending the receipt of revenues, but there are strict limits on the amounts which may be borrowed for this purpose and all such loans must be repaid within three months of the end of the year in which they are taken out. Most other borrowing requires Government consent. These arrangements, which are intended to prevent a local authority building up a large revenue deficit, have been the foundation of the very high standing which local authorities have enjoyed in the financial market. That standing must not be undermined.

6.23 Levels of borrowing cannot be controlled by constraints on revenue alone. Neither would effective control of borrowing or expenditure be adequately provided by a system based on the one which operated before 1981, even if it were modified into an annual control. Local authorities would remain free to replace temporary internal lending of surplus money by external loans at any time, and to allow any degree of year-to-year fluctuation in short-term borrowing for revenue purposes. They would also be free to spend capital receipts at will. With the large bank of accumulated receipts there would be a real risk of a major surge in spending and external borrowing in the early years of the system. Even when that transitional problem was past, the level of the LABR would be liable to very considerable fluctuation from one year to the next. Overall, influence over the LABR would be no greater than now and influence over spending would be less.

Alternative approaches to borrowing control

6.24 Paragraph 6.4 explained the difference between internal and external borrowing by local authorities. The unsatisfactory system of control which was operated before 1981, and the associations' proposal for an improved version of it, both related to internal borrowing. Greater influence over the LABR would be achieved if it were possible to exercise control directly over external borrowing for capital. The only element of the LABR outside control would then be fluctuations in revenue borrowing. But such a control would be very difficult to operate. Local authorities cannot readily say whether their external borrowing is for capital or for revenue purposes. They simply borrow or repay borrowings as necessary to maintain an adequate cash-flow without having money sitting idle. For a control to be operated on external borrowing for capital purposes, authorities would have to separate their external borrowing into capital and revenue elements. They would thus be maintaining two flows of cash instead of one, and would not be able to optimise the use of cash to hold down the overall level of external borrowing.

6.25 A broader approach would be needed if the future system was going to be based on control of borrowing alone, without a direct capital expenditure control. The Government has looked closely at the possibility of introducing a control over local authorities' total net external borrowing, for both revenue and capital purposes, through a system of external borrowing limits (EBLs). An EBL system, if operated successfully, could guarantee that a desired level of LABR would not be exceeded. It would exercise a powerful influence over levels of capital expenditure, though the only element over which it would give direct control would be that financed by borrowing.

6.26 There are serious practical difficulties with EBLs to which solutions would have to be found. It would not be practicable to set a tailor-made EBL each year for every one of more than 450 local authorities in England and Wales. EBLs could be set on a formulaic basis, which might for example assume that all local authorities in a given class had the same need for external finance per head of population. Alternatively, they could be set by reference to capital expenditure requirements only, assuming that local authorities could operate their revenue cash-flow so as to avoid fluctuations in the level of their revenue borrowing between one year-end and the next.

6.27 But in practice individual local authorities' borrowing requirements for a given year bear little or no relation to the level of their capital expenditure, or to their borrowing requirement in other years, or to the borrowing requirement of other local authorities in the same class. These borrowing requirements, like the national LABR, are the difference between two large numbers: annual income and annual expenditure. A small percentage fluctuation in annual income or expenditure leads to a much larger percentage fluctuation in borrowing. Cash-flow is the determinant of the borrowing requirement, not capital expenditure alone, still less class of authority. It is not clear, therefore, how to set satisfactory EBLs for each local authority.

6.28 Some form of safety valve would in any event be needed, so that a local authority could increase its borrowing beyond its basic EBL to cover unforeseeable expenditure or an unexpected shortfall in income. There are various ways of providing such a safety valve, which are largely extensions of the facility which exists in the present capital control system for one authority to transfer capital expenditure allocations and accompanying borrowing approval to another authority.

6.29 The simplest approach would be to allow a swap system to operate within an EBL system, or to allow local authorities to borrow from each other without effect on the borrowing authority's EBL. At the other extreme, a closed market might be established in cash or promissory notes in which only local authorities could deal and which would therefore not affect the LABR. There are various ways in which such a market might work. For instance, a local authority whose EBL proved inadequate might be allowed to sell promissory notes, using the proceeds to provide additional finance. The notes would be bought by local authorities with otherwise spare borrowing power. They would be redeemable in a stated future year, and would sell at a premium or a discount according to the state of the market.

6.30 The difficulty about any form of safety valve is that local authorities are likely to be cautious about concluding much in advance of the end of the year that they have spare borrowing power. There would probably be insufficient fluidity in the swapping or market arrangements. No such arrangements could compensate for insufficiently robust initial EBLs. The operation of the safety valve would involve a cost to the authority obtaining the extra finance; this would be inequitable if the need for it sprang from an incorrectly set initial EBL.

6.31 The local authority associations have indicated that they have particularly strong misgivings about the EBL approach and the Government too has reservations. Direct expenditure control would be no more than partial, and it is not clear whether the practical problems could be overcome. Nevertheless, this approach is a radical new option which, if it could be made workable and effective, would relieve local government of much of the detailed control involved in the present system.

Expenditure control

6.32 It looks doubtful whether an effective and practicable borrowing control can be achieved. There is already an expenditure control. Although there are many problems with it, they are not such as to suggest that it would be impossible to operate an improved version of expenditure control effectively and efficiently. The Government sees such control as the most likely solution. Paragraph 6.13 explained that under the present system annual control at national level is exercised over the aggregate of local authorities' net expenditure, that is gross expenditure less capital receipts received in the year. Greater stability for local authorities could be obtained with a system in which the national cash limits were set on gross expenditure. This would mean that local authorities collectively were aiming at a fixed rather than a moving target. At present, any fluctuation in the actual national level of capital receipts above or below the Government's forecast affects the total amount of gross expenditure in the year which is compatible with the net cash limit. Under a gross system, the level of expenditure compatible with the cash limit would not be affected by in-year fluctuations in receipts.

6.33 The Government has therefore concentrated on looking at ways of operating a control over gross expenditure. The key elements of such a system are considered in the rest of this chapter. An allocation system would be retained, based at least in part on need as at present. The spending power derived from capital receipts would either be incorporated in allocations or remain available as a separate supplement. The former would offer a more stable system than the latter, at the price of some lost flexibility for individual local authorities. Local authorities might also be allowed some additional spending out of budgeted revenue contributions. A simple form of borrowing control would continue to operate alongside the expenditure control. A separate consultation paper will be issued on other aspects of the proposal. Figure 17 shows the sources of spending power under the proposed system, compared with the present one.

Figure 17: Sources of spending power under the present system and under a gross expenditure control system

(i) Allocations

6.34 Each local authority would be given basic capital expenditure allocations each year as at present. In England, the separate components for the various service blocks are at present derived in a variety of ways. This may involve an individual assessment of an authority's expenditure needs, or a formula reflecting such factors as population or state of the housing or school building stock, or a mixture of methods. In Wales, a fairly simple formulaic approach is used for most allocations, but separate allocations are given for certain major projects such as highway works. No attempt has been made to standardise allocation procedures in England because of the differing characteristics of capital expenditure on different services. Under a new system there would continue to be scope for Ministers to make basic allocations in whatever way seemed most suitable in a particular case. It is envisaged that the scope for virement between services would be preserved in the new system. Authorities would also be allowed a degree of year-to-year tolerance on allocations, as now.

(ii) Capital receipts

6.35 Local authorities are free to spend the cash attaching to capital receipts at any time, either to finance capital spending or to redeem debt. That freedom would remain under a new system. But a change would be needed in the present arrangements whereby in any given year a proportion both of capital receipts generated in that year and of those accumulated in earlier years may be used not simply to finance capital spending covered by a local authority's annual expenditure allocations but to justify increased amounts of such spending over and above those allocations.

6.36 At present, there is no certainty at all as to the extent to which local authorities in aggregate will choose to increase their capital spending each year on the strength of their capital receipts. The theoretical maximum is very large. The interpretation which has been placed on the relevant legislation means that receipts may be used in their entirety over time; only the rate of use in any one year is constrained.

6.37 The problem which the Government faces in controlling expenditure in the face of such uncertainty leads directly to problems for local authorities through the continual prospect of rule changes. Local authorities also experience uncertainty about the precise timing of new receipts. In deciding on changes, a balance must be drawn between the need to achieve stability in the system and the desirability of maintaining flexibility for individual local authorities.

6.38 To achieve maximum stability, it would be essential for the level of spending power available from receipts to be known both to the Government and to individual local authorities before the beginning of each year, and for the features of the present system which allow a steady build-up of spending power to be removed. At the same time, it would help if the level of spending power available for use by an individual local authority did not fluctuate widely from year to year.

6.39 To achieve this three conditions are necessary.

— Individual local authorities' allocations should be made on a gross basis. This would mean that the spending power from receipts would be included in allocations, rather than being available as an addition to allocations as at present. Allocations would consist of two elements: a needs element, determined individually or by formula as now, and a receipts element.

— Each local authority should be allowed each year to spend a proportion of the receipts generated by that authority in, say, the previous three years. Because each year's receipts would influence three consecutive years' allocations, year-to-year variations in spending power would be damped. Anything less than three years would fail to achieve the damping effect; a significantly longer timespan might weaken the incentive to generate receipts. Basing spending power solely on previous years' receipts would avoid the forecasting problem which applies to the immediate availability of new receipts. The precise level of each local authority's receipts for a particular year would not be known when allocations were set for the following year. Any necessary adjustment would be made later, by increasing or decreasing the level of allocations which would otherwise have been given for the year after that. This approach would also avoid the build-up of spending power from receipts. Subject to any tolerance arrangements, receipts would be available to increase spending only in the three specified years.

— If it were felt necessary to preserve a means of catering for large projects outside the scope of the normal allocation process, for which local authorities have hitherto been able to save up receipts, it would be possible to incorporate a large projects pool in the arrangements for allocations.

6.40 Transitional arrangements would be needed during the first few years of the system, because the receipts element in allocations could not be fully based on receipts generated under the new system until Year 4. This would provide the opportunity for local authorities to take advantage of accumulated receipts brought forward from the present system. Much of the cash associated with those receipts has been spent or used to redeem debt, but the Government estimates that around £3bn remains available nationally. The estimate is extremely tentative; accurate information is to be collected from local authorities. Local authorities have been given the assurance that this amount will be available in full over time to justify additional capital expenditure. Under this version of a gross control system, an amount equal to the cash still available to each authority from its accumulated receipts could be added to that authority's allocations during the first three years of the new system. In Year 1, the receipts element in allocations would be based wholly on accumulated receipts; in Years 2 and 3, the relevant receipts would be a mixture of accumulated and new system receipts.

6.41 An alternative approach would be to stick more closely to the present arrangement for receipts. The new legislation would ensure that only the prescribed proportion of receipts could be used over time to justify extra spending, rather than the whole. In order to remove unnecessary uncertainty, authorities would not be able to use capital receipts for extra spending in the year in which they arose. Apart from those changes, the existing rules would continue. The prescribed proportion of receipts would be available for spending as an addition to basic needs-based allocations in any year or years starting from the year after that in which the receipts were obtained. As in the first approach, transitional arrangements would be needed and would enable local authorities to use receipts accumulated under the present system.

6.42 This alternative approach would put the emphasis on preserving flexibility. But the level of use which would be made of receipts to justify extra spending would be more difficult to forecast accurately. With the first approach, a receipt which had not been used in that way within three years would have to be used to repay debt or to finance expenditure covered by the needs-based element of allocations; with this alternative approach it would continue to be available to increase spending power at any time. It would be correspondingly more likely that the Government would have to make adjustments, for example greater year-to-year changes in the level of allocations, in order to keep the national total of gross expenditure within the cash limits. Nevertheless, the risk of this would be reduced as compared with the present system. Such an approach might be more practicable in Wales, where the level of receipts has been proportionately lower than in England and the overspending at national level less marked.

6.43 Under either approach local authorities would have greater certainty in their capital planning if the proportion of receipts to be included in allocations, or allowed as an addition, were fixed at the outset of the system. But this does not seem practicable. The proportion may need to be higher during the transitional period than thereafter, in order to take account of existing receipts. It may also be appropriate to change the proportion over time, or to differentiate between services, to reflect differences in the rates at which receipts are generated.

(iii) Revenue contributions

6.44 Local authorities are and will remain free to use revenue income to finance expenditure covered by allocations, as an alternative to borrowing. They have argued that the ability to incur extra spending from revenue over and above allocations would introduce an important element of flexibility into any system. Such finance would include direct contributions from revenues received in the year and spending from special funds built up by the authority over time for particular purposes. If such a facility were available, local authorities would have an incentive to achieve more effective management in order to release revenue for capital investment. Accordingly, the Government is prepared to consider providing in the new system for local authorities to supplement their allocations in this way to a limited extent.

6.45 The Government would need to forecast and control the extent to which revenue was used to supplement allocations. Each authority would be required to specify in its annual budget the extent to which it intended to do this. Supplements would be subject to an upper limit, perhaps a given percentage of a local authority's capital allocations for the year. The figure selected by each local authority within that upper limit would then become the maximum amount by which the local authority could supplement its allocations in the year. It would also become the minimum amount of revenue finance which would have to be applied to capital in the year. So if outturn capital expenditure fell short of the sum of allocations plus budgeted supplement, an appropriate amount of borrowing approval would have to be forgone.

(iv) Borrowing approvals

6.46 Specific borrowing approvals would still be needed. Local authorities would be assumed to be able to finance expenditure justified by capital receipts from the cash attaching to the receipts, as now. Each local authority would receive approval for new borrowing for capital purposes by service accounts equal to the amount of its needs-based allocations, exercisable only in the year for which the allocations were given. The amount would be subject to marginal adjustments, as now, and would be reduced by any underuse of resources where a local authority opted for a degree of revenue finance, as described above. The local authority would still be allowed to borrow externally to replace internal loans.

Assessment of the expenditure control option

6.47 The Government recognises the importance of stability in the efficient management of local capital programmes, and believes that the sort of option outlined here would be much more successful in offering that stability than the present system. It should be possible to give local authorities more certainty about their likely spending power for two or three years ahead, even though it will still only be possible to make firm allocations at the conclusion of the annual public expenditure planning process, a few months before the year to which they relate. With the flexibility at the margin to add limited revenue contributions, local authorities would have greater certainty in their capital planning than is possible under the present system.

6.48 Other elements of the system would bring further benefits at local authority level. Although receipts would not constitute additional spending power immediately, there would still be a strong incentive to generate them because they would do so in subsequent years. This would fit well with local authorities' natural preference for securing their receipts before committing the spending of them. Above all, the greater effectiveness of the system would mean fewer rule changes, and this more than anything else would mean greater stability and more efficient capital planning.

6.49 At national level, there would be a high degree of control over expenditure and thereby a stronger influence over the LABR than at present. There would still be no control over the considerable annual fluctuations in revenue borrowing. But such control could only be achieved through an EBL system, which is subject to the reservations noted in paragraphs 6.26 to 6.30. For all these reasons, an expenditure control on the lines described above looks at this stage the most acceptable basis for a new system.

Conclusion

6.50 Although no decisions have yet been taken on the timing of the change to a new system, comments on this chapter are needed to a shorter timescale than for the rest of the Green Paper so that early legislation can be sought if that seems desirable. They should be sent to ● in respect of England, and to ● in respect of Wales, by ●.

6.51 Comments are in particular invited on:

— the relative merits of a system of EBLs and an expenditure control system;

— the details of the EBL system, including the practicability of setting EBLs for all local authorities and the scope for establishing satisfactory safety valve arrangements;

— the details of the expenditure control system, including the two approaches to the treatment of capital receipts considered in paragraphs 6.35 to 6.43 and the possibility of limited use of revenue contributions as a supplement to allocations.

Comments will also be invited on a separate consultation paper to be issued on other aspects of capital expenditure controls.

Chapter 7: Other financial measures

7.1 The taxation and grant reforms proposed in Chapters 2, 3 and 4 of this Green Paper represent the core of the Government's proposals to improve the financial accountability of local authorities to their electors. The main theme in those chapters has been that if local accountability is to be effective, electors must be able to see how the price they pay relates to their local authority's expenditure decisions and the standard of services it provides. Getting the framework of Government grants and local taxation right is a key element in achieving that objective; but other measures could also make an important contribution.

7.2 This chapter considers two further areas where the Government believes reforms could help clarify electors' perceptions of the link between their council's expenditure on services and what they are asked to pay towards them. The first — the fees and charges levied by local authorities for the consumption of certain services — is directly related to the principles underlying the proposed new community charge. The second — the framework governing the presentation and implementation of local authorities' annual budgets — is concerned with the extent to which local authorities may distort the link between their expenditure decisions and tax rates by the way in which they organise their internal finances.

Sales, fees and charges

7.3 Chapter 3 described the proposal to introduce a community charge, paid by all adult residents, as a move toward the principle of relating the amount paid in local taxes to the benefit derived from local services, most of which are now provided for people rather than for property. The levying of a charge for a local authority service is of course an even more direct way of ensuring that local people can see what they are getting for what they are paying. Charging has benefits in terms of efficiency as well as accountability. Where consumers have a choice whether to use a service or not, those who provide the service can accurately judge the real level of demand. Realistic charging policies help to improve the efficient use of resources.

7.4 Extensive use is already made of charging for local services. In 1984/85 income to local authorities' rate fund revenue accounts from sales, fees and charges amounted in England to some £200 million — equivalent to 60% of the yield of domestic rates. When income to the main local authority trading accounts and the Housing Revenue Account is added, those figures are increased to £●m and ●% respectively.

7.5 There are reckoned to be more than 600 individual local authority services for which charges are presently made. Some of those charges are far more important as a source of local income than others. And, as Figure ● shows, they tend to be concentrated on particular services.

Figure ●: Income from sales, fees and charges by main services (England 198●/8●)

7.6 The provision of public services cannot, of course, be governed only by market pricing considerations. Local authorities have a monopoly in most licensing and regulatory functions. Other services — like street lighting — have no individual consumers. They are provided for the community at large, and are appropriately paid for by the community as a whole. Some services are provided for the benefit of those who cannot afford the full cost of a service and must be subsidised if real needs are to be met. Many of the personal social services come into this category. Even where the full cost of a service cannot be met by beneficiaries, effective pricing policies help to make more explicit the extent of the subsidy that is provided by the authority. That in turn can help in focussing attention on options for more cost effective forms of provision. For example, under the Transport Act 1985 bus services will be deregulated and fares for commercial services will be determined by the market. Services subsidised by local authorities to supplement those provided commercially will be open to tender.

7.7 The Government's most important contribution to the development of local charging policies is to establish a clear financial climate within which local authorities can judge the correct balance between communal and specific user charges. Before 1981 the resources element of the Rate Support Grant positively encouraged local authorities to increase rates and reduce income from charges by giving authorities an increasing share of grant as rate poundages increased. This feature of the resources element was carried over for many authorities into the early years of the block grant arrangements. However, as the pressures to reduce total expenditure were increased as described in Chapter 1, the advantages of reducing net expenditure by increasing income from fees became more evident. There is some evidence that income from sales, fees and charges has now started to grow in real terms.

7.8 The gradual move to the new financial arrangements described in Chapters 2-4 will reinforce this trend. It will lead to a clearer understanding of the marginal cost to local taxpayers of extra spending funded from the community charge. Each extra £1 spent will cost local taxpayers £1 more, and each £1 saved will cut the local tax bill by the same amount. The benefits of paying for service improvements by increased charges will be more apparent, since that will clearly put the extra cost on to those who use the services.

7.9 A marked feature of current local charging practice is the differences between local authorities in the proportion of their expenditure met from fees and charges. There will inevitably be variations in local circumstances that will affect the scope for charging — for example city centre authorities can obviously raise more from car parking. But even after taking account of this the range is still very wide, as Figure ● shows.

Figure ●: Variations in proportion of rate fund spending met from charges (1984/85)

Improving charging practice

7.10 Because of the real differences in the circumstances of authorities, any overall re-adjustment in the balance between funding services from general revenues or from specific user charges will depend ultimately on the day by day decisions of individual local authorities. It would not be practicable for central Government to attempt to lay down a particular pattern of charges — nor would it be compatible with the emphasis on local accountability which lies at the root of the proposals in this Green Paper. The Government can however affect the environment within which individual local authority decisions are taken.

7.11 The Government has already taken steps to increase the scope for local authority charging. The new fees introduced for planning and building regulation control in the Local Government Planning and Land Act 1980 have been particularly important in generating additional revenue —£ ● m and £ ● m respectively in 1984/85.

7.12 There will be other opportunities to extend the range of services for which local authorities can charge. In addition the Government will re-examine the case for relaxing central control of existing charges. There are over 100 local authority charges which are set directly or indirectly by central Government through regulations or national agreements. Central controls on charges are inefficient since they do not allow for differences between authorities in the cost of providing a service. Many of these centrally determined charges relate to local authorities' licensing functions which the Government has undertaken to reconsider in the White Paper "Lifting the Burden" (Cmnd ●), with a view to reducing unnecessary bureaucratic burdens on business. The Government has therefore established a review of centrally determined charges.

7.13 The review will have two main stages. First, where the charge relates to a regulatory function, the need for any continuing regulation will be considered. Second, where it is decided that continuing regulation is justified, the case for retaining central controls or national agreements over pricing policy will be re-examined. In the first stage the presumption will be that licensing functions should be abolished unless there is a good case for their retention. In the second stage the presumption will be that local authorities should have *discretion* to make charges which are reasonable in relation to their costs in performing the function to the necessary standard unless there are powerful arguments in favour of national charges.

7.14 The wide variation in the proportion of local authorities' expenditure met from charging supports the conclusion reached in many studies of local charging practices that local authorities have widely different levels of performance in relation to charging strategies or procedures for determining charging levels. Local government is itself trying hard, particularly through its professional bodies, to increase knowledge of the best practices in charging. The Audit Commission too is promoting better practice. It has been argued, however, that the efforts of the professional organisations might be more successful if they were backed by a requirement for local authorities to have regard to a statutory code of conduct in reviewing and determining user charges or the possibility of intervention by the auditor where authorities fail to review charges properly. The Government will consider these propositions as part of the review announced above.

The budgetary framework

7.15 The proposals for reforming the taxation and grant systems will go a long way towards helping local taxpayers understand the relationship between what they pay and what they get. They will remove the distorting effects of the present grant and non-domestic rating arrangements on the relationship between expenditure and taxes at the margin and they will shift the currency of local domestic taxation from rate poundages, varying in their effect on rate bills according to the rateable value of property, towards a flat-rate amount levied on all resident adults of an authority.

7.16 However, the relationship between marginal changes in an authority's expenditure and the level of its tax is also affected by the way in which the authority organises its own finances. For example, an authority can reduce the effect of an increase in expenditure on tax levels by drawing on its reserves. Conversely, if it wishes to raise revenue to replenish its reserves, it will need to increase tax levels more than is necessary simply to finance an increase in expenditure on goods and services. Other internal financing arrangements can have similar effects.

7.17 In recent years, there has been considerable distortion in the relationship between changes in authorities' expenditure and rate levels at the margin. This has been due in part to financing adjustments which authorities have considered necessary to cope with the instability and uncertainty of the present grant system described in paragraphs 4.16 to 4.18 above, and to minimise grant losses under the system of penalties which operated from 1981/82 to 1985/86. The proposals for a new grant system which is stable and which involves grant allocations to authorities which are fixed at the start of the year should significantly reduce the need for such financing adjustments, although the Government recognises that local authorities will need to retain some flexibility in deploying their resources in the interests of prudent financial management.

7.18 However, in a few cases there is some evidence that distortion has occurred in the relationship between expenditure and rates as a result of decisions (either explicit or implicit) within the local authority's control. Such distortion has been caused by inadequate rates to meet planned expenditure by understating planned expenditure against the authority's own policies, or by not specifying where economies have to be made or income raised, i.e. the total of revenue expenditure given the local authority's plans and commitments. Local authorities are under a legal obligation to levy a rate sufficient to meet their expenditure after taking account of income from other sources. But accounting devices may conceal the true state of the council's finances or various stop-gap measures may be adopted to keep the authority's books balanced in the short term thus avoiding an immediate crisis in the authority's finances. Such practices may be storing up serious long-term problems. And they mislead local electors about the true costs of the services provided for them. This is an undesirable development which is not in the interest of responsible local government, hard-pressed local taxpayers or healthy local democracy.

7.19 The auditor has, of course, an important part to play in ensuring financial propriety. But the main focus of his powers is the authority's audited accounts, after the end of the financial year. He can act once financial impropriety can be established but this is not always easy to do unless clear evidence is available. But his ability to intervene to forestall improper or imprudent financial actions before or during the financial year is very limited.

7.20 One way of tackling this problem might be to set up a process whereby authorities' budgets were subject to some sort of checking or scrutiny by the auditor before they were approved by the authority to ensure that they were soundly based. But it would not be practical or necessary to submit all authorities to such a procedure. The problem of unbalanced budgets is not widespread, and a measure such as this would be understandably resented by local government. The Government would therefore much prefer a "self-policing" solution which drew upon the professional probity of local government financial management to ensure that sound budgetary practice is maintained in all authorities, and that, where departures from such practice occur, they are drawn to the attention of the authority and of its electors.

7.21 This could be achieved by establishing a specific statutory role for the treasurer or chief finance officer in relation to the legality and propriety of the expenditure by his local authority. This would bear in particular on the preparation of the budget and rate demand (or community charge demand, as it would be under the new arrangements) and the monitoring and audit of expenditure and income during the financial year. A possible approach to this might be to establish a statutorily recognised role for the chief financial officer in the drawing up and execution of budgetary decisions, with a requirement that he be a properly qualified accountant. It would be possible for example to provide that:

— no taxing resolution of the council would be valid without a certificate from the treasurer that the authority's proposed tax demands for the coming year were adequate to meet its estimated revenue expenditure, given the authority's plans and commitments;

— the treasurer would have a legal duty to satisfy himself, in deciding whether to make such certification, that the authority's estimated revenue expenditure for the year represented a fair and reasonable statement of the council's expenditure policies;

— the treasurer would have a legal duty to make a formal public report to the full Council, which would be available to the auditor, if he considered at any time that a proposed item of expenditure or financing mechanism were either illegal or improper (he already has a professional duty to do so);

— the treasurer would also be obliged to make a formal report to the full Council at any time during the year if on the basis of his professional judgment he considered that the authority's resources were likely to be inadequate to finance its expenditure, either on the basis of existing expenditure plans or proposed new commitments or a failure to raise anticipated revenue. In that event the Council would be obliged to take remedial action.

7.22 If the Council were to persist in incurring expenditure which they had been warned was unlawful or improper, councillors would weaken their position in any action which might subsequently be taken against them by the auditor or in the courts. And any warning that resources were likely to be inadequate to meet expenditure, together with the Council's response to it, would be on the record when the authority's accounts came to be audited at the end of the financial year.

7.23 In practice, the Government envisages that treasurers would rarely have to invoke the third and fourth of the duties listed in paragraph 7.21. An informal warning by the treasurer to his council that, if they were to undertake a particular course of action, he would be obliged to invoke these duties should normally be sufficient to cause them to reconsider the proposal. If a treasurer were obliged to take action, this could of course cause difficulties for his relationship with the majority group of councillors. Nevertheless the Government considers that if local authorities are to be made more accountable to local electorates, then those electorates must be able to rely on the adequacy and professional impartiality of the self-policing arrangements. The auditor is not in a position to fulfil that role. The treasurer, however, is best placed to provide the necessary safeguard: and the electorate would expect him to proceed in the way suggested.

7.24 The Government considers that a duty along these lines which leaves the responsibility with the treasurers of local authorities to draw the risk of financial impropriety formally to the notice of their Councils, so that local electors are aware of potential problems, would do much to ensure that authorities were not tempted to act imprudently, so that the relationship between their spending and taxation decisions was kept as clear and direct as possible. In this way, the accountability of authorities to their electors would be further enhanced.

7.25 The Government recognises that this proposal has a bearing on the issues currently under consideration by the Committee of Inquiry into the Conduct of Local Authority Business, and has already raised this issue in its evidence to the Committee.

Summary

7.26 The central objective of the proposals contained in the Green Paper is to increase local accountability by clarifying for electors the link between what their local authority spends and the costs they are asked to bear. This objective lies at the heart of the proposals for reforming the grant and local taxation systems. But it also underpins the proposals in this chapter.

7.27 If local authorities are given greater freedom over the level of fees and charges they levy; are encouraged to adopt a more systematic approach to charging policy; and are given a greater incentive to maximise income from charges, electors should acquire a clearer perception of the cost of the services they consume and be able to exercise more effective choice and influence over the services they want their local authority to provide. If treasurers are required to guarantee the financial propriety of their council's expenditure and taxations decisions, the scope for distortion of the effects of those decisions should be significantly reduced. Both sets of proposals contained in this chapter should therefore make an important contribution to improving the accountability of local authorities to their ratepayers.

Chapter 8: Scotland

8.1 Earlier chapters have looked at defects in the present system of paying for local government services largely in terms of the specific administrative arrangements applying in England. While the structure and administration of local government in Scotland differ in important respects, similar problems have been encountered in the working of the financial arrangements and the principles of the Government's proposals apply equally in Scotland. There remains however ample scope to tailor the approach to meet distinctive Scottish circumstances and perceptions. Local government is subject to separate Scottish legislation and in administering it the Secretary of State for Scotland can accommodate the detailed application of policy and the timing of change to suit Scottish conditions.

8.2 The chapter describes briefly the existing system of local government finance in Scotland and in particular developments over recent years, drawing attention to some of the important differences from the English system. It then reviews against Scottish circumstances the proposals in Chapters 2 to 7 above on the future of non-domestic rates, local domestic taxation, the system of Government grants, the combined impact of new taxation and grant regimes, controls on local authority capital expenditure and the budgetary framework of local government. The chapter concludes by identifying a number of areas where a distinctive approach may be necessary in Scotland or where the Government consider it would be desirable to adapt their proposals in the light of Scottish conditions.

8.3 All Scottish rateable values were re-assessed with effect from the beginning of 1985-86. This affects the relative contribution of different ratepayers in Scotland and this chapter departs from the normal practice elsewhere in the Green Paper of quoting 1984-85 figures. Wherever possible below illustrative figures are given for the financial year 1985-86. The results for households and tax units discussed below and in Annex J are however on the same 1984-85 basis as for England and Wales. This is because of the difficulties of adapting FES data to take account of the effects of the revaluation.

Scottish Local Government Finance

8.4 Over a long period the structure of local government has evolved somewhat differently in Scotland. The 1975 re-organisation of local government introduced two distinct tiers of local authorities for mainland Scotland. The larger regional councils provide most major services including education, police, social work, water and sewerage. Regions account for almost 8% of total local government expenditure in Scotland. The lower tier of district councils provide the more locally based services including housing, cleansing, leisure and recreation. Districts account for slightly under 20% of total expenditure. The balance of some 3% of expenditure is attributable to the all-purpose islands councils which undertake the whole range of local government functions in Orkney, Shetland and the Western Isles.

8.5 There are differences between Scotland and England in the range of services provided by local authorities. In financial terms the most important is that Scottish Regions and Island authorities are responsible for the full range of water and sewerage provision in their areas, while in England this responsibility falls on separate Water Authorities which are nationalised industries and not part of local government. The costs of water and sewerage add significantly to the scale of expenditure by local government and the burden of local rates in Scotland. To illustrate the impact on domestic ratepayers, in England the average local authority rate bill for 1985-86 was around £350, while for Scotland including domestic water rates the average was significantly higher at £392. For a valid comparison based on a similar basket of services the average charge for water and sewerage provision must be added to local authority rates in England, yielding a total of over £430 — 10% higher than the Scottish figure.

8.6 Since 1980 the Government have been successful in expanding owner-occupation in Scotland and about 70,000 public sector houses have been sold to sitting tenants. However, local government in Scotland retains responsibility for a very much greater proportion of the total housing stock than in England. Local authorities have to finance expenditure on housing through a separate Housing Revenue Account excluded from general figures on local government spending. The Government have statutory powers to limit support for housing from authorities' general account. Such Rate Fund Contributions are steadily being reduced and now account for no more than 2½% of general local authority expenditure.

Expenditure

8.7 In 1983-84, the last year for which full figures are available, Scottish local authorities spent around £3640 million on general rate fund services. Of this 88% was for current expenditure on goods and services with 12% going on loan charges arising from debt incurred to finance capital expenditure over the years. The most important sources of income to local authorities to finance this expenditure were:

— grants from central Government (including domestic rate relief		
— and rate rebate grants)	£2050m	(56%)
— local authority rates	£1320m	(36%)
— sales, fees and charges	£170m	(5%)
— other income	£120m	(3%)

8.8 In 1985-86, local government net expenditure per head of population was about £700, against a figure of [£540 per head in England]. Additional expenditure in Scotland reflects for example the inclusion of spending on water and sewerage services and the acceptance by Governments over the years that Scottish local authorities face increased costs in providing services because of such factors as harsher climate and topography and the existence of remote and widely dispersed populations in the Highlands and Islands. Because Scottish authorities face these additional spending needs and have a lower level of rating resources overall the proportion of expenditure met from Government Grants in Scotland has traditionally been higher than in England. In 1985-86 this proportion was 58% in Scotland, ahead of the 49% provided in England but below the Welsh figure of 67%.

Government grant

8.9 The total of the major Central Government grants to local authorities in Scotland administered by the Secretary of State is termed Aggregate Exchequer Grant (AEG), amounting to £1962.5 million in 1985-1986. The first charges on AEG are the specific grants in support of services such as police which accounted altogether for 12% of AEG. The remaining 88% constitutes Rate Support Grant (RSG) divided in turn into three elements:

domestic element	£102.3 m
resources element	£203.5 m
needs element	£1424.5 m

8.10 The domestic element is paid to the regional and islands councils which collect the rates on behalf of all authorities. It is applied to provide a subsidy to domestic ratepayers by reducing directly the rate poundage they pay by a fixed amount per pound of rateable value set by the Secretary of State. Following the 1985 revaluation domestic relief for 1985-86 was set at 8p in the £, equivalent to about £1 per week for the average domestic ratepayer in Scotland. For 1986-87 it will be 7p.

8.11 The resources element is intended to compensate to some extent for the differences in rating resources between local authorities, primarily due to the uneven spread of commercial and industrial development across the country. It is applied to bring those authorities which receive resources element to a position where a common rate poundage would raise the same amount in rates per head of population. At present there are 9 authorities which receive no resources element of grant since they already have sufficient rateable value locally to take them above the standard level to which all other authorities are raised.

8.12 The needs element is designed to equalise the varying levels of expenditure need among authorities so that all authorities can provide a similar standard of service at a similar cost per head. For instance, the education service is more expensive to provide in sparsely populated areas and higher levels of needs element on this account compensate so as to equalise the cost to the ratepayer. Needs element is distributed on the basis of client group assessments of relative expenditure need which are built up service by service. The assessments are designed to identify the factors outwith the control of authorities which affect the need for and the cost of services. The assessments are expressed in terms of primary and, where appropriate, secondary indicators. For instance the primary indicator for school teaching costs is the number of pupils in the authority, the secondary indicator is the settlement pattern of the authority (to measure sparsity). In other services there are factors to reflect the extra cost of providing services in urban areas or areas of deprivation. The total of assessments for all services is the basis for needs element distribution. Grant is distributed so that after needs element a similar amount remains to be financed from the rates. The client group method is not yet fully implemented as a method of distributing grant. It was introduced in 1983-84 but transitional arrangements still apply to limit the gains and losses to authorities in moving to the new basis of distribution. The needs entitlement is also adjusted to reflect an estimate of the specific grants to be paid to the authority.

Rates

8.13 Leaving aside the small proportion raised in fees and charges at present almost 59% of the money spent by local government in Scotland is provided through grants from the national taxpayer. The remainder comes from rates levied in proportion to assessed rental value on occupiers of property in Scotland such as hotels, shops, offices, factories, public buildings and dwelling houses. Of the total raised from ratepayers 69% comes from non-domestic ratepayers in commerce, industry etc with no direct voice in the election of local councillors. After taking account of all rate rebates, in the domestic sector there are about 1.1 million householders paying full rates out of an electorate of 3.9 million adults. This contribution from domestic ratepayers pays for only 13% of total Council revenue spending.

Figure 8.1 – Sources of funding of local government in Scotland.

Valuation for rating

8.14 Valuation of non-domestic property for rating in terms of assessed rental rests on the same basic principles in Scotland as elsewhere in Great Britain. The administration and practice of valuation is governed by separate Scottish legislation dating back to the middle of last century and rooted in the distinct Scottish law of landholding. Valuation is carried out by assessors for each separate region who are employed by local authorities but act independently of local Councils and Ministers in arriving at their professional judgement of property values in each area. In England and Wales the task of assessment falls to the Valuation Office which in part of the Inland Revenue. Inevitably over the years significant differences have emerged in the practice of valuation as applied to certain types of non-domestic properties between Scotland and the rest of Great Britain.

When valuing domestic property the law in Scotland allows the assessor to take account of rents fixed by administrative action, for example by a rent officer in terms of the Rent Acts, in arriving at a general level for domestic values in an area. In England and Wales only those rents set in open market terms may be used. One result of this has been that the share of total value attributable to domestic property is markedly lower in Scotland. On a comparable basis domestic property accounts for 39.1% of total rateable value in Scotland as against 48.8% in England and 47.1% in Wales.

8.16 The larger share of the total rates burden falling on the non-domestic ratepayer in Scotland is recognised in the case of industrial property by a measure of de-rating. It is assumed that industry in Scotland will normally face competition directly from firms based in England and Wales and taken as a whole the industrial sector in Scotland should face rate bills which are comparable to those elsewhere in the country. At present this results in the valuation of all industrial property in Scotland being reduced by 40% for rating purposes.

8.17 Scottish assessors have carried out regular revaluations of all property in 1971, 1978 and again in 1985. In England and Wales a general revaluation was last carried out in 1973 and in consequence rateable values in Scotland are now set at levels several times greater than those for property elsewhere in the country: rate poundages are correspondingly lower. The use of managed rents as evidence in fixing Scottish domestic values (paragraph 8.15) has been a major factor in allowing revaluations to go ahead in Scotland. Certainly the lack of evidence of true market rents for domestic property would have made it exceedingly difficult to undertake a general revaluation in England and Wales in recent years. Regular revaluations are fair within the terms of the present rating system in that they share out the same overall rates burden more closely in line with up-to-date evidence of rental values but a price has to be paid in the disruption faced by ratepayers following any revaluation.

8.18 While revaluation does not of itself alter the total to be raised from all ratepayers in Scotland, it affects the bill paid by the individual ratepayer in a number of ways. Most obviously his own rateable value may increase significantly more or significantly less than the average for property in the area as a whole. Changes in the aggregate of rateable values between local authorities affect the distribution of the resources element of Rate Support Grant (paragraph 8.11) and so change the amount which each authority has to take from ratepayers locally. There may be major switches in the relative share of total value borne by different sectors, domestic, commercial, industrial etc leading to changes in the scale of domestic rate relief or industrial de-rating. The combined impact of these changes, quite aside from any real movement in the pattern of local authority spending, may easily face someone with a rates bill increasing by a factor of 50% or even 100% or more in a single year.

8.19 Initial figures from the 1985 revaluation suggested that over Scotland as a whole the share of rateable value in the domestic sector would increase sharply with a corresponding decline in the share of the industrial sector. The Government increased the domestic element of Rate Support Grant (paragraph 8.10) eightfold in 1985-86 to ease the impact of revaluation and adjusted Scottish industrial derating from 50% to 40% to maintain parity with industry elsewhere in Britain. After allowing for these adjustments, domestic ratepayers were still faced with 1985-86 rate bills rising on average by 6% in Highland, 11% in Grampian, 15% in Borders and Dumfries and Galloway, 20% or more in Tayside, Fife, Lothian and Strathclyde. Such changes were wholly disproportionate to any movement in spending on local services and have faced the individual householder with what is seen as a quite arbitrary and unpredictable imposition.

8.20 Average movements at the regional level mask even more dramatic increases falling on individual ratepayers. The average domestic valuation in Scotland increased on revaluation by a multiplier of almost 2.7, but 130,000 Scottish householders faced multipliers of more than 3 times their previous rateable values. The degree of fluctuation about the average was still more marked in the commercial and industrial sectors. To mitigate the impact on those ratepayers hardest hit by revaluation the Government introduced legislation during the summer of 1985 to establish a special scheme of Revaluation Rate Rebates. Under this, 1985-86 rate bills were limited to the amount payable on three times the 1984-85 valuation of a property with a central Government subsidy making up the difference where the valuation had increased by a multiplier of more than 3. Despite the benefit of this to those worst affected by revaluation over 100,000 householders in Scotland have faced increases of more than one-third in their rate bills between 1984-85 and 1985-86. This reflects the way in which some authorities increased their spending after revaluation, as well as the impact of above-average increases in rateable values.

8.21 Against this background it is no surprise that the 1985 revaluation has forcibly reminded many Scottish ratepayers of the defects in the rates as a means of paying for local government. In many areas there has been widespread loss of public confidence in the present Scottish rating system and a vociferous demand for reform.

Controlling local government spending

8.22 As in Britain as a whole local government current expenditure in Scotland grew rapidly in the 1960's and into the 1970's at an average annual rate of around 4 per cent more than the rate of inflation. The full cost of this increase was hidden from ratepayers by a steady increase in Government grants; by 1975-76 Aggregate Exchequer Grant in Scotland had reached 75%. Local Councils could not continue to pre-empt an increasing share of national resources in this way and the previous Labour administration cut expenditure sharply in 1977-78 and had reduced AEG to 68.5% by 1978-79.

8.23 On taking office in 1979 the present administration were committed to relieving the growing burden which public expenditure was imposing on the wealth-creating sector of the economy. The Government acted decisively to control spending on major centrally provided services but had no direct control over local authority current spending. Over the years from 1979 a number of measures have been introduced in Scotland designed to restrain spending by local Councils. The rate of Government grant has been reduced from 68.5 per cent in 1980-81 to 57.7 per cent in 1985-86. This increases the proportion of spending funded directly by local ratepayers and aims to maintain the pressure on authorities from their own electorate to spend responsibly.

8.24 Since 1981-82 the Secretary of State for Scotland has had the power to take selective action against an individual authority planning excessive and unreasonable expenditure. Initially action involved reducing the scale of grant to the authority concerned but from 1983/84 there has been power also to require such an authority to reduce its rate. Selective action may be initiated early in the financial year on the basis of an authority's forward budget for the year. The Secretary of State decides on whether to initiate action on the basis of a number of considerations such as the degree of excess expenditure planned and the level of spending in relation to comparable authorities. Subject to Parliamentary approval the rate poundage set by the authority is cut, and rate bills for all ratepayers in the authority's area are reduced. Similar powers apply where an authority attempts to make an excessive Rate Fund Contribution to housing expendiutre (paragraph 8.6). Over the past three years some £40 million has been returned to Scottish ratepayers by the Secretary of State's use of these powers.

8.25 To control increases in expenditure by authorities more generally the Secretary of State issues current expenditure guidelines to all authorities in the autumn before they take spending decisions for the following year. These guidelines have as their basis the client group assessments of relative expenditure need described above (paragraph 8.12). The assessments of expenditure need are adjusted if necessary so that no authority is expected to make an unrealistic reduction in its expenditure in one year. An upper limit is also placed on the expenditure increases implied by the guidelines in any one year. Authorities are not required to spend at their guideline, but if they exceed it their grant is reduced. The grant penalties are based on a tariff which becomes more severe according to the percentage overspend against guideline. Thus in 1985-86 an authority which overspent by 1% lost an amount of grant equal to 90% of the overspend. An authority overspending by 3.5% lost grant equal to 170% of overspend. Penalties are imposed on the basis of budgets and revised on the basis of outturn expenditure. Authorities can recover penalties at outturn by reducing planned expenditure (and vice versa).

8.26 These various measures have had some success in showing the growth of local authority spending but this has been achieved at a heavy price. Tensions between central government and local authorities have increased. General measures such as cuts in the grant percentage inevitably affect low-spending and prudent councils. The outcome has been only fairly modest overall reductions in spending and total planned expenditure by Scottish local authorities in 1985-86 was still 3.2% above Government guidelines.

The government's proposals

8.27 The reasons for the failure of Government measures to achieve adequate control of local authority spending in Scotland are essentially the same as those in England examined in earlier Chapters. There is a serious mismatch between those who elect the local councillors taking spending decisions and the ratepayers who have to bear the financial consequences. Authorities are free to raise a high proportion of their rate income from non-domestic ratepayers with no direct say in local elections (paragraph 8.13). The existing system of Government grant, coupled with dramatic change in rateable values at regular revaluations, sends confusing signals to electors about the relation between Council spending and what they have to pay (paragraph 8.19).

8.28 The broad proposals for change outlined in earlier Chapters offer a route to more responsible spending policies through greatly improved accountability of Councils to their local electorate. They would greatly increase the numbers of electors who have to contribute towards the costs of local spending decisions taken on their behalf. The non-domestic ratepayer would no longer face demands varying widely and unpredictably from year to year and in future the full consequences of marginal changes in spending would fall on local electors. Application of the proposals in Scotland must take account of specific institutional differences in local government and the way the existing system is seen by Scottish ratepayers.

Non-domestic rates

8.29 Chapter 2 explained the Government's view that rates based on property values should remain as a form of taxation in the non-domestic field. Rate poundages would in future be set by central Government and the income from non-domestic rates would accrue centrally and be redistributed to local authorities as a standard level of grant. In applying these principles to the Scottish situation allowance will have to be made for the wider range of services funded from local authority rates and the generally higher level of non-domestic rates in Scotland.

8.30 Paragraph 2.* above proposed that non-domestic property in England should be revalued with effect from 1990. Under statute at present a further Scottish revaluation is due also in 1990 and the Government propose that this should go ahead but be confined solely to non-domestic property. Following experience of sharp movements in commercial values during the 1985 revaluation there may be benefit in phasing in new values over a period of years from 1990.

8.31 The major concern of the valuation system and related appeals procedures has been to ensure fairness between ratepayers in each local valuation area. The Government see advantage in moving in time to a common non-domestic poundage in all areas and it may be desirable to harmonise valuation procedures to provide for a common standard. Where significant differences persist between Scottish and English valuation practice affecting certain types of property further statutory changes may have to be considered to ensure fairness in valuations throughout the country. Until such moves took effect the Government would propose to retain industrial de-rating, to start by capping existing Scottish non-domestic rate poundages based on up-to-date valuations in each locality, and to control future poundage increases by linking these to some general index of price movements (paragraph 2.*). This would provide an immediate guarantee of much greater stability in the rate burden levied on industry and commerce in Scotland.

Local domestic taxation

8.32 Chapter 3 sets out a series of reasons why the Government now favour the concept of a community charge payable by all adults as the main form of local domestic taxation in the years ahead. This will lead to many more electors contributing directly to local taxation and authorities will be conscious that changes in their expenditure will reflect directly in a charge paid by all adult residents with incomes above the level qualifying for rebates.

8.33 While the general arrangements for a community charge in Scotland would be similar, the Government consider there is scope for faster transitional arrangements north of the border. The degree of variation in average rate bills from area to area is less extreme in Scotland and there are no local authorities levying average domestic rate bills at the very high levels typical of central London (which will require the phasing out of a local domestic property tax there to extend over a considerable number of years). It is evident from reaction to the 1985 revaluation in Scotland (paragraph 8.21) that existing arrangements for valuation and rating of domestic property are no longer a satisfactory basis for contribution to the cost of local government services.

8.34 Inevitably the move to a community charge in place of domestic rates would involve a degree of disruption and the change could not sensibly take place in a single year. But the Government will not tolerate any delay beyond the minimum necessary. Those most affected, who have not been making a contribution to domestic rates in the past, must have time to come to terms with the effects of having to do so; but the Government believe that in Scotland the transitional period need not exceed 3 years from new legislation coming into effect. Certainly there is no question of any further revaluation affecting domestic rateable values in Scotland. One possible timetable would be for all local authorities to reduce the poundage of domestic rates in 'year one' of the new system to 60% of the poundage based on a designated year under the present system and to make up the yield thus lost by levying a community charge. The proportion met from rates might fall in successive years to 40%, 20% and then zero with the final abolition of domestic rates in the fourth year of the new system.

The grant system

8.35 The general objectives of a new grant system for Scotland would follow those set out in Chapter 4. Local authorities would be given grant which would allow them to provide similar levels of service at a similar cost to local residents in terms of a community charge. There would be two major elements of grant:

(i) A needs grant to compensate authorities for differences in the costs of providing a standard level of service in different areas of Scotland.

(ii) A standard grant representing a uniform level of contribution from central Government towards the cost of local services.

8.36 The needs grant would be based on the client group assessments of relative expenditure need used at present in distributing grant in Scotland. These have been developed in consultation with the Convention of Scottish Local Authorities and there would continue to be a separate system of assessment reflecting Scottish needs and circumstances. The process of equalisation would be similar to that used at present for needs element of RSG with grant being given to meet the difference between the needs assessment per adult of each authority and that of the authority with the lowest assessment per adult. the standard grant would then be provided to all authorities at the same amount per adult. The proceeds of non-domestic rates would also be redistributed to all local authorities as a fixed sum per adult, supplementing the standard grant.

8.37 In this system there would be no need for a grant to equalise differences in taxable resources. At present the resources element (paragraph 8.11) has as its justification the need to correct the variations in total rateable value between area. These variations arise very largely from non-domestic subjects which would no longer provide significant rating resources specifically for the authority within which they are situated. With the separation of non-domestic and domestic local taxation and the move to abolition of domestic rates there would be no need for domestic rate relief and this would also end.

8.38 Differences in the existing levels of domestic rates from area to area reflect differences in the transitional pattern of spending by each authority in relation to levels of grant and its domestic and non-domestic rating resources. To move directly to the new grant arrangements would entail unacceptable disruption on top of the effects on individuals of the move from domestic rates to a community charge. The Government propose therefore to introduce a safety net. For a base year an amount would be added to, or subtracted from, each authority's entitlement under the new regime to ensure that the claim on domestic taxpayers was unchanged if spending remained constant. These amounts would be fixed in cash terms for subsequent years, so that changes in spending would be reflected in the level of each authority's community charge.

8.39 Specific grants in support of particular services would continue to have their place in the new system. As explained in paragraphs 4.* — 4.*, the Government see a need for continuing review of the pattern of specific grants and these will be looked at in Scotland against the general principles set out in paragraph 4.*

8.40 The islands councils in Orkney and Shetland, thanks to offshore oil development, presently enjoy a very high level of non-domestic rating resources. Domestic ratepayers contribute less than 10% of rate income and domestic rate bills are markedly lower than in mainland Scotland. Equally however the councils, particularly Shetland, have incurred very heavy capital expenditure to facilitate expansion of the oil industry and as a result Shetland carries an exceptionally heavy burden of capital debt. In these circumstances the Government consider that special consideration should be given to the position of the islands councils in introducing their new proposals.

8.41 The new system as a whole is expected to achieve greatly improved control over local government expenditure through increased accountability, and to bring home to the entire local electorate the consequences of any excessive spending by a local authority. The level of Government grant will be unaffected by the spending policies of any particular local authority and there will be no continuing need for general grant penalties (paragraph 8.25). The Government will however retain a last-resort power — analogous to that which they have at present — to reduce impositions on the local domestic taxpayer where an authority is clearly planning expenditure which Parliament judges to be excessive and unreasonable.

Impact of the grant and taxation changes

8.42 With the safety net proposals described in paragraph 8.38 above the impact on households and tax units will depend on the changes in the domestic tax arrangements. As in England and Wales there will be a shift in the burden of taxation from householders to non-householders who will be brought into local tax for the first time. Single adult households will gain, at the expense of households with three or more adults.

8.43 The results in Annex J show that in Scotland, with a 100 per cent community charge and a full safety net grant, ● per cent of households would gain and ● per cent would lose. ● per cent of tax units would gain and ● per cent would lose. Most losses would be under £2 a week, but ● per cent of tax units would lose over £2 a week.

8.44 The Annex also shows the impact in the first year with the transitional scheme envisaged for England and Wales. As paragraph 8.34 makes clear a speedier transition is envisaged in Scotland. In particular it is proposed that all domestic rate bills should be cut by 60 per cent in the first year of the scheme and the shortfall would be made up by a community charge. This would mean community charges ranging from ● in ● to ● in ●.

8.45 In the first year the *pattern* of gains and losses will be similar to that with a 100 per cent community charge, but the *scale* of gains and losses will be smaller.

Capital expenditure

8.46 Scottish arrangements for the control of local authority capital spending are considered to be working well at present and the Government do not intend to apply the proposals of Chapter 6 in Scotland.

Budgetary framework

8.47 The proposals in Chapter 7 for improving the budgetary framework under which local councils operate should be applicable equally in Scotland. The duty to certify a sincere budget (7.*) would naturally fall on the Chief Finance Officer of each authority in Scotland.

A timetable for change

8.48 The Government are convinced that there is a demand for early action on reform of local government finance in Scotland. The Secretary of State for Scotland is at present planning to find room for the necessary legislation in the separate Scottish legislative programme for the coming 1986-87 Parliamentary Session. Immediate changes in Scotland could introduce the machinery of a community charge along with the new grant system and provide for the capping of non-domestic rates. With legislation in the 1986-87 Session these changes could be introduced with effect from 1 April 1989, leading to the final abolition of domestic rates in Scotland at the end of March 1992.

Consultation

8.49 Comment from Scottish ratepayers and others on the Government's general proposals and the specific Scottish points in this Chapter should be sent to the Scottish Office, Room 7/12, New St Andrew's House, Edinburgh EH1 3TB. To allow for early legislation in Scotland, comments should be submitted by 30 April 1986 at the latest.

Chapter 9: Wales

Background

(i) Development of central-local government relations in Wales

9.1 The Secretary of State for Wales has responsibility for the great majority of the services provided by local government in Wales. The main exceptions are police and fire which remain with the Home Secretary.

9.2 Since its creation in 1964 the Welsh Office has provided a direct link between local and central government in Wales. But it was not until 1980, when the Conservative Government transferred responsibility for the financing of local government to the Welsh Secretary, that a comprehensive dialogue on the contribution, cost and funding of local services in Wales could begin. This new function provided the vehicle for the often unique needs and circumstances of Welsh councils to be reflected in the arrangements for distributing capital resources and grant to individual authorities.

9.3 The decentralisation of financial decision making from London to Cardiff has required the local authority associations in Wales to develop a view as to the needs of their members across the whole spectrum of local authority activity. Indeed, a notable feature of the Welsh scene in recent years has been the important part played by the associations in helping to create the conditions for a constructive dialogue between central and local government, despite differing views on the need for expenditure restraint by the local sector. A real effort has been made by both sides, whenever possible, to operate in partnership.

(ii) Local authority performance in Wales

9.4 As in the rest of the United Kingdom local athorities in Wales throughout the 1960s and 1970s absorbed an increasing share of national income. Spending on services grew by 3 to 3½% per annum more than inflation, and by about 1 to 1½% more than the economy as a whole. Manpower grew by leaps and bounds. In 1960 Welsh local authorities employed about 85,000 people. By 1979, employement had risen by 80% to 155,000 — almost 1 in 7 of the total labour force in Wales.

9.5 Rate rises also significantly outstripped inflation. Between 1960 and 1979 rates increased 8 to 9 fold, whereas prices rose by only half that amount.

9.6 The apparently irresistable increase in revenue expenditure led to a position in which capital investment in roads, schools and houses had to be trimmed in order to contain total spending. As a consequence, by the end of the 1970s investment had fallen to about 20% of total local spending compared with a typical share of 30% in the early 1960s.

9.7 The Government came into office in 1979 determined to half, and if possible reverse, these damaging trends. The record shows that its objectives have been achieved in Wales.

9.8 Since 1979:

— current spending on services has for the first time grown broadly in line with, and not faster than, inflation: in real terms councils in Wales are now spending no more than they did in 1979;

— local authority manpower has been reduced by over 6,000 (5%);

— rates have risen by about 7 percentage points less than the Retail Price Index;

— success in reining back revenue expenditure has allowed a significant amount of resources to be released for capital investment. Since 1981 gross capital investment by Welsh local authorities on a wide range of schemes has increased by 46%, or twice as fast as inflation over that period.

9.9 These changes have not been easy to achieve. But the effort has been worthwhile. Local government is now leaner, more effective and cost conscious. At the same time key services have been developed. Education spending per pupil is now at a record level; and spending on other priority activities such as the police and personal social services has grown by 18% and 9% respectively more than inflation since 1979. Relatively new services such as recreation have improved almost beyond recognition. This does not mean that councils are yet in a position to claim that they are even close to securing full value for money from the resources entrusted to them by the community. But a good start has been made.

(iii) The case for change

9.10 In short, if the case for a thoroughgoing reform of local government finance rested solely on the need for expenditure restraint then the impetus for changes in Wales would not be a strong one. However, the case is far more widely based than this.

9.11 In particular:

— the need for a better balance between the demand for local services and the cost of providing them is as strong in Wales as in the other countries;

— the damaging mismatch between those entitled to vote in local elections and the relatively small numbers who actually pay for local services is as great in Wales as elsewhere;

— non-domestic ratepayers in the Principality, although not faced with the severe pressures encountered by their counterparts in some areas of England and Scotland, deserve the measure of protection and certainty the Government proposes to give them in other parts of Great Britain;

— although central and local government have made strenous efforts in Wales to keep the block grant system as simple as possible the case for further simplification and greater clarity and predictability is a powerful one.

9.12 The fact that it has proved possible to achieve the Government's expenditure and rating objectives for Wales using the existing financial system should not blind us to its imperfections or make us complacent about the future. The need for a self regulating local government sector underpinned by a greater measure of local accountability is as pressing in Wales as in England and Scotland.

(iv) Need the reforms be the same in Wales?

9.13 While the Government's objectives and the principles underlying the proposals for reform apply to the whole of Great Britain, the structure of the reforms needs to be tailored to the circumstances of each country. With this in mind the key elements of the review are now put into their Welsh context.

Local non-domestic taxes

9.14 As Figure [ ] shows 60% of the rate income of local authorities in Wales is drawn from the non-domestic sector — broadly the same proportion as in England. The balance represents the domestic sector's contribution, net of rate rebates.

Figure [ ] Source of rate income (Wales: 1984/85)

9.15 National averages often conceal sharp differences between areas. Within Wales the non-domestic sector's share of the rate burden varies from under 50% in some areas to over 80% in others. Put another way, in certain areas for every £1.00 contributed by domestic ratepayers, who have a vote, non-domestic ratepayers, who do not, are charged as much as £4.00. This imbalance, together with the complicated grant arrangements aimed at equalising rateable resources, disguises the true cost of extra spending from domestic ratepayers. Until the actual cost of additional spending is apparent to the electorate greater local accountability cannot be achieved, and the non-domestic sector will not have the measure of protection its vulnerable position so clearly demands.

(i) The options

9.16 Chapter 2 proposes that a national non-domestic rate should be set. The same poundage would apply in all areas. An alternative would be to 'cap' non-domestic poundages. But that would mean freezing the present pattern of poundages in perpetuity. Under either scheme annual increases in the non-domestic charge would be linked to the projected rate of inflation for the following year, although this calculation could be adjusted to take account of the underlying growth of non-domestic rateable values. In the case of the national rate option individual authorities could add to the yield by levying a small supplement which could be retained locally. This local flexibility would be allowed for when setting the national rate. Within each country the yield of the non-domestic rate, on either model, would be pooled and distributed to local authorities as a standard amount per adult. There would be no need for separate non-domestic resource equalisation arrangements.

9.17 Both these schemes would give a far greater degree of protection to non-domestic ratepayers and both would allow them to predict far more accurately their contribution to the funding of local services. It would also ensure that the entire cost of spending in excess of the amount allowed for in the Government's expenditure plans would be borne by those with a vote — the domestic sector.

(ii) Impact of a uniform rate

9.18 As in England, the Government is setting in hand work for a revaluation of non-domestic rateable values in 1990. This means that any move to a uniform non-domestic poundage would be combined with the introduction of new rateable values. The effect on an individual non-domestic ratepayer would therefore depend on the combined impact of the re-assessed rateable value and the uniform poundage.

9.19 In the present financial year the highest non-domestic rate poundage is 36% above the lowest, compared with 130% in England. As Figure ( ) shows, the relatively narrow range in Wales means that, although a move to a national rate could not be accomplished overnight (see paragraph 9.46 below), the shift in non-domestic rate payments from heavily to lowly rated *areas* would not be as great as some might imagine.

Figure [ ]: Shift in non-domestic rate payments

9.20 The largest gainers in percentage terms — if the uniform poundage was set to maintain the present yield of non-domestic rates — would be non-domestic ratepayers in the heavily rated areas of Clwyd, Mid and West Glamorgan. The cash switch from relatively low to relatively high poundage areas amounts to £14m, only 10% of the total non-domestic rate income of the areas concerned. These figures assume that local authorities all levy the discretionary local rate, and do not take account of the possible impact of revaluation.

9.21 Chapter 2 suggests that the degree of local discretion might be set at 5% of the national poundage. Given the relatively low average level of non-domestic rateable values, and the comparatively even distribution between authorities, 10% might — at some stage — be a more appropriate margin of flexibility in Wales.

9.22 This new framework would put all non-domestic ratepayers on the same footing by removing the existing variation in local non-domestic tax rates — rates which many would argue are almost unrelated to the level or quality of service received by the sector, and the business community in particular.

Local domestic taxes

9.23 The case for abandoning domestic rates is as strong in Wales as it is in England and Scotland; and the anomalies thrown up by rating are just as unacceptable. The Government is therefore firmly committed to replacing domestic rates in Wales with a community charge paid by all adult residents. There will continue to be assistance for those with low incomes, but the principle that everybody should pay at least part of their local tax bill will be preserved in the new system. For the first time in local government history every adult will have a direct financial stake in their local council.

9.24 The effect of moving to a community charge in Wales will be to increase the number of persons contributing to local services from about 700,000, the number of householders now paying at least some rates, to 2,100,000, the total number of adults — or broadly the same number as those eligible to vote.

9.25 Annex G sets out the operational requirements for the community charge and the treatment of special cases, for example, second homes and charities.

Grants to local authorities

9.26 Chapter 4 examines the role of grants within the present local government finance system and sets out the Government's proposals for change. In some respects these apply only to England. A section within Annex B describes the existing grant regime in Wales.

9.27 In 1984-85 local authority revenue spending in Wales amounted to £680 per adult. Of this £125 was met by non-domestic ratepayers, and £105 by domestic rates net of rate relief grant. (When allowance is made for rate rebates the domestic sector's contribution falls to £75 per adult.) The balance, £450 per adult, and by far the largest contribution, came from the national taxpayer in the form of grants. How this grant is paid has an important bearing on the way in which local authorities plan their spending and on how local domestic taxpayers perceive the cost of services in their area.

(i) Basis of the new lump sum grant

9.28 The Government proposes that existing rate support grants — which are paid in support of local services in general, and dependent on what individual local authorities actually spend —

should be replaced by a fixed or lump sum grant made up of 2 parts. A *variable grant* which would compensate authorities for differnces in the local cost of providing services to a typical or average standard, and a simple *population based* grant — standard grant — which would provide an additional contribution from central taxes towards the cost of services. Had the reforms taken effect in 1985-1986 the variable grant would have amounted to £75 million, and the standard grant to about £760 million — 9% and 91% respectively of the total.

(ii) Simplifying the present assessment of local spending

9.29 The new lump sum grants would radically simplify the present arrangements. Further simplification and clarity would be achieved if the relatively small amount of variable grant could be determined using a far simpler assessment of local costs than the present measure — grant related expenditure (GRE).

9.30 In the case of county services — such as education, law and order and road maintenance — the GRE formula presently used in Wales is made up of over 40 indicators, ranging from pupil numbers to measures of social deprivation and population sparsity. Although the formula commands a fair degree of support amongst the authorities concerned, and is significantly less complex than its English counterpart, there is undoubtedly scope for reducing the number of indicators involved and concentrating on the factors determining the main variations in the cost of providing services as between areas.

9.31 The GRE formula for assessing the cost of the predominantly discretionary services provided by district authorities has not achieved the same measure of support as its county equivalent. It falls between two stools. It is neither an accurate measure of the spending need of individual services nor a rough and ready guide as to the cost of providing a typical overall level of service in each area. No relatively simple formula could ever hope, of course, to meet the requirements of those who would wish to have individual service costs assessed to a fine degree of accuracy. The best course would therefore be for the district formula to set its sights on a realistic and achieveable target — a broad measure of local costs based on as few indicators as possible. It is conceivable that the formula could be reduced to as few as 3 or 4 elements — population, population sparsity, a general indicator of economic and social well being and, possibly, an allowance for the impact of tourism and travel-to-work flows. If such a formula could be achieved it would readily be understood by all, and provide the stability and clarity of purpose many district authorities have argued for.

9.32 At an early stage in the consultation period the Welsh Office will come forward with a range of proposals for simplifying the present GRE formulae for discussion, in the normal way, with the local authority associations.

(iii) Resource equalisation

9.33 The present arrangements for equalising rate poundages between areas rather than rate bills produce exactly the same anomalies in Wales as in England and Scotland in terms of what people actually pay for their servies. They enable authorities in areas with low rateable values to increase their rate bills by a smaller amount that high rateable value authorities in order to pay for a similar rise in spending. Figure ( ) illustrates the point.

Figure [ ]
Mismatch between spending, domestic rate poundages and domestic rate bills
(Wales: 1985/86)

9.34 The Government therefore proposes, for the reasons set out in Chapter 4, that resource equalisation should not be a feature of the new grant arrangements in Wales.

(iv) The role of specific grants

9.35 In addition to the general, or unhypothecated, grant discussed so far the Government also pays grant towards the cost of individual services or projects. In 1985/86 these specific grants amount to £153 million, 15% of the total grant paid to Welsh local authorities. These grants will always have a part to play in funding certain local authority services. But widespread use of such grants could well detract from the central theme of this Green Paper — the need for greater local accountability and choice. The Government has therefore launched a separate review of the role of specific grants in the new financial structure and this will cover the position in Wales as well as that in England and Scotland.

The combined effect of changes to local taxation and grant

9.36 This section looks at the impact on local authorities, households and individuals of the Government's proposals in Wales. Further detail on the impact throughout Great Britain is given in Annex J.

(i) The effect on local authorities

9.37 The proposals on the non-domestic rate, for introducing a lump sum grant and for ending domestic resources equalisation would produce shifts in local authority income. Authorities spending above their GRE or with low domestic rateable resources would receive less income than at present from non-domestic rates and grant. Low spending authorities, or those with relatively high rateable values, would receive more.

9.38 If these changes fed through into local domestic tax bills, bills in some areas would double, whereas in others they would fall by up to 40%. The Government believes that it would be completely wrong to impose this degree of disruption on to domestic taxpayers. So, as in England, it proposes safety net arrangements to preserve broadly the non-domestic rate and grant income of authorities between the first year of the new system and the last year of the old. It is for consideration whether this safety net arrangement should be reviewed in Wales when domestic rates have been completely replaced by the comunity charge.

(ii) The effect on individuals and households

9.39 As the starting point for the new system will be the present pattern of domestic rate income at the rating authority level, the impact of the reforms on individuals and households will arise solely from the change in the domestic tax arrangements. If the community charge were introduced immediately as a full replacement for domestic rates the effect would necessarily vary from household to household, and from person to person depending on their circumstances and, equally important, on the expenditure decisions of their local authorities. Nonetheless, the general pattern of gain and loss can be predicted.

9.40 Households will be affected in two ways. Size will be a key factor. In general, single person households will gain from the shift away from a tax on property to one on people. Households with three or more adults will pay more. The other factor is the rateable value of each property. For a given household size, those living in relatively high rateable values houses will pay less, and those in houses with relatively low values will contribute more. Within households the main pattern of redistribution will be from 'householder' couples to other adults who at present do not pay any local taxes. The majorty of the new local taxpayers will be young single people aged 18 to 24.

9.41 Had domestic rates been abandoned in 1984-85 the community charge would have averaged £105 in Wales. £105 would therefore have been the average bill for one adult households. Households with 2 adults would have paid £210, and so on. Those on low incomes might well have paid as little as 20% of their community charge. In 1984/85 a 20% minimum contribution would typically have amounted to £21 per adult.

9.42 To put these charges into perspective, the full community charge 1984-85 would have cost each adult less than £2 per week, on average. For those entitled to the maximum rate of assistance with their charge the weekly cost would have been reduced to an average of only 40 pence — well below the price of a packet of cigarettes or a pint of beer.

9.43 When account is taken of the pattern of local authority spending within Wales the community charge would have ranged from £65 to £142 per adult — the equivalent of £1.25 to £2.75 a week. Despite the variation the impact of a move to a community charge would have been felt everywhere since within each rating authority the same general pattern of single adult households paying less and those with 3 or more adults paying more would have applied.

9.44 The effect on households and "tax units" — couples or single people who may form part of a larger household — of a full replacement of rates by the community charge is discussed in some detail in paragraphs 30 to 35 of Annex J.

Transitional arrangements

9.45 Throughout this Green Paper it has been stressed that the proposals for reform could not be fully implemented in just one year. They will need to be phased in over a period — and probably a fairly lengthy one in the case of the community charge.

(i) Easing in the non-domestic changes

9.46 The arrangements for introducing a uniform non-domestic rate, even when combined with a complete revaluation of non-domestic rateable values, need not be complex. The proposed method of easing in a national rate is described in detail in Chapter 2, paragraph [ ]. The relatively compact range of non-domestic poundages in Wales could well allow the period of transition to be shorter than in England: possibly as short as 3 years.

(ii) Easing in the community charge

9.47 Although the analysis in Annex J shows that the majority of households — particularly single person households — would benefit from an immediate replacement of domestic rates by the community charge, others might find it difficult to absorb the change in just one year. The Government therefore believes that it would be right to introduce the community charge gradually in order to give both the local tax payer and the local administrator an opportunity to adjust to the new financial arrangements.

9.48 For illustrative purposes it is assumed that the community charge will initially be no more than £50 per adult in any rating area. The yield from this charge would be used to reduce domestic rate bills in the first year.

9.49 As there are approximately two adults for every house in each district of Wales the yield of a £50 community charge would enable rate bills to be cut by an average of about £100 per domestic property. There are *two ways* in which the proceeds of the charge could be used to reduce rate bills *within* each area:

— by a common percentage;

— by a common cash amount, approximately £100 per property or the actual rate bill, whichever is the smaller figure.

9.50 For England it is envisaged that there should be a percentage cut. This would give the greatest relief to those presently footing the highest rate bills.

9.51 The relatively compact range of rate bills within authorities in Wales means that the cash cut option can also be considered. One important feature of this option is that it would *guarantee* that all single adult households with rate bills presently in excess of £100 per year, including old age pensioner and single parent family households, would pay about £50 less than they otherwise would in the very first year. Even single adult households with rate bills of between £50 and £100 would benefit from the change. Two adult households currently paying more than £100 a year in rates would face broadly unchanged bills, and only those with 3 or more adults would pay more — £50 more for each adult. In addition, those with bills of less than £100 per year — approximately 10% of all Welsh households — would find that, from the outset, they were no longer liable for rates, but just for the new community charge.

9.52 The two options have rather different distributional effects on households and individuals. As noted above a percentage cut in rates would provide the most relief — in cash terms — to those households with the high bills. Conversely, households with relatively low rate bills would tend to gain the most — in percentage terms — from the standard cash reduction scheme.

9.53 The analysis presented in Chapter 5 and paragraphs 25 to 29 of Annex J assesses the impact of the initial £50 community charge and the percentage reduction in domestic rate bills on different types of household throughout Great Britain. The effects are similar in Wales.

9.54 As expected, the impact of a low initial community charge on local domestic taxpayers would be relatively small. 82% of households would gain or lose less than £1.00 a week, and 97% would experience changes of less than £2.00 a week. Looked at in "tax unit" terms, the largest proportion of gainers are in the single pensioner and one parent family categories.

9.55 With a uniform *cash cut* in rates far fewer households in Wales — probably under 10% — would face changes of more than £1.00 a week in the first year, compared with nearly 20% in the case of the *percentage cut* approach.

9.56 Both the options identified have their strengths. But a decision on which transitional scheme would best suit Welsh circumstances will not be made until the views of all those concerned have been fully weighed.

(iii) How long will it take to abandon rates completely?

9.57 Under either of the options domestic rate bills in Wales will be reduced substantially in the *first year.* In order to allow the system to establish itself, and to enhance the electorate's perceptibility of local spending decisions, and their effect on the community charge, rate bills will then be frozen for a three year period. Thus, from the outset, the community charge will bear the full cost of any increase in local authority spending not met by government grant or the non-domestic rate 'pool'. After three years there will be a further shift from rates to the community charge. This will almost certainly lead to rates being completely replaced by the new charge in about half of Wales. Three years later a third, and final, shift will eliminate domestic rates in the remaining areas. Thus six years after the new arrangements come into effect the community charge will have replaced domestic rates throughout the Principality.

Local authority capital expenditure

9.58 As in England there is widespread dissatisfaction in Wales at the way in which the present system for controlling local authority capital expenditure has worked in recent years. Local authorities believe that the system has not been stable enough to allow them to plan their spending programmes efficiently and effectively. They would prefer the Government, as in the pre-1981 period, to focus on the control of borrowing rather than expenditure.

9.59 Capital expenditure in Wales forms a large and important part of local authorities overall activities. Gross capital investment on local services presently amounts to about £350m. Over 40% of this is spent on housing. Principally as a result of the success of the Right to Buy campaign district authorities, in particular, have accumulated an enormous store of capital receipts. By the end of 1985/86 it is estimated that these accumulated receipts will amount to some £250 million to £300 million, about 70% of which relate to the disposal of housing assets.

(i) The options

9.60 Two basic options for reform are identified in Chapter 6. First, the control of local authority net external borrowing – their contribution to the Public Sector Borrowing Requirement; and secondly, a form of expenditure control in which the national cash limit is fixed by reference to gross provision, rather than provision net of capital receipts as now.

9.61 The net external borrowing approach has some attractions from a theoretical standpoint, particularly as it would involve much less detailed control at local level – but it would pose major practical problems for both central and local government.

9.62 There are two possible approaches to the expenditure option. The essential difference is the treatment of capital receipts. In one version the Government would build into individual authorities' capital allocations an allowance for their capital receipts over, say, the last 3 years. In the other approach, the Government would set allocations at a rather lower level, with authorities continuing to have access to their capital receipts as an addition to allocations.

9.63 On balance, the latter approach appears to come closer to meeting the criticisms of the Welsh local authority associations. Under either option it is likely that allocations would, as now, be distributed largely on a formula basis in Wales – a basis agreed with the associations and one which is widely acknowledged as providing authorities with a sound basis for managing their capital programmes.

The role of fees and charges

9.64 The case for increasing the contribution made by fees and charges to the cost of running local services is as strong in Wales as elsewhere. Indeed, the generally low level of income from this source in Wales, particularly in the realm of leisure activities, suggests there is considerable scope for action. The review of fees and charges referred to in Chapter 7, paragraph 7.11 will also cover Wales.

Summary and conclusions

9.65 The arguments for reform of the present systems of local government finance in Wales are broadly the same as in England, but have to be seen against the distinctive Welsh background. This may lead to a package of reforms tailored to the particular circumstances of Wales.

9.66 This chapter indicates a preference for certain options. It would, of course, be unrealistic to suppose that any package of reforms could satisfy the aspirations of everyone in Wales, and preference has been indicated as an aid to debate and a focus for discussions at a technical level. All the options are open, and the Government hopes that they will be carefully considered and commented upon not only by major interests and representative bodies in Wales but also by individual rate and tax-payers, whose contributions actually pay for local services.

9.67 Although comments are invited on the whole package of reforms set out in this Green Paper there are a number of proposals which are specific to Wales. Views are therefore also invited on:

— the case for giving local councils, at some stage, the discretion to top-up the national non-domestic rate by 10% rather than the 5% flexibility suggested for the early years of the new system (paragraph 9.21);

— the 3 year transition period for moving to a uniform non-domestic rate (paragraph 9.46);

— the proposal to simplify – particularly in the case of district authorities – the present method of assessing expenditure for grant purposes (paragraphs 9.29 to 9.32);

— whether safety net grant should be reviewed when domestic rates have been replaced throughout Wales by the community charge (paragraph 9.38);

— the merits of using the yield from the initial community charge to cut domestic rate bills in the first year of the transition period by a standard cash sum within each rating area rather than by a fixed percentage (paragraphs 9.47 to 9.56);

— the arrangements proposed for phasing out domestic rates by stages (paragraph 9.57).

9.68 Comments should be sent to the Welsh Office, at the address given at the page [ ], by 31 July 1986. A Welsh language copy of this chapter is available on request from the same address.

Chapter 10: Summary and conclusions

10.1 This Green Paper sets out proposals for perhaps the most radical reform of local government finance in Great Britain this century. It does so against the background of a pressing need to reduce the burden which the public sector imposes on the private sector and on taxpayers – a burden of which more than a quarter is now accounted for by local government.

10.2 Since 1979 the Government has sought to create the climate and the incentives to which local government might respond with expenditure restraint. Conscious of the long-established tradition of independent, democratically-elected local authorities in this country, it has tried to achieve this objective not by direct control from the centre but by measures designed to enhance the accountability of local government to its electors and taxpayers. Between 1979 and 1984 a succession of such measures was introduced. But this aproach brought into ever sharper focus serious underlying flaws in the system of local government finance which weaken the accountability of local authorities to local people, and which made it neccessary for the Government to introduce in 1984 powers to limit directly the rates of selected local authorities.

10.3 It was against this background that the Government came to the view that incremental measures to enhance accountability within the existing framework would be unlikely to succeed and that more fundamental reform would be needed, in particular to deal with the clear defects of the rates and to develop a grant system which was more understandable and did not obscure the link between changes in local spending and changes in local taxation.

10.4 The Government is committed to a system of local government finance which fairly reflects differences in local needs and at the same time promotes local accountability. All the main proposals in this Green Paper have been designed to achieve that end. They may be summarised as follows.

— *Non-domestic rates* should in future be set by central Goverment, as a uniform rate in the £; the proceeds should be pooled and redistributed to all authorities as a common amount per adult. The introduction of this scheme would be accompanied by a revaluation of non-domestic properties.

— *Domestic rates* should be phased out over a ten-year period and replaced by a flat rate community charge, payable by all adults.

— *The grant system* should be radically simplified. It would consist of needs grant, which would compensate for differences in what authorities needed to spend to provide a comparable standard of service, and standard grant, which would be paid to all authorities as a common amount per adult.

— *Distributional changes*, on introduction of the new scheme, would be prevented by a system of self-financing adjustments.

10.5 These proposals lie at the heart of the Government's reforms. They would widen the tax base so that virtually all adults would have a financial stake in the affairs of their local authority; they would ensure that the full costs or benefits of any changes in a local authority's expenditure would fall on its domestic taxpayers alone; and while non-domestic ratepayers would still make a significant contribution to local government expenditure overall, authorities would no longer be able to finance extra expenditure by taxing them at their own discretion. Together these reforms would ensure that the accountability of local authorities to local electors and taxpayers would be greatly enhanced.

10.6 In addition to these proposals, the Government has identified in this Green Paper a number of areas where reform or further analysis of the scope for reform would be desirable. In particular, it has

— initiated a review of specific grants to local authorities;

— set out proposals for reforming the system of capital expenditure controls in England and Wales;

— initiated a review of centrally-determined fees and charges for local authority services and is considering ways of improving charging practices;

— outlined a possible framework of duties to be placed on local authority treasurers to guarantee the propriety and soundness of their authorities' budgets.

10.7 [Scotland]

10.8 [Wales]

10.9 [Subsidiary matters for consultation]

Annex A: Recent Trends in local authority spending, Taxation and Manpower

A.1 The Layfield Report on Local Government Finance (Cmnd 6453), published in 1976, included an extensive study of longer-term trends. This highlighted the almost continuous growth of the local government sector this century, its increasing share of national resources, and the growth in central Government financial support. This Annex picks up where the Layfield Report left off, and examines trends over the last decade. It supplements the discussion in Chapter 1.

The scale of local government

A.2 The economic influence of local government is now very large.

— In 1984/85 local government in England alone had a turnover of £39 billion.

— Local authorities' expenditure represents over a quarter of the public expenditure planning total and 11% of GDP.

— Local government employs nearly 3 million people (full and part time) in Great Britain: 14% of the workforce.

A.3 Figures A1 and A2 show how the £39 billion of expenditure in England in 1984/85 was spent on the different services provided by local government and how that expediture was financed.

Figure A1: Local authority gross expenditure by service (England: 1984/85)

Figure A2: Sources of local government income (England: 1984/85)

Expenditure

A.4 Figure A.3 shows how local authority expenditure as a proportion of GDP grew steadily to its peak in 1975 (the last year covered in the Layfield Report). Since then it has fallen, though largely because of the decline in capital expediture.

Figure A3: Local government current expediture on goods and services and gross domestic fixed capital formation as a share of GDP.

A.5 This decline in net capital expenditure can be more clearly seen in Figure A4. This shows capital expenditure *net of sales*. Because there has been a large increase in the sales of council houses since the Housing Act of 1980 the growth in gross capital expenditure since 1981/82 has been higher than the growth of net expenditure. Figure A4 also shows that current expenditure has continued to grow over the decade. However, as described in Chapter 1 (paragraph 1.27 and Figure 2), the rate of growth is considerably lower than in the 1960s and early 1970s.

Figures A4: Local government current expenditure on goods and services and gross domestic fixed capital formation at 1980 prices.

Income

A.6 Figure A2 showed the sources of local authorities' income for all services, accounts and funds (current and capital accounts, rate fund and housing accounts, special funds, etc.) The rate fund revenue account is financed by rates, central Government grants and fees and charges. Figure A5 shows how the balance between rates and grants has changed in England and Wales over the last 10 years. The Layfield Report noted an increasing proportion of central Government support and a declining contribution from rates towards local government expenditure. Figure A5 shows how this trend has been reversed in the last 10 years. By 1984/85 rates, together with rate rebates, were larger than aggregate Exchequer grant.

Figure A5: Rate fund revenue account – England and Wales Rates and Grants

A.7 The increase in rates is also shown in Figure A6 where the annual increase in average domestic rate bills in England is shown in relation to inflation. This shows rates rising faster than inflation in the years 1981/82 to 1984/85. Exchequer support was reduced over this period in order to increase local accountability. As noted in Chapter 1 this effect is reduced by rate rebates, which represented about 22% of domestic rates in 1984/85. Local authorities in England exceeded the Government's expenditure plans over this period, leading to rate increases higher than the Government had planned for.

Figure A6: Changes in domestic rate bills in England compared to inflation.

A.8 Other sources of income have moved broadly as follows.

- *Rents* were a declining source of income to local authorities until the 1980 Housing Act when they began to increase. The recent increases in housing benefits have halted this rise.
- *Capital receipts* in England increased from about £¼ billion in the mid-1970s to about £¾ billion at the end of the decade. The right to buy legislation has led to a sharp rise in council house sales in the 1980s. Together with other incentives to sell assets this led to an increase in local authorities' capital receipts to about £2¼ billion in 1984/85.
- *Borrowing* has been fairly volatile over the last decade. The local authority borrowing requirement in the United Kingdom has been as high as £3 billion in 1974/75 and 1979/80, and as low as –£¼ billion in 1981/82.

Manpower

A.9 Figure 2 in Chapter 1 illustrated how local authority manpower in England grew during the 1960s and 1970s. Between 1979 and 1982 numbers fell by about 4%, but have remained fairly stable since then.

Annex B: The present local government finance system: a summary

Local authority income and expenditure

B.1 In the United Kingdom, local government is responsible for about 27% of total public expenditure. In England alone local government had a turnover of about £39bn in 1984/85. The total of local authority expenditure can be divided into three main types:

current expenditure (77%) — spending on running costs, such as salaries;

capital expenditure (15%) — spending which creates tangible assets such as houses; and

debt repayment (capital and interest) (8%).

B.2 Local authorities have three main sources of income — *rates, central Government grants* and money received from services such as school meal charges and bus fares, from housing rents, and from the sale of assets such as council houses. Local authorities can also borrow from central Government or the private sector to finance capital expenditure. Figure A● in Annex A shows the breakdown of English local authorities' income by service in 1984/85.

B.3 There are two main tiers of local government in each area. Responsibility for services and therefore expenditure between these tiers varies. The pattern of local authority expenditure in England by service is as shown in Figure A● in Annex A.

Rates

B.4 In each area the lower tier authority — district or borough council — is the *rating authority*. This means that they issue rate demands and collect the rate payments. Other authorities, county councils and parish councils for example, issue precepts. A precept is a demand for a specified amount which the rating authority has to collect on the other authority's behalf.

B.5 When the rating authority fixes its rate and budget for the coming year, it first estimates how much it will spend in that year from its rate fund together with any precepts. It then deducts the amount of grant it expects to receive from the Government, and its income from other sources. The balance left over is raised from local ratepayers. To calculate how much each ratepayer should pay the council first estimates how much of a rate of 1p would produce. This is called the *penny rate product*.

B.6 The council then divides the amount it needs to raise from ratepayers by the penny rate product. The end figure reached is the rate in the pound which has to be levied. This is called the *rate poundage*. Other authorities calculate their precepts in broadly the same way on the basis of estimates of the penny rate products of the rating authorities in their area. The precept is then collected with the rating authority's rate, and passed on to the other authority.

B.7 The rate bill for an individual property is calculated by applying the combined rate to its rateable value (an assessment of the estimated annual rental income which each property might earn if let on the open market). For domestic properties *domestic rate relief* (18.5p in the pound: see paragraph B.12) needs to be subtracted from the total rate poundage. The calculation of the rate bill on a domestic property is therefore as follows:

rateable value × (rate poundage domestic rate relief)

Central Government grant in England

B.8 Each year the Government decides on its view of what the level of local government spending should be in the following year. It then decides how much of the spending to be financed from the rate fund revenue account should be met by central government grant. (There are separate arrangements for controlling the total of capital spending, whether financed from revenue or from borrowing — see paragraphs B.49-B.51 below.)

B.9 Central Government grant, which is known as *Aggregate Exchequer Grant* (AEG), consists of three elements — *specific grants, supplementary grants* and *rate support grant*. Specific grants are paid in aid of specific projects. Examples are the urban programme, derelict land grant, police grant. Supplementary grants are paid in support of transport and national parks expenditure. Rate support grant, as the name suggests, is a non-specific grant to subsidise spending which would otherwise have to be financed by ratepayers. In 1984/85 the Government's preferred level of local government rate fund revenue spending was £22.9bn. It decided that 51.9% of this would be met by AEG. 21.5% of the AEG total would be paid as specific and supplementary grants, and 78.5% as rate support grant.

Rate support grant

B.10 Rate support grant is paid in support of net revenue spending, ie spending on wages, salaries, goods and services, debt charges and revenue contributions to capital projects, *less* income received from other sources. This net expenditure is referred to in the relevant statutues as *total expenditure* (that is, the "total expenditure" for rate support grant purposes).

B.11 Rate support grant is made up of two elements: domestic rate relief grant and block grant. It is paid to local authorities in thirty-eight instalments during the financial year.

B.12 Domestic rate relief grant is the smaller of the two elements of rate support grant (about £692m out of £9322m in 1984/85). Under the existing arrangements, domestic ratepayers benefit from a discount on their rate poundages, as compared with non-domestic ratepayers who do not. The size of the discount is determined by the Government. Its cost is met by domestic rate relief grant. Domestic rate relief was introduced in 1967 as an interim measure to give some assistance to domestic ratepayers pending the possible overhaul of the rating system following the Royal Commission on Local Government which was set up in 1966. In the event the rating system was not reformed and domestic rate relief has remained. In England the rate of payment has for a number of years been 18.5p in the £.

B.13 Block grant makes up much the larger part of rate support grant. The aim of the block grant system is first to compensate for differences in the cost to authorities of providing a standard level of service (for example, because of different social, economic and geographic characteristics) and second to compensate for differences in resources. Authorities' resources are measured in terms of the total rateable value of properties in their area, which in turn reflect the relative rental values of property in different parts of the country. In other words, block grant is distributed so as to ensure that, regardless of differences in their expenditure needs and rateable resources, all authorities are in a position to finance a comparable standard of service for the same rate in the £. This means that ratepayers in areas with high spending needs and low rateable resources can be charged the same rate in the £ for a given standard of service as ratepayers living in areas with high rateable resources but low spending needs. This process is known as 'rate poundage equalisation'.

B.14 It is worth noting that it does not equalise rate *bills* since the rateable values of similar properties vary throughout the country.

Equalising needs and resources

B.15 In order to equalise expenditure needs and resources, the Government calculates two things — a *grant related expenditure* (GRE) for each authority and a schedule of *grant related poundages* (GRP).

B.16 The GRE is an estimate of the overall costs to an authority of providing a standard level of service. It is calculated for each authority taking into account variations in local circumstances by the application of a formula. Each authority's GRE is built up by applying components of the formula relating to the different services it provides. But it is the overall GRE for each authority which is used as a basis for distributing block grant. The amount spent on each service remains a matter for the individual local authority to decide.

B.17 For most services, the two main factors in the GRE formula are the numbers for whom the service is provided (for example, the number of primary school children) or the number of units of service which have to be provided (for example the number of premises from which refuse has to be collected), and the unit cost of providing the service.

B.18 In some cases a further set of factors has to be taken into account where these seem likely to influence the cost of providing a service or the amount of service of be provided. These include such considerations as a scattered population or a concentration of social problems or substandard housing conditions. London authorities also receive some allowance for higher costs — for example, London Weighting payments in salaries.

B.19 Since GREs are intended to be an objective assessment of the need for spending they are not usually based on the actual expenditure by the authority on a particular service. However, in a small number of cases where an authority has no choice about how much to spend (for example, mandatory students' grants) the GRE is based on actual spending.

B.20 The total of the GRE figures for all authorities is calculated to fit in with the Government's overall spending plans for local authorities.

B.21 Each authority's GRE assessment will change from year to year to reflect changes in the way GRE components are calculated and to incorporate new data.

B.22 Once GREs have been set, equalisation is achieved through the GRP schedule. This specifies a common rate poundage, which all authorities are assumed to levy for spending at the level of GRE, and a specified cost for authorities and their ratepayers, in terms of higher or lower rate poundages, for every £ per head of spending above or below GRE. This tariff is known as the grant-related poundage schedule. The GRP for spending at GRE changes from year to year. The Government can also change the cost of marginal increases in spending by specifying a different rate of increase in GRPs for each additional £ per head of expenditure.

B.23 The national grant-related poundage schedule is divided between the tiers of local government in proportion to the planned spending on functions they carry out. For example in non-metropolitan county areas, where the county council provides the bulk of the services, the GRP for spending at GRE would be much larger for those councils than for district councils.

How block grant is calculated

B.24 Block grant is paid to make up the difference between authorities' total expenditure and the revenue they could raise by charging ratepayers a rate poundage equivalent to the appropriate GRP. This can be summed up like this:

block grant = total expenditure – (GRP × rateable value)

B.25 In practice a council with high rateable value will be able to raise more from a rate set at the GRP level than a council with low rateable values. For the same level of spending in relating to its GRE, the low rateable value council will receive more block grant. This achieves the objective of enabling authorities to finance a comparable level of service for the same rate poundage.

B.26 For 1986/87 it is proposed that the amount authorities are assumed to raise from their ratepayers (the GRP) should increase by 1.1p for every £1 per head increase in expenditure. The GRP decreases at the same rate as expenditure falls.

B.27 The amount an individual authority is assumed to raise from its ratepayers is therefore calculated like this:

$$\text{GRP} = \text{GRP}^{*} + 1.1\text{p} \left(\frac{\text{Total expenditure} - \text{GRE}}{\text{population}} \right)$$

*the GRP for that kind of authority spending at GRE.

B.28 At a level above GRE, which is known as the *threshold* (set nationally at 10% of GRE), the amount an authority has to raise from its ratepayers for each increment in spending rises, in order to provide a disincentive to high spending. Above the threshold the assumed local rate increases by 1.5p for every additional £1 per head of spending.

B.29 Figure B1 below illustrates how this works.

Figure B1: The block grant schedule (England 1986/87)

B.30 The practical effect of this schedule is that for the great majority of authorities, their grant *decreases* as their spending *rises*, and vice versa. That is they have *negative marginal rates of grant.*

B.31 This is because almost all authorities, except those with very low rateable values per head of population, can raise more than £1 per head by charging ratepayers the additional 1.1p (or 1.5p above the threshold) which it is assumed they will raise in order to finance each additional £1 per head of extra spending. In order that the equalising effect of block grant continues to operate the additional sum is *subtracted* from the authority's grant entitlement. Otherwise the authority would be able to take advantage of its higher rateable values and levy a lower rate poundage than other authorities for a comparable level of spending.

B.32 To take an example:

An authority has a rateable value of	£50 m
It has a population of	500,000
It increases its spending by	£500,000
=	£1 per head
It is therefore assumed to raise from its ratepayers an additional	1.1p
which will raise	£550,000 (ie £50m × 1.1p)

Its total block grant is therefore *reduced* by £50,000: the £550,000 raised *less* the £500,000 it wants to spend. Some authorities have such high rateable values per head that they receive no block grant whatsoever.

B.33 New information about authorities' spending is constantly being received by the Government. The initial RSG announcement for the coming year, which is known as the Settlement, is made before authorities have set their budgets. Final audited figures for spending in any one year may not be received until as long as 2 years after the end of the financial year concerned. Adjustments to grant entitlements are therefore made in a series of rate support grant *Supplementary Reports.*

B.34 The amount of block grant available for distribution is a sum set in advance for each year by the Government. In order to match the claims for grant to this sum, the GRP for spending at GRE may have to be adjusted in a Supplementary Report in order to reduce or increase each authority's grant entitlement. This kind of adjustment is called *close-ending.*

B.35 ***Multipliers*** adjust an authority's grant entitlement. They are used mainly to produce *safety nets* or *caps* which prevent authorities from having large grant changes between years. Safety nets are used, for example, to limit the effect of year-on-year changes in the method of calculating the GRE where these would otherwise cause large grant losses. Caps are used to limit large gains in grant.

B.36 The multiplier works by multiplying the product of the authority's GRP and its rateable value either to increase or reduce the amount the authority is assumed to raise from its ratepayers before block grant is paid. The grant of an authority in this position is calculated like this:

Grant = total expenditure – (GRP × rateable value) × multiplier

B.37 ***London*** is subject to the block grant distribution arrangements. However, there are two differences in the treatment of London to take account of London's high rateable values.

B.38 If the normal equalising effects of the block grant system were to apply, these higher rateable values would lead to much higher rate bills for equivalent standards of service. Part of the rateable value of each London authority is therefore discounted when its block grant is calculated, by the use of a special multiplier. The discount is higher in Inner London because of particularly high rateable values there.

B.39 For the reasons explained above, the central London authorities with the very highest rateable values get no block grant. Instead they make payments to other London Boroughs through a special London rate equalisation scheme. Domestic ratepayers in contributing authorities are compensated by increased domestic rate relief.

Expenditure guidance/targets

B.40 From 1981/82 to 1985/86 the Government superimposed a separate system for controlling local government spending on the basic block grant system. This was done by giving every local authority a *'target'*. If an authority spent more than its target, it forfeited grant on the basis of a fixed tariff. Grant lost in this way was known as *holdback* or *penalty* and was retained by the Treasury. The Secretary of State can exempt some spending from the penalty system. These exemptions are called *disregards*, because the spending is disregarded when holdback or penalty is calculated. So if an authority spent £10.1m against a target of £10m, but spent £100,000 on items for which expenditure was disregarded, it would not incur holdback.

B.41 Although targets are being discontinued in 1986/87, their effects will continue to be felt in the implementation of holdback and disregards until the books are closed for the years during which targets were issued.

Rate limitation

B.42 Selective *rate limitation* or *'rate capping'* was introduced by the Rates Act 1984. Rate capping has enabled the Secretary of State to concentrate efforts to reduce high spending on a small number of the highest spending authorities. It protects ratepayers in these areas from excessively high rate demands, because the Secretary of State sets a maximum for the rate in the pound which a rate capped council can raise.

B.43 Every summer, a number of authorities are selected for rate capping in the following financial year. To be selected for ratecapping, an authority's spending has to meet three criteria. First, it has to be 'excessive'. Second, it has to be higher than a level set by the Secretary of State. This level is currently fixed at £10.6m, so that councils whose spending is low in absolute terms are excluded from rate capping. And thirdly, an authority's spending has to be higher than its GRE.

B.44 When they are selected, councils are notified of their *expenditure levels* (ELs). The EL is the sum the Secretary of State assumes the council will spend in the following year.

B.45 Councils have the right to apply to the Secretary of State for a higher EL. This process is known as *redetermination*. If a council makes an application for redetermination, the Secretary of State can raise the EL, reduce it, or leave it unchanged.

B.46 When the expenditure level has been decided, the rate limit is calculated at a level which will finance the EL. The two other main factors in making this calculation are an authority's block grant entitlement and its level of reserves. The Secretary of State first calculates how much grant the authority will get for spending at its EL. He then decides how much of the rest should be raised from ratepayers, and how much (if any) from reserves. The figure arrived at is then divided by the penny rate product to produce the provisional rate limit. Councils subject to rate limitation may not raise a rate in the £ higher than their rate limit.

Capital expenditure controls

B.47 Each year the Government decides on the overall level of local authority capital expenditure which it believes to be compatible with the national economic interest. Each authority may spend an amount, known as its prescribed expenditure allocation, notified by central Government, together with a proportion of the proceeds of asset sales and of repayments of grants and advances made by the authority, and the profits of trading undertakings.

B.48 In deciding on the total of allocations to be divided between authorities, the Government has regard both to the national total of spending which it wishes to see and to the extent to which authorities are able to add to their allocations from the other resources mentioned. In England, each authority receives allocations in up to six blocks, covering Housing, Education, Transport, Personal Social Services, Urban Aid Services and Other Services, depending on the range of services for which it is responsible. There is no obligation on an authority to match expenditure to allocations: allocations may be transferred both between blocks and between authorities. There is also a limited facility to carry over into or anticipate from the following year's allocation.

B.49 Authorities have freedom in choosing how to finance expenditure within the permitted level. Their borrowing for capital purposes is controlled through a block approval issued by the Government, but the amount of the approval is broadly equal to the authority's total allocations for the year, so that it should not serve as a constraint. They can also use the proceeds of asset sales and repayments of grants and advances; contributions from the rate fund; savings in special funds; and such grants as they may receive from central Government, public bodies like the Sports Council, the European Community and the private sector. The present arrangements for controlling capital expenditure are described more fully in Chapter 6.

Appendix B1

Typical Timetables for Rate Support Grant and Rate Limitation

Rate Support Grant

July	— Provisional RSG announcement, usually comprising totals of expenditure and grant to assist local authorities in advance planning for the following year.
	First Supplementary Report for the current financial year, in which adjustments to grant are made on the basis of budget information and grant abatement (or holdback) is implemented.
	Final Supplementary Report for the financial year three years earlier, to 'close the books' in the light of audited outturn expenditure information.
December	— RSG settlement for the coming financial year, in which Government plans for local authority spending, the total of AEG, and individual authorities' grant-related expenditure are announced.
	Second Supplementary Report for the previous financial year, to adjust grant and holdback to reflect provisional spending information.
January	— December RSG reports debated by the House of Commons.
April	— Payments of grant for the current year start.

Rate Limitation

end July	— Report laid before the House of Commons which lists selected authorities and explains the criteria for selection.
end July	— Selected authorities are notified of their ELs.
October	— Last opportunity to apply for redetermination of ELs.
December	— The Secretary of State announces his decision on redeterminations.
December	— Selected authorities are notified of proposed rate limits on the basis of the original or a redetermined EL.
mid-January	— Last opportunity to accept or comment on rate limits.
Feburary	— Rate limits order debated by the House of Commons.

Annex C: Key facts on households, tax units and tax yields

C.1 This Annex contains background information on:

— the characteristics of households and tax units in England, Scotland and Wales;

— the population of communal establishments which could be subject to collective community charges;

— comparative tax yields of different national and local taxes.

C.2 It comprises the following tables:

Figure C1: Household composition
Figure C2: Tax unit composition
Figure C3: Tax units: status in household (ie householder or non householder)
Figure C4: Tax units: economic status
Figure C5: Multiple tax unit households
Figure C6: Adults present in communal establishments on census night
Figure C7: Revenue effects of illustrative tax changes

C.3 The totals in Figure C1 for "all households" are based on 1981 Census data which have been adjusted for absent households and projected forward to mid-1984/85. All remaining household and tax unit data are derived from the Department of the Environment's Family Expenditure Survey (FES) database, which contains information for the four years 1980 to 1983 inclusive, revalued to 1984/85 prices*. The sample data have then been grossed up by reference to the Census based estimates to give national figures.

C.4 The following definitions apply to the material presented in this Annex.

(i) **Household.** A household is either one person or a group of people (who may or may not be related) living at the same address with common housekeeping. A household may contain one or more tax units.

(ii) **Tax unit.** A tax unit is a unit assessable for income tax purposes and may comprise one person or a married couple, with or without dependants. All married couples are treated as single tax units, although in some instances each partner may opt for separate tax assessment. All children aged under 16 are treated as dependants; those aged 16 and 17 are also treated as dependants if their parents receive child benefit for them.

(iii) **Adults.** Adults are those aged 18 and over, except where otherwise indicated.

(iv) **Pensioner household/tax unit.** A pensioner household or tax unit is one where either the head or the head's spouse is of pensionable age — ie at least 65 for a man or 60 for a woman.

(v) **Householder/non-householder.** In this Annex householder tax units are those paying rates. A non-householder tax unit is one assumed not to be contributing towards rates. Most households consist of only one tax unit. For multiple tax unit households, it has been necessary, for modelling purposes, to make an assumption about the split of the rates bill. This has been based on the rules regarding eligibility for housing benefit. Unrelated single persons sharing accommodation are assumed to be joint householders, whereas a young person living with his/her parents has been regarded as a non-householder. The alternative assumption would be that only one tax unit in any household pays rates. No assumption can precisely reflect the actual financial arrangements within households.

(vi) **Resident/non-resident.** The figures for communal establishments cover adults (in this case those aged 16 and over) present on Census night. Residents are those whose usual address was the establishment. They include resident staff and their relatives, resident guests and inmates. Non-residents are those whose usual address was elsewhere, eg visiting relatives and guests. The "Census 1981 Definitions" volume provides more detailed guidance on the selection of usual address for people in institutions, for example, according to length of stay. Non-residents present include visitors from abroad.

* For background information on the survey see the Department of Employment's "Family Expenditure Survey 1983" or the OPCS "Family Expenditure Survey Handbook", both published by HMSO. As indicated above, the FES data have been further processed by the Department of the Environment.

Figure C1: Household composition (thousand households)

	England	Scotland	Wales	GB
Households containing:				
One adult	4425	475	225	5125
Two adults	10875	1150	650	12675
Three or more adults	2350	275	150	2775
All households	17650	1900	1025	20575

Figure C2: Tax unit composition (thousand tax units)

	England	Scotland	Wales	GB
Single pensioner	3275	375	200	3875
One parent family	750	100	50	900
Other single[a]	6425	700	350	7475
Couple with:				
no children	6325	625	375	7325
one child	2175	250	150	2575
two children	2625	275	175	3050
three or more children	1075	150	50	1275
All tax units	22650	2475	1350	26475

Note: (a) Including [redacted], [redacted], [redacted] and [redacted] thousand 16 and 17 year olds in England, Scotland, Wales and GB respectively.
Numbers may not add owing to rounding.

Figure C3: Tax units: status in household (thousand tax units)

	England	Scotland	Wales	GB
Householder tax units	19425	2100	1150	22675
of which head under 25	1250	125	75	1450
Non-householder tax units	3225	375	200	3800
of which head under 25	2975	350	175	3500

Figure C4: Tax units: economic status (thousand tax units)

	England	Scotland	Wales	GB
Head of tax unit not working	13750	1425	750	15925
Head of tax unit not available for work:				
Pensioner	5150	550	325	6025
Other	875	125	75	1075
Head of tax unit unemployed	2875	375	200	3450

Figure C5: Multiple tax unit households (Great Britain: thousands)

Total multiple tax unit households	4300
Total tax units in these households	10175
Total secondary tax units[a] of which:	5875
— single pensioner	500
— other single[b]	5200
— pensioner couples	25
— all other couples	150

Notes: (a) Including some joint householders.
(b) Including [redacted] thousand 16 and 17 year olds.

Figure C6: Adults (aged 16 and over) present in communal establishments on 5 April 1981
(thousands)

	England		Scotland		Wales		GB	
	Residents	Non-Residents	Residents	Non-Residents	Residents	Non-Residents	Residents	Non-Residents
Hotels and boarding houses	75	101	11	16	4	5	90	122
Hospitals/homes – psychiatric	114	17	19	3	6	1	139	20
Hospitals/homes – other	89	149	13	20	5	10	107	179
Homes for the old and the disabled	185	7	15	1	10	0	210	8
Children's homes	7	2	1	0	0	0	8	2
Educational establishments	22	39	2	6	1	4	25	49
Prison department estabs.	17	25	2	2	0	1	19	28
Defence establishments	70	23	5	2	2	1	77	26
Civilian ships, boats and barges	0	3	1	1	0	0	1	4
Hostels and common lodging houses	32	8	4	2	1	0	37	11
Miscellaneous communal establishments	30	16	2	7	1	1	34	24
Campers, persons sleeping rough etc.	0	9	0	5	0	2	1	16
Total: All establishments	643	399	76	64	31	26	749	489

0 = less than 500
Numbers may not add owing to rounding.
Source: Census 1981 Communal establishments

Figure C7: Revenue effects of illustrative tax changes[a] (£mn cash prices)

Tax	Actual Yield 1983/84	Actual Yield 1984/85	Actual Yield 1985/86[b]	Assumed change in tax rate	Effects of changes: Equivalent marginal yield (in full year) 1983/84	1984/85	1985/86
Domestic rates[c]							
England	5300	5600	6100	1p in £	35	35	36
Wales	190	210	230	1p in £	1.3	1.3	1.3
Scotland	520	560	640	1p in £	4.4	4.4	11.4
Non-domestic rates[c]							
England	6300	6600	7200	1p in £	37	37	37
Wales	240	260	290	1p in £	1.4	1.4	1.5
Scotland	940	980	1030	1p in £	7.6	7.5	15.8
Income Tax[d]	31108	32507	35200	1p on basic rate	930	1150	1200
VAT[e]	15218	18535	18800	1 percentage point	690	740	840
Corporation Tax[f]	6184	8341	10100	1 percentage [g]	170	240	310
				point [h]	20	25	30
Beer	1679	1825	1960	1p/pint (incl VAT)	90	95	90
Wine[i]	663	648	650	1p/70cl (incl VAT)	5	5	7.5
Spirits	1702	1242	1460	1p/bottle (incl VAT)	1	1	1
Tobacco	3806	4140	4400	1p (incl VAT)	34	35	35
Petrol	4340	4681	5020	1p/gallon (incl VAT)	45	50	50
Derv	1074	1190	1255	1p/gallon (incl VAT)	12.5	12.5	15
VED (cars and light vans)	1578	1793	1972	£1/vehicle	18.6	19.9	19.7

NOTES:

(a) Except where otherwise stated.

(b) Latest estimates.

(c) The marginal yields of a change of 1p in the rate poundage for England and Wales are not comparable to that for Scotland as the poundages are levied on different rateable value bases. In addition the rateable value base for Scotland changed between 1984/85 and 1985/86.

(d) In 1983/84 the marginal yield for England alone is estimated at £785m. The figuring in Chapter 3 assumes that England would account for the same proportion of the total UK yield in 1984/85.

(e) The total VAT yield in 1984/85 was boosted by the once-and-for-all effect of the withdrawal of postponed accounting. To allow for changes in the coverage of VAT, in Chapter 3 the England yield is assumed to be 84.4% of the 1985/86 UK yield, deflated to 1984/85 prices by a factor of 5%.

(f) Including public corporations and North Sea oil companies.

(g) Main rate only.

(h) Small businesses rate only.

(i) Wine duty was reduced in the 1984 Budget.

Annex D: Impact of the proposals on local non-domestic taxes

D.1 Chapter 2 sets out the Government's proposals for centrally-determined non-domestic rates. Two possible approaches were described. The first was to freeze the existing pattern of non-domestic poundages, and increase them by a uniform percentage each year. The second approach, which the Government prefers, is to set a national non-domestic rate poundage which would apply to all non-domestic ratepayers across the country. In both cases the proceeds from the national pool would be distributed in the same way — in proportion to adult population.

D.2 This annex provides further background information on the Government's preferred option. It assesses the consequences for business ratepayers of the proposals for a national non-domestic rate and considers the likely impact of a non-domestic revaluation, both separately and in combination with a national non-domestic rate. It also assesses the wider economic implications of geographical shifts in the burden of non-domestic rates.

Variations in rate poundages and rateable values

D.3 Paragraph 2.25 described why the Government prefers a uniform national non-domestic rate to the existing wide range of poundages. Variations in non-domestic poundages primarily reflect differences in standards of services which are provided to domestic ratepayers and their families different areas, and differences in levels of local authority efficiency. They have little to do as with variations in the levels of service provided to industry and commerce. While local authorities do provide some direct services to industry and commerce, in general non-domestic rates take the form of an "onerous" tax; that is, payments are generally unrelated to the benefit received. Indeed, direct charges are made for a number of the services — like refuse collection — which directly benefit business. The net result of this is that the business in Newcastle, for example, is faced with a rate poundage which is very much higher than its counterpart in Croydon for reasons which are largely unrelated to the services it receives.

D.4 For the reasons set out in paragraphs 2.6-2.13, the Government is concerned that the existence of such wide variations in rate poundages between areas must distort location decisions at the margin and reduce the competitiveness of firms in highly taxed areas. In turn, this is likely to lead to lower investment and employment by firms in these areas. Paragraphs D.15-D.16 below show that many of the areas with highest non-domestic rate poundages also have high unemployment.

D.5 In these circumstances, the case for a national non-domestic rate poundage can be made on two grounds.

— *Efficiency*. It would previous location and investment decisions from being distorted in a way which has no economic justification.

— *Equity*. It would mean that businesses would be taxed only according to the value of the property which they occupied, as reflected in rateable values. With the proposal for a non-dometic revaluation in 1990, rateable values would be based on up-to-date rental evidence. This means that businesses would be taxed on a consistent basis across the country according to the amount and value of the property they used. Their liability to tax would not be affected by the spending behaviour of individual local authorities.

D.6 It is proposed that the proceeds of the national non-domestic rate should be pooled and then redistributed to local authorities in proportion to adult population. In this way, business rates would make an equal contribution towards the costs of local services across the country — equivalent to a general reduction in the level of community charge of £185 per adult.

D.7 The redistribution of non-domestic resources achieved through pooling is necessary because of the wide range of variation in non-domestic resources that would be available to local authorities if the yield were retained locally. Figure D.1 shows for English authorities the range of variation in non-domestic rateable values in relation to their adult population. Excluding the City of London, non-domestic rateable value per adult ranges from under £40 to £1540. This means that in the absence of some form of pooling or other arrangements those authorities with very high non-domestic rateable resources would be able to finance a high proportion of their expenditure out of business rates, while those with low resources would have to levy very much higher levels of community charge. In the Government's view, non-domestic rates should be regarded as a national resource to be used in support of local expenditure generally. The level of community charge levied by an authority should not be affected by particular concentrations of non-domestic rateable values which may in many cases reflect accidents of history, such as the location of a power station in a particular area.

Figure D1: Distribution of non-domestic rateable value per adult (England 1984-85)

D.8 A further consequence of the proposal for pooling and redistributing the yield from the non-domestic rates is that domestic taxpayers in individual authorities will continue to receive protection from the effects of non-domestic rateable value losses due, for example, to factory closures. This feature of resource equalisation under successive grant systems has prevented the occurence of fiscal decline of the kind which characterised some North American cities, whereby falling taxable capacity leads to higher tax rates in order to maintain services, which, in turn, accelerate the outward migration of businesses.

D.9 However, the corollary of this is that authorities in England and Wales have been given little incentive under successive grant regimes to encourage new development, since any financial advantage from higher rateable value is offset by reductions in grant. To prevent the continuation of this feature under the new pooling arrangements, the Government considers that authorities should retain the discretion to levy a small rate, over and above the national non-domestic rate the proceeds of which could be kept locally. As indicated in paragraph 2.34, the proposal is for a poundage equivalent to 5% of the national non-domestic rate.

Effects of the national non-domestic rate on business

D.10 The introduction of a national non-domestic rate would [illegible] variation in non-domestic poundages except in so far as authorities choose not to levy the small discretionary element described above.

D.11 Figure D2 shows the impact this would have had on non-domestic rate bills in England in 1984-85. The wide dispersion in existing rate poundages means that the introduction of a national non-domestic poundage would produce some significant changes in individual rate bills – although almost 60% of bills would change by less than 15%. Approximately 11% of properties (200,000) would have their bill reduced by more than 25%, but less than 1% (13,000) would have their bills increased by more than 25%. This distribution means that, overall, bills would be increased than would be reduced, but that increases generally are small.

D.12 Businesses who would gain from the national non-domestic rate tend to be located in high spending areas in the North of England and London. Conversely, businesses in low spending areas in the South of England, and the West Midlands would face higher rate bills. This pattern is the converse of that described for domestic taxpayers in Annex J. It is in those areas where businesses gain from the national rate that domestic taxpayers would have to pay more for local services.

D.13 Figure D3 shows the regional pattern of changes in non-domestic rate bills that would have been implied in 1984-85. Non-domestic ratepayers in the three Northern regions would be better off by £105m, and those in London by £152m, while those in the South East would have to increase their contribution towards the costs of local government by £116m.

Figure D3: Changes in the rate bills by region

	No. of hereditaments (thousands)	Change in the rate bill £m	%
Northern region	99	–35.179	–10.2
Yorkshire and Humberside	170	–30.711	–6.0
North West	230	–39.079	–5.5
East Midlands	132	29.989	+7.9
West Midlands	191	52.641	+9.5
East Anglia	72	22.066	+11.7
Greater London	380	–151.492	–6.7
South East	331	115.958	+10.3
South West	184	36.318	+9.3

Sources: Changes in rate bills – Department of Environment estimates based on 1984/85 non-domestic rate revenues.

D.14 These shifts in tax burden will tend to assist businesses in areas of high unemployment. An analysis at county level within England shows that there is a negative correlation between the percentage reduction in average tax bills and unemployment. Figure D4 shows the effect. Within London, the correlation is even stronger, with the biggest gains accruing to businesses in those boroughs with the highest unemployment rates. Appendix 1 shows the estimated regression equations for counties and London boroughs. The results for counties suggest that the introduction of the national rate would also tend to relieve non-domestic rate burdens in urban areas. This again reflects relative spending patterns.

The impact of revaluation

D.15 Chapter 2 explained that the effects for any individual non-domestic ratepayer of the proposals would depend on the impact both of the non-domestic revaluation and of the setting of a uniform national poundage. The effect would depend both on the new rateable value assessments and on the relative poundages in each authority in the last year of the old regime. Neither can be predicted at this stage. This section looks at the possible impact on non-domestic rateable values based on surveys made in 1985, and the impact on poundages, based on the 1984-85 pattern on non-domestic rates. The results apply to England only.

D.16 The last non-domestic revaluation in England and Wales was implemented in 1973. Changes in non-domestic rateable values since then will reflect movements in the rental values of different non-domestic properties. If non-domestic rates are to yield the same both before and after the revaluation, there will be shifts in the burden both between different *types* of property and between *areas.*

D.17 Since 1973 the values of most non-domestic property types have increased significantly, but some values have increased more rapidly than others. The largest increases have been in prime shops. A revaluation alone could put up the rate burden on such premises by an average of just under 50 per cent. Increases for secondary shops in central areas and district shops would be lower — about 20 per cent.

D.18 The relative rateable values of most other types of non-domestic property would fall. The only other sectors likely to see an increase would be period offices and new large industrial premises and new warehouses. The largest falls would be among older industrial and warehouse properties. The relative rateable values of large pre-1919 industrial and warehouse properties could fall by as much as 40 per cent.

D.19 Among more specialised sectors, increases in rateable value would be expected for hypermarkets and superstores, for mineral producers (other than coal), for successful petrochemical complexes and for high technology industrial units. Rises would also be likely on average for hotels, boarding houses and licensed premises. Significant reductions are likely for older iron and steel plants, older car manufacturing units, and shipbuilding yards.

D.20 In addition to the average trends between *properties,* there is likely to be a regional trend. In particular the North and the Midlands will see rateable values reduced; rateable values will increase in the South. This may compound the sectoral trend; rateable values for prime shopping sites in the South East will go up well in excess of the national average for prime shops. Similarly, rateable values of industrial and warehouse properties in the North-East and North-West may decline far more than the average for the group. In other cases, the regional trend and the sectoral trend offset each other. Rateable values of large industrial and warehouse properties will generally decline, but in the Thames Valley these properties are likely to face increases in rateable value.

The combined impact of a revaluation and a uniform poundage

D.21 The non-domestic ratepayers likely to face the largest increases in rate bills from the combined effect of the national non-domestic rate and revaluation are prime central shops in the South-East and South-West. At the extreme, rate bills would fall dramatically on older industrial and warehouse properties in the North. In some Northern cities, bills for such properties could fall by over two thirds.

D.22 As a proportion of rent and rates together, the likely increases are much smaller. The sectors facing the largest increases are those where rents have risen fastest since 1973, and where rates are presently a small proportion of the total rent and rate bills (and a yet smaller proportion of total occupancy costs). So, although overall the uniform national rate and non-domestic revaluation could put up the rate bills of prime central shops by 40 per cent, this will only mean an increase in the combined rent and rate bill of some 10 per cent. This sort of property tends to be held on a leasehold basis with rents reviewed every five years. Rents for this sector are currently growing by some 10 per cent a year, so that with suitable prior warning changes of this order could be absorbed within the transitional period, as outlined in Chapter 2.

D.23 The biggest reductions in costs would occur where rates — because of high poundages and disproportionately high rateable values — form the largest part of occupancy costs. Many of these properties are held on a freehold rather than a leasehold basis. In these cases there will be a direct and substantial benefit to the owner of the property, who will find his competitive position improved. The combined (notional) rent and rate bills of older industrial and warehouse properties could fall, on average, by some 20 per cent. In the North and North-West the falls will be larger.

Annex E: Implications for the housing market of the local domestic taxation proposals

E.1 A staged abolition of domestic rates could be expected to affect significantly the workings of the housing market since, in principle, it would be equivalent to a substantial reduction in the price of housing services. The effects would, however, work differently in the different parts of the housing system. The likely effects on the market for owner-occupied housing would be different from those on local authority housing, and the impact on the private rented sector would differ again.

E.2 Two aspects of the proposed changes are particularly important. First, as rates are abolished they will be replaced by another tax to provide the same amount of revenue. Secondly, the speed at which rates will be abolished will differ between areas. Where rateable values are at present particularly high, domestic rates will remain an important part of local revenues for up to ten years. These two factors, taken together, will reduce the impact of abolition on the housing market.

E.3 The abolition of domestic rates could affect the housing market in a number of clearly definable ways. There could be:

(i) *a price effect.* The cost of housing to the household would go down, lowering its relative price in comparison to other goods and services. This would increase demand for housing. The size of the increase would depend upon the extent of the price reduction and the price elasticity of demand for housing.

(ii) *an income effect.* Although there would be a replacement tax to provide the same revenue, there would still be small changes in the distribution of income (see Annex J) which might affect overall demand for housing.

(iii) *a supply response.* As a result of the shift in demand, more new houses would be built. The extent of this supply response would depend upon the price elasticity of supply, and would determine how much of the increase in demand would be taken up in increases in house prices and how much in additional provision.

Similar effects would be expected in England, Wales and Scotland, but the estimates in this Annex relate only to England.

E.4 To postulate a direct price effect in the housing market is to assume that rates are seen by households that pay them as one element of the price of housing. An alternative view would be that rates are instead mainly percieved as a payment for local services unrelated to the amount of housing consumed. If this were the case, their removal would not modify perceptions of the price of occupying housing. Any income effect would, however, remain.

Variation in the effect on different tenures

E.5 All three effects on the housing market would work differently according to variations in the extent to which prices were market determined in different sectors. The effect on local authority tenants, who in England now comprise some 25% of households, would be minimal. Rents of local authority housing are set by reference to historically incurred costs as mitigated by Exchequer subsidies or rate fund contributions and so would not be affected by the replacement of rates by another form of local taxation.

E.6 Within the non-local authority rented sector, the effects will differ according to whether or not rent levels are subject to regulation. Rents of most houses and flats belonging to housing associations are set by the rent registration system, as are the rents of about 450,000 dwellings rented from private landlords. Abolition of rates could not lead to increases in these rents. For some regulated tenancies for which a rent has not been registered (more than half a million) the right of a tenant to apply for a fair rent to be registered would limit the possibility of any part of the effect of abolition of domestic rates being shifted into higher rents. Only in parts of the market where the rent registration system is rarely used, notably for furnished lettings, is there much scope for shifting the effects of abolition of rates into higher rents and increased supply. The effects would be more pronounced in areas where there is a shortage of furnished accommodation. This is a small sector of the housing system, accommodating about 3% of all households.

E.7 For owner-occupiers (rather more than 60% of all households) the effects of abolishing rates would be different. The increase in demand, arising from the lower relative price of housing, would result in some increase in house prices and an expansion in supply.

E.8 For these reasons it is primarily in the market for owner-occupied housing that the effects on the housing system of abolition of domestic rates are likely to be found.

E.9 Within the owner-occupied sector, it is necessary to distinguish between present owner occupiers and first time buyers. Those who will have bought their houses before the beginning of the reform (or its announcement, if that led buyers and sellers to anticipate its effect) would not have their house purchase outgoings increased by any general increase in house prices resulting from the extra demand generated by abolition of rates. They would benefit from the increase in the value of their houses, which they could take with them when they moved, either to keep down their borrowing (and hence mortgage outgoings) or as a cash sum. Newcomers to owner-occupation, in contrast, would face higher house prices and mortgage outgoings that would partially offset the savings in rate payments. The number of newcomers to owner-occupation is about half a million a year (excluding right-to-buy purchasers), compared to a total of 11½ million owner-occupiers. The extent of such an effect for newcomers would depend on how much of the reduction in rates was capitalised into house prices, which would be likely to vary from area to area, according to whether supply could increase or not. The importance of new supply as a proportion of all houses and flats that are traded varies substantially between areas.

House price effects for owner-occupiers

E.10 Rates paid by owner-occupiers are a significant element of their housing costs and are therefore relevant to their housing decisions. There is no unambiguous way of converting the annual payment into a capital sum that can be compared with the prices paid for houses, nor of turning the prices paid into an annual equivalent with which the annual rate payment can be compared, which, in principle, is the appropriate basis of comparison. One practical way of approaching the problem would be to compare rates with the outgoings on an newly acquired house, on the grounds that it is at the time of acquisition that rates can influence the offer price which a buyer makes. Rates are, on average, equivalent to about 15 per cent of the total of mortgage outgoings net of tax relief, average expenditure on repair, maintenance, and decoration plus insurance of the structure. There is likely to be a wide variation around this average. The relationship between rateable values and price is not the same for all kinds of houses and flats, and average domestic rate bills vary from area to area in a way that does not necessarily accord with variations in outgoings on new mortgages. How many house buyers perceive rates as a tax at about this rate on the houses they are buying is uncertain.

E.11 There have been a number of estimates made of the price elasticity of demand for owner-occupied housing (that is how sensitive to price changes is the quantity demanded). For England, the estimates are generally in the range −0.5 to −0.8. This means that, for a given change in price, the quantity demanded changes in the opposite direction by 50% to 80% of the change in the price. With a 15% reduction in the 'price' of housing owing to abolition of rates, this range of values for the elasticity of demand would imply, at one extreme, an increase of 7½% to 12% in the quantity of housing purchased if the supply was lightly responsive, and, at the other extreme, an increase of 7½% to 12½% in house prices if there was no supply response at all. Since the abolition of domestic rates is to be phased, the effect on house prices could well build up gradually, though anticipation of the full effect is a possibility.

E.12 The phased abolition of domestic rates would give the house building industry time to respond to the increase in demand. The response would necessarily be gradual, since at a minimum houses take several months to build and the estimated time lag between start and completion for houses built for private owners is nearly 1½ years. To organise a sustained increase in house building, allowing for site acquisition and the provision of services, takes longer. There are more problems about estimating the supply elasticity for owner-occupied housing than the demand, and so the exact extent to which increases in supply would reduce the increase in house prices below the 7½-12½% referred to above must be uncertain. It would also vary from place to place. But the probability is that, in England as a whole, the increase in house prices in the longer run, after allowing for the supply response, would be about one-half of the figures cited above: about 5% or perhaps rather less as a central estimate. This would be accompanied by an increase in the amount of housing provided (see paragraph E.18 below). The fewer the purchasers that in reality act as if domestic rates were an indirect tax on housing, the smaller would be the effect on house prices of abolishing them. The increases in both price and supply would be spread over a number of years broadly corresponding to the period over which rates would be phased out in an area.

Income effects on the demand for owner-occupied housing

E.13 Income effects depend on the extent and pattern of changes in the distribution of income. The estimates in Annex J suggest that both gainers and losers are concentrated among single people and large adult households on low incomes. Over a quarter of single adult non-pensioners and about one fifth of single pensioners (in all tenures) can ultimately expect to gain more than 2% of their income as a result of the complete replacement of rates by a community charge. On the other hand, 85% of three adult households will lose, about 17% losing more than 2%. The other major group to lose will be single adults who are not currently householders. Almost 10% of single person non-pensioner tax units without dependants can expect to lose more than 5% of their net income.

E.14 These changes are unlikely to have much effect on the demand for owner-occupied housing. Most three-adult households are families where a son or daughter has reached adulthood, and not many owner-occupiers move house at this stage. Exercise of the right-to-buy (where many purchasers are in their forties and fifties) would be little affected. The fact of ownership makes no difference to the rates payable and hence would make no difference to the effects of abolishing rates; and the large discount (now averaging 45%) would cut down any increase in the outgoings for purchase that might follow from the effect on pre-discount values caused by partial capitalisation of rates abolition into house prices.

E.15 In recent years, single adult householders below pensionable age have become owner-occupiers to a greater extent than previously. The 1981 Census showed that, of men under age 30 living as one-person households, 38% were owner-occupiers; and for those aged 30-44 the proportion was 52%. The corresponding figures for women were 27% and 53%. Some increase in demand for owner-occupied housing as a result of the increase in net income might therefore by expected, but not much in total, since one-person households below retirement age make up only 6% of all owner-occupiers. The small increase in demand in this sector of the market might balance, in broad terms, some reduction in the demand to trade up by couples with older children.

E.16 Although young single adult non-householders are among those who lose most in terms of net income from the new local tax system, the replacement of domestic rates by a community charge would lower the relative cost of setting up home on their own instead of living at home with parents or flat sharing. But, because the community charge payable will be the same, whether they set up on their own or not, the effect on household formation and housing demand is likely to be small.

E.17 Overall, the redistribution of income caused by the replacement of domestic rates is unlikely to have any significant effect on total demand for owner-occupied housing and thereby on house prices and supply.

Effects on supply of owner-occupied housing

E.18 For reasons discussed in paragraph E.12, the supply of new housing is very unresponsive in the short term to changes in demand; but in the longer term some expansion of the supply is possible and likely. Estimates of the responsiveness of supply (the supply elasticity) are not very secure, but suggest that the increase in supply in the very long term would be about the same in percentage terms as the increase in prices. Since the new houses built for owner-occupation are equal to only 1½% of the stock in any one year, the "long run" is here a very long period of years. The increase in supply would comprise increases in both the quantity and quality of housing. As with conclusions about the effect on house prices, these long run supply effects depend upon house buyers responding to the abolition of domestic rates as if it were the removal of a tax on housing. What proportion would respond in this way is not known, but the absence of any demonstrable effect in recent years of changes in domestic rate payments in real terms on the growth of owner-occupation and the rise in house prices suggests that it is not great.

E.19 Abolition of domestic rates would reduce not just the outgoings from buying a house, but also the cost of making improvements that now lead to an increase in rateable value. This should lead to some increase in home improvement with consequent effects for the building industry.

Conclusions

E.20 The following conclusions may be drawn from this analysis:

- The effect on the housing market of phasing out domestic rates will be mainly concentrated on the owner-occupied sector; elsewhere the effects are only likely to be significant for furnished lettings which comprise a very small sector of the housing market.
- The redistribution of income brought about by the replacement of rates by a community charge is unlikely to have any significant aggregate effect on the housing market, both because of the relatively small scale of changes in net income and because of the characteristics of those likely to gain.
- There would be a more substantial price effect, which is analogous to the removal of an indirect tax on housing of about 15%. How much would be capitalised into prices and how much would be taken up in increased supply is uncertain. Best estimates indicate that after taking account of likely increases in supply, there would be an increase of about 5 per cent in house prices, on average, relative to what would have happened had domestic rates remained.
- With the proposal to phase out rates over a 10 year period in England, the effects on the annual rate of increase in house prices over this period are likely to be small.
- In the long term there should be some increase in the supply of housing, perhaps on the same scale, in percentage terms, as the price increase.

Annex F: The relationship between local taxes and income

F.1 This Annex describes the relationship between local taxes and incomes under the present and proposed systems of local taxation. It supplements the discussion in Annex J. The Annex includes seven tables and histograms — Figure F1 to Figure F7 — which are grouped together at the end.

F.2 A *prima facie* argument against a flat-rate per adult local tax such as the proposed community charge is that it would be regressive, comprising a higher proportion of income for low income households than for high income households. The results in this Annex show that this is also a feature of the present local tax system and that, by comparison with domestic rates, the community charge would bear less heavily on households with the lowest incomes.

F.3 The results are based on actual expenditure and grant entitlements (before holdback) for 1984/85, and in the case of the community charge assume operation of a "safety net" to remove inter-area effects arising from the proposed reforms to grant and non domestic rates. Average local tax bills, rateable values and net incomes are all calculated at a household level for Great Britain. The work is based on 4 years' data from the Family Expenditure Survey (FES), giving a sample of 28778 households whose incomes and benefits have been scaled to 1984/5 price levels. Net household incomes and net local tax bills have been calculated throughout assuming prior implementation of the proposals contained in the White Paper "Reform of Social Security" (Cmnd 9691), including the new housing benefits scheme with everyone paying at least 20% towards local taxes.

The present rating system

F.4 The Allen Committee, set up in the early 1960s to investigate the impact of rates on households, concluded that rates were a regressive tax.

> "The regressive nature of rates is most clearly brought out by the fall in rates as a percentage of income, from about 8% for the lowest incomes . . . to less than 2% of high incomes . . ." (Cmnd 2582)

Following the Committee's report, rate rebates and allowances were introduced for those on low incomes. A more recent analysis of the impact of rates is contained in the Layfield Committee report (Cmnd 6453). The results in this annex update this earlier work.

F.5 Figure F1 and Figure ● in Chapter 3 show average gross and net rate payments both in absolute terms and as percentages of net income in each band of net income.* Gross rate bills increase in absolute terms as net incomes rise, but as a percentage of net incomes they fall rapidly at first and then more slowly as net incomes rise. Gross rate bills for those with the lowest incomes (less than £50 per week) represent more than 10% of net income, whereas for those with the highest incomes (greater than £500 per week) they amount to less than 2% of net income. These results clearly confirm the findings of the Allen and Layfield reports.

F.6 The effect of the rebate system is to make rates mildly progressive for households with net incomes up to £100 per week. The housing benefit scheme, as modified in Cmnd 9691, reduces rates from 10% to just over 3% of net income for households with incomes of less than £50 per week.

F.7 The main reason for the regressive impact of unrebated rates is the relationship between rateable values and incomes. For rates to be a progressive tax, rateable values would need to rise at least proportionately with incomes. But Figure F2 shows that the ratio of rateable values to net income actually falls as incomes rise. The ratio is 5 times higher for households in the lowest income band than for those in the highest income band. Since rate poundages are largely unrelated to household income, it is the declining ratio of rateable values to net incomes which explains the falling proportion of income accounted for by rates.

F.8 The average rateable values for each income band conceal wide variations in rateable values within each income band which further undermine the usefulness of rateable values as a measure of ability to pay. Figure 3 shows the distribution of rateable values within five broad net income bands. Almost 7% of households with net incomes below £50 per week have rateable values greater than £250 (ie over 80% above the average for this income group). Over 10% of households with incomes over £300 per week have rateable values of less than £150 (ie less than 50% of the average for this group).

F.9 The wide variation in rateable values within income groups is due to two main factors:

- regional variations in the relationship of average house prices to income;
- the fact that the value of housing currently occupied is related to past levels of household income for most households.

Regional average net household incomes only range from 90% of the Great Britain average in Yorkshire and Humberside to 110% in Greater London, whereas average rateable values range from 70% to 130% of the Great Britain average. Single pensioners on average have net incomes which are only 40% of the Great Britain average but the average rateable values of the properties they occupy are over 80% of the Great Britain average.

F.10 Thus rates are not well related to ability to pay because rateable values on average do not rise proportionately with income, and households with similar incomes can occupy properties with very different rateable values.

How the community charge compares with domestic rates

F.11 The proposed community charge will be collected from each adult in any local authority area at a flat rate. Because the gross charge would not vary with income, its incidence before rebates might be expected to be regressive. Figure 4 sets out the relationship between a 100% community charge and net household income. As with rates, the charge rises in absolute terms as incomes rise — though in this case this is largely the result of the increased number of adults per household on average as household incomes rise. The gross community charge falls from 7.4% of net income in the lowest band to only 1.6% in the highest income band. As with rates the rebate system makes the incidence of the charge progressive for households with net incomes of up to £150 per week.

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* "Net income" is income from employment, unearned income, and state benefit (except for any housing benefit attributable to local taxes) net of income tax and national insurance contributions.

F.12 Figure ● in Chapter 3 compares the relationship between gross rates and community charge across the income range. The community charge results in a much lower gross local tax bill for households in the two lowest net income bands. For those households with net incomes of less than £50 per week the community charge, before rebates, would represent 7.4% of net income compared to 10.1% for rates. After rebates the figures are 2.4% and 3.1% for the community charge and rates respectively. In the middle ranges of net household incomes, containing the majority of households, the gross community charge is a slightly higher proportion of net income than gross rates. Only at the highest levels of income (£500 per week and above) is the charge a lower proportion of net income.

F.13 The lowest income households therefore stand to gain, on average, from the introduction of the community charge. This is because of household size. 94% of households with net incomes below £50 per week and 65% of the next income band are single adult households. Thus very low income households gain because of the redistribution of the local tax burden from small to large households.

F.14 However the comparison between rates and a community charge by bands of actual household net income takes no account of differences in household size and composition. Another approach is to split all households into bands of equivalent net income and then to measure rates and the community charge as percentages of actual net income within each band. Equivalent income is a way of measuring relative standard of living or ability to pay by adjusting actual income for differences in household composition. So, for example, a single adult with the same net income as a couple would have an equivalent net income nearly double that of the couple.*

F.15 Figure F5 shows the relationship between gross and net local taxes and actual net income, by bands of equivalent net income. Figure F6 shows the relationship between unrebated rates and the unrebated community charge as a percentage of net income, while Figure F7 shows the same relationship with rebates. On this equivalent basis, the community charge is still a slightly lower percentage of income, both before and after rebates, for the lowest income groups. The gains for low income households are however generally lower. This is because only 52% of households in the lowest equivalent net income band comprise single adults, compared with 94% in the lowest actual net income band. By comparison with domestic rates, the community charge would be a slightly higher proportion of net income for middle bands of equivalent income and considerably lower for the highest bands.

Conclusions

F.16 The following main conclusions can be drawn from this analysis.

(i) There is a poor relationship between domestic rateable values and income. Domestic rates do not reflect ability to pay.

(ii) Both domestic rates and the community charge, without rebates, would constitute a much larger proportion of income for low income households. The impact on low income households is reduced in both cases through the operation of housing benefit. For low income households the incidence of local tax depends less on the characteristics of the local tax system than on the system of rebates.

(iii) As compared with domestic rates, the community charge would reduce the burden of local taxation on single adult households, who constitute a large proportion of those households with the lowest incomes.

(iv) The switch from rates to a community charge would produce relatively small average changes in the pattern of local tax incidence across households. After rebates, the average proportion of net income paid in local taxes under the community charge would decline from 1.9% for the lowest income households — on an equivalent income basis — to 1.0% for those households with the highest incomes. With rates, the equivalent figures are 2.0% and 1.8%.

(v) The greatest burden of local taxation relative to income in both cases is borne by households whose income is a little above the level where they qualify for housing benefit. Under the community charge, the average tax burden on these households would slightly increase — from 3.6% to 3.8% of net income.

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* The adjustment factor used is the ratio of the supplementary benefit level of a couple with no children to the calculated supplementary benefit level for each household type considered.

Figure F1

Relationship of gross and net rates to net household income (Great Britain: 1984/85 prices)

	Ranges of net household income (£pw)											All households
	Under 50	50–75	75–100	100–150	150–200	200–250	250–300	300–350	350–400	400–500	500+	
Rate Bills												
Gross Rates £pw	4.15	4.64	4.93	5.26	5.75	6.35	6.98	7.70	8.42	9.57	12.00	5.68
Net rates £pw	1.28	2.14	3.26	4.81	5.60	6.26	6.90	7.64	8.38	9.49	11.93	4.80
Average Rates as a % of net income in each range												
Gross Rates	10.1	7.4	5.7	4.2	3.3	2.9	2.6	2.4	2.3	2.2	1.9	3.6
Net Rates	3.1	3.4	3.8	3.8	3.2	2.8	2.5	2.4	2.3	2.2	1.9	3.0

Figure F2

Relationship between rateable value and income (Great Britain: 1984/85 prices*)

	Ranges of net household income (£pw)											All households
	Under 50	50–75	75–100	100–150	150–200	200–250	250–300	300–350	350–400	400–500	500+	
Average Rateable Value – annual	139.58	155.31	165.80	178.11	196.48	216.08	238.41	264.09	289.63	327.41	409.95	192.86
Average Rates/Average Net Income (in weekly terms)	6.50	4.75	3.67	2.74	2.17	1.87	1.68	1.58	1.50	1.44	1.23	2.33

* Scottish rateable values reassessed more recently than those for England and Wales.

Figure F3

Percentage of households in each income range with rateable values in specified ranges
(Great Britain: 1984/85 prices*)

	Ranges of net household income (£pw)					All households
Ranges of Rateable Values (£s)	Under 50	50 –100	100 –200	200 –300	300+	
0 – 50	6.2	2.6	1.4	0.4	0.1	1.8
50 – 100	26.2	16.6	11.0	6.2	2.8	11.9
100 – 150	28.1	29.1	20.2	13.6	7.4	20.6
150 – 200	23.1	27.1	28.2	22.6	14.6	25.4
200 – 250	9.8	15.5	21.4	24.0	17.4	19.3
250 – 300	4.4	6.1	10.7	16.4	16.6	10.7
300 – 400	1.6	2.4	5.8	12.9	23.3	7.5
400+	0.6	0.6	1.3	3.9	17.8	2.9
	100.0	100.0	100.0	100.0	100.0	100.0
% of all households in each income band	7.6	24.5	40.0	20.0	7.9	100.0

* Scottish rateable values were reassessed more recently than those for England and Wales.

Figure F4

Relationship of gross and net community charge to net household income*

	Ranges of net household income (£pw)											All house-holds
	Under 50	50–75	75–100	100–150	150–200	200–250	250–300	300–350	350–400	400–500	500+	
Community Charge												
Gross £pw	3.07	3.95	4.93	5.46	6.08	6.79	7.55	8.31	9.02	9.68	10.04	5.74
Net £pw	1.01	1.75	3.05	4.82	5.69	6.45	7.18	7.94	8.58	9.19	9.51	4.76
As a % of net income												
Gross Community Charge	7.4	6.3	5.7	4.4	3.5	3.0	2.8	2.6	2.4	2.2	1.6	3.6
Net Community Charge	2.4	2.8	3.5	3.9	3.3	2.9	2.6	2.5	2.3	2.1	1.5	3.0

* Assuming full replacement of rates

Figure F5

Relationship of Rates and Community Charge* (both Gross and Net) to net household income in each band of equivalent net income

	Ranges of equivalent net household income (£pw)											All house-holds
	Under 50	50–75	75–100	100–150	150–200	200–250	250–300	300–350	350–400	400–500	500+	
Average Local Tax Bills (£pw)												
Gross Rates	4.51	4.81	5.30	5.89	6.39	6.76	7.59	8.35	9.50	10.22	12.49	5.68
Gross Community Charge	4.31	4.93	5.68	6.33	6.45	6.22	6.11	6.18	6.15	6.06	6.64	5.74
Net Rates	1.11	2.71	4.69	5.81	6.37	6.74	7.59	8.32	9.50	10.16	12.48	4.80
Net Community Charge	1.02	2.77	4.94	6.08	6.33	6.16	6.06	6.12	6.08	6.00	6.64	4.76
Average local tax bill (as a % of net income in each equivalent income band)												
Gross Rates	8.3	5.8	4.1	3.2	2.8	2.6	2.6	2.5	2.5	2.3	1.8	3.6
Gross Community Charge	7.9	5.9	4.4	3.4	2.9	2.4	2.1	1.9	1.6	1.4	1.0	3.6
Net Rates	2.0	3.2	3.6	3.2	2.8	2.6	2.6	2.5	2.5	2.3	1.8	3.0
Net Community Charge	1.9	3.3	3.8	3.3	2.8	2.4	2.1	1.9	1.6	1.4	1.0	3.0

* Assuming full replacement of rates

Annex G: Administration of the community charge

G.1 The proposal to introduce a new, flat-rate, community charge payable by all adults is described in Chapter 3. Introduction of a personal charge in payment for local services will be a new departure in Great Britain. This Annex looks at the ways in which the community charge might be administered. Wherever possible it draws on established procedures and existing local systems to carry over their strengths and provide the benefits of continuity. The Government will enter into detailed discussions with local government and other interested parties about the practical issues discussed below.

The basic requirements

G.2 In order to administer the community charge the local authority will need to know who is liable to pay the charge. For this purpose it will be necessary to draw up a register of all adults living in the area. There would need to be ways to ensure that everyone who is liable is registered and to enforce payment when it becomes due. It is fundamental to the new charge that many more adults will be liable to make a contribution than under the present arrangements. Arrangements will therefore have to be made for assistance to those on low incomes who would otherwise have difficulty in meeting the charge.

The register

G.3 Registration is not new in Great Britain. Householders are required by law to register those in their household who are eligible as electors. Virtually all adults are registered for national insurance and national health purposes. And there are other large registration schemes applying to significant proportions of the population, for example to car owners and, for rating purposes, the occupiers or owners of every home.

G.4 Other countries have gone further in their registration schemes. Some have unified their separate registers and use them for several different central administrative purposes. Because many countries also have a system of national identity cards, it is often assumed that a national register requires a national identity card system to support it. But in Sweden, for example, there is a comprehensive national registration system without a compulsory national identity card scheme. The question of whether to have an identity card system is therefore separate from the question of registration.

G.5 The British tradition on registration is different. Registers are kept separately for different purposes by the body which needs them for a particular purpose. And they are expected to hold no more information than is reasonably necessary for that purpose. It is proposed that the community charge registers should be kept separately for each area by the relevant local authority. There will be no central register and no obligation to carry an identity card.

Who should be registered?

G.6 In principle, all adults should be registered in the authority where they are normally resident (see paragraph G.8). That requirement should apply to those like foreign nationals who are not presently required to register for electoral purposes. But, for practical administrative reasons, explained below, certain categories of people will not be registered individually.

G.7 There is a question about the age at which individuals should start to become liable for the community charge. Individuals benefit from local services from the earliest age, but they have no say in the provision of local services until they become eligible to vote at 18. It would be possible to make them liable for the community charge from their eighteenth birthday. By then many are working or receiving support from the state in their own right. Many others, however, are still at school and entirely dependent on their parents. The social security system recognises this and there is provision for payment of child benefit to continue up to the age of 19 where a person is receiving full-time, non-advanced education. It would be consistent with this for liability for payment of the community charge to be linked to the cessation of payment of child benefit for those over 18. That would avoid imposing an additional burden on the many families who support their children in continuing education. It might also be desirable, for administrative simplicity, that liability to pay the charge for the first time should not arise until the start of the first full financial year after the relevant birthday.

Where should people register?

G.8 The community charge will continue to be collected by the authorities which are presently responsible for collecting rates — district or borough councils in England and Wales and Regional Councils in Scotland. Individuals should therefore be registered with the appropriate authority in which they live. The overwhelming majority of people live in one place only and will be registered there. A minority have two or more homes and they should be registered where they mainly live. This concept is similar to the test of main or only residence used in determining eligibility for mortgage interest tax relief. Which residence is the main one is a matter which should be easily established on the facts of the case. For the small minority of cases where the facts do not give a clear cut answer it may be necessary to have an independent adjudication procedure. Second homes are dealt with further in paragraph G.39 below. They will need to be separately identifiable.

Who should be responsible for registration?

G.9 At present the head of the household is responsible for providing the information necessary for registering eligible adults for electoral purposes. It is proposed that the head of household should similarly be responsible for providing information for registration for the community charge. As with electoral registration it will be a criminal offence not to comply with this duty.

G.10 It is for consideration whether there should be a separate provision to deal with cases where an individual exerts pressure on the head of household not to register him. The duty on the head of household would need to take account of such cases.

What happens when people move?

G.11 A large number of people move house every year. Not all of those moves are from one local authority area to another, but many are. The register of those living in an area will have to be updated to keep track of all changes of main residence within or between authorities. There are two approaches to this.

G.12 Some countries, which have a system of local personal taxes, specify a qualifying date for residents in an area and all those residents in an area on that date are liable to pay their local tax to that authority for the whole of the next financial year. If a similar approach were adopted in Great Britain it would be possible to run a registration system similar to that used for electoral registration. There would be an annual canvass of households for the names of those resident on the qualifying date, and the register compiled on that basis would be updated a year later to incorporate all the changes in the preceding twelve months. That approach, however, has a number of shortcomings in relation to the specific proposals for the community charge.

G.13 First, the community charge will be collected directly from individuals and not through a third person who will not generally move, such as an employer. If a person moves after being registered and does not notify the authority, collecting the community charge will be difficult.

G.14 Secondly, it would make enforcement of registration more difficult if there were large numbers of people who could legitimately claim services from a local authority without being registered there because the register would inevitably be out of date between annual revisions.

G.15 Thirdly, local authorities administer housing benefit. It would add to the complexity of that task if they had to take account of widely different community charge liabilities for those who had moved into the area after the qualifying date and who were therefore paying a community charge to another authority at the rate applying there.

G.16 The alternative approach is to maintain a rolling register. This would allow the arrangements for collecting the community charge to be similar to those which exist at present for the payment of rates. Liability to the community charge would cease when a person left the authority and the amount payable to an authority would be pro rata to the portion of the year that the individual had lived there. There would be an incentive on those leaving the area to notify the council of their move — so as to terminate their liability — and this would provide a continuing flow of information to the authority about changes of occupation of properties which would assist enforcement. Inter authority administrative arrangements could be developed to simplify the transfer of registration. The difficulty with housing benefit administration described above would be avoided, since all residents in a local authority's area would be paying its own rate of community charge.

G.17 In order to maintain a rolling register it will be necessary for there to be a statutory requirement for individuals to be registered with an authority within a reasonable period of time of taking up residence there. The concept of residence described in paragraph G.8 would preclude people from having to register in places where they were staying for a short period only. Foreigners taking up residence in the country would however be required to be registered. As for the basic registration process the duty to register new arrivals should rest with the head of household.

Form of the register

G.18 The electoral register is a public document which can be examined by any member of the public. The Government proposes that the community charge register would be similarly open. An open register would be of assistance in enforcing registration.

G.19 The public register however should contain no more information than is necessary. That might be just the names and addresses of eligible adults or even the list of addresses with the numbers of eligible adults resident there. Authorities will need to keep additional details for working purposes — for example, a record of who is the head of the household, or the arrangements for payment.

G.20 The coverage of the community charge register would be different from that of the electoral register. If a rolling register is adopted the character of the register will also be different since the electoral register is static and updated annually. It would not be possible, therefore, for the same register to be used for both purposes. Nor is it, in principle, desirable for it to be so. Entitlement to vote should not depend upon registration for the community charge. Nor should the community charge be avoided by those such as resident foreign nationals who enjoy local authority services but are not eligible to vote.

Enforcement of registration

G.21 Placing an obligation on the head of household to provide the information necessary for registration, backed by criminal sanctions, will be sufficient to ensure compliance in most cases. These pressures will not however be fully effective unless there are efficient procedures for registering people and checking registration so that the public in general accept that there is little possibility of evading detection for long.

G.22 It is one of the technical strengths of rates that, because they are tied to the occupation of immovable property, they are easy to collect and the level of evasion is relatively small. Taxes which are not linked to immovable property have greater enforcement problems. This is true of income tax and road fund licensing for example at the national level. Even so estimates of evasion are low overall.

G.23 Proposals for transition to the new community charge arrangements envisage that an element of rates will continue to be paid in all authorities at least in the early years. This will carry over to the new arrangements something of the ease of collection of domestic rates by maintaining links with the head of household. There will be continuity while the new arrangements are settling down.

G.24 A successful registration process will require two elements. First, effective canvassing of households. Local authorities already have a great deal of experience in compiling electoral registers on which to build. They will be able to develop new techniques to meet the new circumstances they will face. A large measure of discretion should be possible about the way in which they approach the task. It may not, for example, be necessary for all authorities to have a full canvass of households each year. However, some additional resources and effort will be required if the coverage of the community charge register is to achieve the level of accuracy needed for enforcing a tax. OPCS have estimated that the 93% coverage of the electoral register could be increased by improving the record of addresses, chasing up non-responders, door to door canvassing and a variety of other measures. But people will have an incentive to avoid registration for the community charge.

G.25 The second ingredient will be the link between registration and the use of local services. This does not mean that authorities should be expected to require proof of registration before providing a service. In the case of emergency services, for example, that would be entirely inappropriate. But many authorities already require evidence of residence when providing a service to individuals. Libraries are a common example. The task for local authorities will be to develop their information systems so that, where they are providing a service to an individual, it is possible to check back conveniently, either before or after the event, on whether a person is registered and take steps to register those who are not.

G.26 There will also be a great deal of scope for schemes to encourage registration through the administration of services for which charges are made. An obvious example would be to issue membership cards or season tickets which give preferential rates for those using leisure facilities or public transport who are registered as living within the authority's area. Some authorities already have such preferential charging schemes. They are common practice, for example, in the provision of adult education classes.

Payment: who is responsible?

G.27 In order to obtain the maximum benefit from extending the tax base and make the greatest possible number of electors aware of the cost of the local services they vote for, separate bills should be sent to each registered individual.

G.28 In principle, each individual should also be individually liable for paying his or her bill. However, this may be difficult where people have no independent income of their own. This situation will occur most frequently with married couples where one partner is not working. Latest estimates are that slightly more than half of all wives below retirement age do have some independent income and so could pay their own community charge. However, it would be possible to deal with the problem more generally by making husbands and wives jointly and separately liable for each other's community charges. This would be well precedented in general taxation law and would reflect the practical financial arrangements which most married couples with only one earner adopt. It would also reflect the arrangements which the social security system makes by assessing married couples jointly.

Enforcement of payment

G.29 The Government envisages that the existing procedures for the enforcement of payment of rates would be carried over to the new arrangements. The procedures are well established but the Government is prepared to consider practical suggestions for further improvements.

Assistance for those on low income

G.30 At present means tested help with rates bills (rate rebates) is available through the housing benefit scheme to people on low incomes. Some ● households get a full rebate because they are receiving supplementary benefit; another ● receive partial help, depending on the composition of the household, the size of their rates bill and their weekly income.

G.31 The White Paper "Reform of Social Security" (Cmnd 9691) announced a number of changes to the housing benefit scheme, including a requirement that those on the lowest incomes should have to pay a minimum contribution of 20% towards their rates. It would be possible to extend the application of the revised housing benefit scheme to everyone liable to pay the community charge. There will be separate consideration of the interaction between the community charge and the benefit system, including whether any modifications are required to housing benefit in the light of the new local tax proposals and the arrangements for phasing their introduction in England, Wales and Scotland.

A Collective Community Charge

G.32 So far this Annex has been concerned with the arrangements necessary to cope with the circumstances of the great majority of individuals. However a part of the population, estimated at [●], is extremely mobile. These are people living in multiple occupation, in boarding houses, or institutions. For this group the arrangements described so far would be inappropriate and onerous to administer satisfactorily. Nevertheless the Government's view is that these people should make a contribution towards the cost of local services. Equally, the authority should be accountable to this group of residents. At present the accommodation they occupy is generally treated as non-domestic property for rating purposes. If this practice were continued in the new arrangements, the rates levied on those properties would form part of the national pool and this would deny any direct link between these individuals and the authority in which they live.

G.33 The problem of local taxation in respect of the most mobile groups is one which occurs within the present rating system. It is dealt with by giving local authorities the power to designate classes of property for which the owners, rather than the occupiers, are liable to pay the rates. The owners are also required to provide information when requested as to who the occupants of any such property are. It would be appropriate in the new system to build on those arrangements by designating certain classes of property as liable for a collective community charge, payable by the owner, but recoverable through rents charged to the occupants.

G.34 The amount of the collective charge would be determined by a formula for which the starting point would be the amount of accommodation provided in the property. The Government wishes to consult separately on which other factors should be taken into account, for example evidence of average occupancy rates. The Government will also be consulting on the classes of property which would be covered by these arrangements and the arrangements for adjudicating disputes.

G.35 The consequence of these arrangements is that it will not be necessary for those living in designated properties to be registered individually with their local authority. The authority will, of course, keep a register of the properties covered by the collective charge so that the enforcement procedures described above can operate. The existing requirement on owners of such property to keep records of those occupying the property should be carried over to the new arrangements so that the entitlement of those living there to local services on the same basis as other residents can be established.

G.36 The Government intends to preserve the benefits of the existing rate relief arrangements for charities in the form of a discount from collective community charges.

Special groups

G.37 *Crown Property.* Those occupying Crown Property — like the armed forces — do not at present pay rates. Instead the Crown makes a contribution to local authorities in lieu of rates. The convention against taxing the Crown would not apply in the same way to individuals occupying property owned by the Crown. Nevertheless many of those occupying such property are very mobile and it would be sensible to continue the arrangements whereby a single contribution is made by the Crown in respect of those occupying such property. The simplest way of doing so would be for the relevant Government Departments to make a contribution in lieu of a collective community charge calculated on the basis of a formula applied generally.

G.38 *Students.* For students who are not home-based at their college or university it would be difficult in practice to establish which is their main place of residence. It would be complex and costly to require students to register and de-register at the beginning and end of each term or to attempt to apportion liability to community charges between two authorities. The Government's view is that students should be deemed to have their main residence at their term-time address. This would be consistent with the way in which students are presently recorded for rate support grant purposes. This treatment would not of course affect those who are home-based during the course of their studies. In all other respects students would be treated in the same way as any other adult residents, paying a community charge individually or through a collective charge according to the property they occupy.

G.39 *Second Home Owners.* Owners of second homes will make some use of local authority services in the area of their second home. At the moment these homes are subject to rates. Replacement of these by a community charge would give a large bonus to the owners of these properties. The Government considers that there should be a standard charge on second home owners and that it would be most convenient to express that in terms of a community charge liability in the area where the second home is located. It proposes that there should be a standard charge equivalent to two individual charges which would leave second home owners broadly unaffected by the removal of rates.

Precepting authorities

G.40 Those authorities which are financed by issuing precepts to rating authorities will continue to be financed in this way but; once the community charge is fully in place, the precept will be expressed as a flat rate amount per head rather than as a rate poundage. Where there are parish councils the community charge register will have to be kept in a way which will identify the distribution of the population between parishes.

Annex H: New arrangements for grants to local authorities

Introduction

H.1 The Government's proposals in Chapter 4 involve a system of unhypothecated grants with just two elements:

i. needs grant, to compensate authorities for variations in local needs; and

ii. standard grant, to pay an additional contribution towards the cost of local services.

The proposals also envisage the ending of resource equalisation through the grant system and of domestic rate relief grant.

H.2 This Annex describes in more detail how the new grants would be calculated, and the basis of their approval each year by Parliament. It also explains in more detail the reasons why the Government has concluded that resource equalisation through the grant system should be discontinued.

Needs grant

H.3 Whatever grant or local taxation arrangements may exist in the future, the Government remains committed to a grant system which compensates authorities for differences in the amount they need to spend to provide a typical standard of service. This applies equally to differences which arise because some areas have greater concentrations than others of people who need local authority services; and to inescapable differences in the cost of providing those services. Without some form of compensation, authorities affected by concentrations of need, or by higher costs, would have to increase local tax bills, or reduce the standard of service provided. The Government believes, however, that it would be possible to compensate for these differences much more openly and directly than in the past, by paying a separate needs grant to each authority.

H.4 The calculation of this grant would be undertaken by assessing, for every local authority area, how much it might be expected to cost, per adult living in the area, to provide a normal level of local authority services. The result of the calculation would be a needs assessment for each area. The needs assessments would follow similar principles to those used for GREs under block grant, but should be considerably simplified. The way in which they might be derived is set out in more detail in paragraphs H.9 to H.15 below.

H.5 From the needs assessments, a ranking list of areas would be produced. At the bottom of the list would be the area which could provide an acceptable level of service for the smallest amount per adult. At the top would be the area where the same level of service cost most to provide. The Government would then pay a cash amount of grant to each authority to meet the full difference in cost implied by the gap between that authority's needs assessment and the cost for the authority with the lowest assessed need per adult in the country. For example, if the lowest authority was assumed to be able to provide its services for £350 per adult, then another authority with an adult population of 100,000 where the same standard of services would cost £400 per adult to provide would receive a grant of (£400 – £350) x 100,000 = £5m.

H.6 In order to pay needs grant to every authority, rather than just to one tier, it would be necessary both to derive a minimum needs assessment for each class of authority and to split the needs assessment for each area between tiers. There would be more than one way of doing this; similar issues already arise with block grant.

H.7 The total of needs grant to each authority would be fixed. It would not be affected by the actual level of an authority's spending. So an authority spending £25 per adult below its needs assessment would be able to reduce its local tax bill by a full £25 per adult. In the same way, the needs grant would not increase if an authority chose to spend more. If it spent £25 per adult more than its needs assessment, local taxpayers in the area would have to meet the cost of that extra spending in full.

H.8 The total of needs grant required would depend on the exact method of calculating the needs assessments and splitting them between tiers. The amount needed to equalise needs is however likely to be close to the figure contained within block grant. This was £4.4 billion in England in 1984/85—37% of the grant total. In Wales and Scotland it amounted to £●m and £●m respectively, ●% and ●% of the Exchequer grant to local authorities in those countries.

Needs assessments

H.9 Assessing the cost to local authorities of providing an acceptable standard of service has been a consistent thread running through discussions of Government grants to local authorities throughout this century. It was Lord Balfour, in his Minority Report to the 1901 Royal Commission, who first suggested that relative need for expenditure should be assessed by finding the lowest expenditure per head of population for a particular service, and assessing grant for all other authorities on the basis of the unavoidably greater cost to them of providing the same standard of service.

H.10 Nothing came of the Balfour scheme until 1929, when a grant system was introduced which tried to assess the relative needs of different authorities. Its approach, however, was to take only a handful of general factors to assess variations in needs across all services. Immediately before the introduction of block grant these factors were selected automatically by the statistical technique of regression analysis.

H.11 The introduction of GREs marked a big step forward. For the first time, an attempt was made to use a client group/unit cost approach to assess needs for the main services. The previous statistical approach simply weighted socio-economic factors according to the strength of their statistical correlation with the actual pattern of local authority expenditure across all services. The new approach was designed to select and weight factors which laymen and experts alike could accept as being plausibly related to variations in the cost of providing individual services.

H.12 The needs grant system now proposed will continue to be based on the client group/unit cost approach developed under the present GRE system. The Government is concerned, however, that GREs have been subject to frequent changes, and have become steadily more complicated over the 5 years since their introduction. In the run-up to the new system it therefore intends to review the existing GRE formulae to see whether they can be made simpler and more stable.

H.13 The purpose of GREs is to establish the *relative* spending needs of local authorities. Yet it has become apparent that some of the factors that have been introduced into the GRE formulae have very little redistributive effect, yielding very similar amounts per head for all authorities. This is true of several minor services which at present feature separately in the overall GRE formula but where the variation in spending—and in the GREs themselves—is small. A similar pattern arises with some factors in the GRE formulae for the major services: the allocation of GREs would be little different if some of those factors in the formulae were omitted entirely. Needs assessments must be fair. But they must also be as simple and comprehensible as possible. There is no justification for having complicated formulae if the existing pattern of GREs could be broadly reproduced using an approach which would be more easily understood by councillors and electors.

H.14 It may be possible to introduce some simplifications, both in the treatment of minor services and the number of factors used in the formulae for the main services, before the start of the new system. The Government will have this possibility in mind in the normal annual cycle of discussions with the local authority associations. In other cases, it may be appropriate to wait until the new system is introduced before making changes.

H.15 The Government also considers that, after the new system has been set up, it would be appropriate to minimise changes to the formulae used to calculate the needs assessments. Apart from taking acount of new sources of data, changes should only be made where there would be a major gain in fairness that would clearly outweigh the disturbance that would be caused. This would mean placing greater emphasis on stability than has been the case in the past, either with block grant or with earlier systems.

Standard grant

H.16 The Government considers that the most appropriate way of allocating the Exchequer grant after needs grant and specific grants have been paid would be as a constant amount per adult to every local authority area, so as to produce a matching reduction in the size of the community charge. This would be in keeping with past rate support grant arrangements, under which amounts of grant not needed for the purposes of equalisation have been allocated as a constant amount per head. The main difference would be that, with the present and previous grant systems, the extent of this support is obscured within an overall total that also includes compensation for differences in needs and in rateable resources. With the approach now proposed, standard grant, representing the basic level of taxpayer support to local services, would be a free-standing and identifiable element in authorities' budgets.

H.17 If the total amount of Exchequer support were at the 1984/85 level, and the amount needed for specific grants and needs equalisation remained broadly unchanged, the total available for use as standard grant in England would be about £4.7 billion, or £134 per adult across the country, on the assumption that the grant for domestic rate relief, which would no longer be required, were absorbed in standard grant. In Wales it would be about £●m, or £● per adult; and in Scotland £●m, or £● per adult.

Resources equalisation

H.18 Under the existing grant and rating arrangements, some compensation within the grant system for variations in authorities' rateable resources has been essential. Without it, rates in authorities with few commercial and industrial properties and low average rateable values would soar. Such authorities would not be able to afford to provide a reasonable standard of services. This would clearly not be acceptable. But the fundamental changes in the local government finance system now being proposed by the Government offer new ways of tackling the problem.

H.19 The main factor which causes variations in authorities' total rateable resources is non-domestic property. Even excluding London, where there is the greatest concentration of non-domestic resources, non-domestic rateable values in England range from £36 per adult to £50,900 per adult. Under any system where the entire yield of non-domestic rates lies locally, it is inevitable that the Government should intervene to compensate areas with only a small amount of commercial and industrial development, and to draw off some of the income from authorities with large concentrations of shops, offices and factories. Otherwise there would be very substantial variations in local services and local domestic tax bills, caused solely by the extent of industrial and commercial development in different areas.

H.20 However, the proposed reforms of the non-domestic rate described in Chapter 2 deal with this problem. The proposal to pool and redistribute the yield of non-domestic rates as a common amount per adult among all authorities ensures that the benefit from non-domestic rateable resources is shared equally among all authorities, thus removing a major source of variation. This would achieve automatic equalisation of non-domestic resources in a simple and transparent way without any of the cumbersome arrangements of a resource equalising grant.

H.21 If non-domestic resources are pooled and redistributed in this way, variations in authorities' resources arise only in the context of the domestic tax base. If, in future, the tax base were to be simply the adult population of the area — that is, if rates were to be replaced entirely by a community charge as proposed in Chapter 3 — each authority could be assumed a prior to have the same taxable resources per adult. With a needs grant of the kind proposed, two authorities spending at the level of their assessed needs would both need to levy the same amount per adult.

H.22 The domestic tax proposals described in Chapter 3 indicate the Government's intention to begin its reform of local taxation with a combination of a community charge and domestic rates, with the former increasing as a proportion of the tax base over a period of years, while the latter diminishes. As long as some element of domestic rates is retained, there will be variations in authorities' taxable capacity. But their significance will be much smaller than at present, and under the proposals in this Green Paper, they will ultimately disappear.

H.23 During the transitional period, local taxpayers will not pay exactly the same tax bills for the same level of service, although the £ for £ relationship at the margin between changes in expenditure and changes in tax bills will be the same everywhere. It will be necessary to ensure that in the initial years of the new system, while domestic rates remain a significant element of local finance, this does not lead to major changes in the burden of local taxation. The special arrangements discussed in Chapters 4 and 5 will achieve this.

The City of London and the Isles of Scilly

H.24 Under block grant and its predecessors, special grant arrangements have been made to take account of the special circumstances of the City of London and the Isles of Scilly. Both are authorities with very small resident populations — about 5,000 in the City and about 1,500 in the Scillies. Comparable arrangements will need to be made under the new system proposed in this Green Paper.

H.25 In the case of the City, the bulk of services is provided for a very large non-resident population and for non-domestic ratepayers. Uniquely, some non-residents retain the right to vote in elections for the City Corporation. It would therefore not be appropriate to adopt without modification proposals under which the full cost of marginal expenditure above the City's assessed expenditure needs fell solely on the resident population.

H.26 In the case of the Scillies, the principal problem is the significant diseconomies of sc[illegible] incurred in providing the full range of local authority services to a small resident population. Because of this the needs assessment of the Isles of Scilly and the level of grant support have to be set with particular care. At present, under block grant, this is achieved by setting the GRE at the level of the authority's agreed budget.

H.27 Some modification of the proposed grant arrangements will be needed in the case of both the City and the Isles of Scilly. The Government intends to discuss with the authorities concerned how best to take account of their distinctive problems.

Calculating grant entitlements and obtaining Parliamentary approval

H.28 One of the problems inherent in block grant is that each authority's grant entitlement is subject to change during, and after, the year in question. The Government proposes to end this practice and to ensure that, under the new grant system, the cash total of grant approved before the start of the financial year will be the exact figure that each authority gets.

H.29 This will be possible because grant entitlements will no longer depend on authorities' actual spending, and there will be no grant abatement or holdback. Instead, each authority will know before it sets its budget for the year the fixed amount of needs and standard grant it will get, and the exact total it will be paid from the non-domestic rate pool.

H.30 This will simplify local authority budgeting. Every authority will be able to see just what income will arise from grant and non-domestic rates, and will know that the gap between that figure and the amount needed to finance its planned spending will have to be met entirely from local domestic taxpayers.

H.31 The total amount of grant which the Government plans to make available, and the basis of its allocation between authorities, will continue to be subject to approval by the House of Commons. The present Rate Support Grant Reports for both England and Wales are cumbersome documents. It is difficult, especially for those who are not experts in the field, to pick out from the mass of material the elements that are crucial in determining how grant is apportioned. The content of these Reports has to meet requirements set down in primary legislation so there is little, if any, scope for simplifying them under the present arrangements. The proposed new grant system is in many ways simpler than block grant. This should automatically mean that the statutory documents can be simpler. But the Government also intends to look again at the way in which details of each year's grant settlement can be presented to Parliament for approval, with the aim of adopting a form of presentation that will make it easier to identify the main principles which are to be decided and on which the grant allocation will be based.

H.32 The Government's intention to avoid within-year changes in authorities' grant entitlements means that there will be only one Rate Support Grant Report for each year; the system of successive Supplementary Reports will cease. If changes need to be made to the calculations set out in the main Report — for example to correct a significant error in the data used, or to adjust any needs assessments that may be based on budgeted or actual spending — this will be done by making explicit compensating adjustments in the grant calculation for a future year.

Annex J: The distributional impact of changes to local taxation and grant

J.1 This Annex supplements the description in Chapters 5, 8 and 9 of the distributional impact of the proposed reforms to local taxation and grant. Additional background material, for example on household numbers, relevant to the analyses in this Annex is included in Annex C.

Distortions in the present local government finance system

J.2 As the discussion in Chapters 1-4 showed, the present local government finance system distorts to a significant degree the link between what local electors pay for their services and the benefit they receive from them. This arises because the present arrangements entail cross-subsidies from non-domestic ratepayers, and direct subsidies from the Exchequer which are related to authorities' spending levels and to the overall rateable values of properties in their areas. This can lead to large differences in the amount, both on average and at the margin, which local domestic taxpayers have to contribute towards the expenditure needed to provide comparable levels of service. Figure J1 shows the wide range of average domestic rate bills that would be paid in English local authorities for expenditure at the level of the authority's GRE. What the average ratepayer pays for similar local services can vary by a factor of four depending on where he lives. For the *individual* ratepayer within each local authority, the link between payment for and benefit from services is further distorted by the fact that his share of local taxes is determined by the rateable value of his house. This will have little or no relationship with his use of local authority services.

Figure J1: Distribution of average domestic rate bills for spending at GRE (England 1984/85)

J.3 Because neighbouring authorities tend on average to have similar rateable values and similar expenditure patterns, this variation also shows through as a broad geographical pattern of rate bills which are lower than might be expected in high spending areas. Figure J2 shows average rate bills and average spending in relation to GRE by English regions. Outside London, some of the highest average rate bills are in relatively low spending areas like the West Midlands.

Figure J2: Average Domestic Rate Bills, and Expenditure in relation to GRE (English regions, 1984/85)

	Expenditure above GRE £/head	Average domestic rateable value £/head	Average domestic rate bill £/hereditament
Northern Region	61.57	142.63	254.96
Yorkshire and Humberside	41.81	136.77	232.12
North West	38.66	172.63	286.62
East Midlands	6.79	169.92	247.27
West Midlands	10.96	203.82	294.01
East Anglia	22.08	186.75	260.31
Greater London	243.97	284.75	503.06
South East (Excluding Greater London)	14.27	233.61	332.23
South West	13.76	182.27	260.83

J.4 To correct these distortions, this Green Paper proposes:

— the settingofanationalnon-domesticratewiththeyieldpooledandredistributedasacommon amountperadult;

— r- eplacementofdomesticratesineachauthoritybyaflat-ratecommunitychargeleviedonall adults;

— agrant comprisinganeedsequalisationelementandastandardelementdistributedonaper-adultbasis.

J.5 These proposals will lead to substantial changes in the income of local authorities and will affect the contributions towards local expenditure paid by their residents. This Annex assesses the scale of these changes, taking account of the arrangements proposed to "safety net" changes in local authorities' external income and to moderate the transition from domestic rates to the community charge.

Assumptions

J.6 The method adopted for illustrating the extent of changes involves comparing the financial effects for local authorities and households of the existing financial regime with the effects of the proposals described in this Green Paper.

J.7 To ensure comparability the baseline and the illustrations of the effects of the new system use data for *the same* financial year – 1984/85. The choice of analysis year was made on technical grounds. Local authority income and expenditure data for 1985/86 are available, but to establish a consistent household data base for that year would not have been practicable. In particular, it is not possible to estimate reliably the effects on individual households of the revaluation of domestic rateable values in Scotland in 1985.

J.8 The local authority income and expenditure data used incorporate estimates of expenditure and grant entitlements before holdback for 1984/85. The results shown are therefore purely illustrative. They cannot be extrapolated into the future since relative spending levels will change in response to grant pressures and the effects of rate limitation.

J.9 For illustrating household effects, data from the Family Expenditure Survey (FES) have been used. Data from 4 years of the survey (1980-83) have been combined and re-priced to 1984/85 levels. The sample size is not sufficient to allow analysis for individual local authorities.

J.10 The assessment of effects on households of changes in local tax bills and housing benefit entitlements is modelled on the assumption that the proposals contained in "Reform of Social Security" (Cmnd 9691) are already in effect, since these are to be implemented before the local government finance reforms. In particular, for illustrative purposes, the analyses incorporate the Cmnd 9691 proposals on housing benefit – including a 20% minimum contribution towards rates/local taxes – in both the base position and the new system. Thus the changes shown for households are those which arise solely from the new local government finance arrangements.

J.11 The illustrations are based on the 1984/85 balance of contributions to local expenditure from central taxpayers and local domestic and non-domestic taxpayers in England, Scotland and Wales.

Effects on local authorities' external income of changes in grant and non-domestic rates

J.12 Under the proposals for non-domestic taxation and grant described in Chapters 2 and 4, local authorities' income would change: first, as a result of the pooling and redistribution of receipts from non-domestic ratepayers on a common per adult basis; and second, as a result of the distribution of general grant to local authorities, over and above that required to equalise needs, entirely on a per adult basis with no resources equalisation through the grant system. The income of individual authorities would also be affected by changes in their needs assessments. The change in income in this case would depend on the detail of changes in the methodology and changes in local circumstances; no general conclusions can be drawn in advance. The effects of the proposals for local domestic taxation are discussed later. They would have no impact on the overall income of a local authority, but would redistribute the local tax burden between adult residents within each local authority.

J.13 The new arrangements for non-domestic rates and grant would lead, if implemented unmodified, to large and sudden changes in local domestic tax bills. Chapter 5 explained the Government's intention to prevent this through a "safety net" arrangement to preserve each local authority's external income on introduction of the new financial system at broadly its present level, with the amount of assistance frozen in cash terms thereafter. The safety net would take the form of self-financing adjustments to the standard grant and, if necesary, non-domestic rate allocations of individual authorities to eliminate most of the gains and losses which result from introduction of the new system. Under this arrangement, the new financial system would generally have a neutral impact on local authorities' income in the first year if they maintained their spending at previous levels.

J.14 Authorities' external income (net of specific grants, fees etc.) would then comprise:

i. national non-domestic rate revenue;

ii. standard grant, paid at the same amount per adult to all authorities;

iii. needs grant;

iv. safety net receipts or contributions, fixed in cash terms.

In future years, changes in the first two components would affect all authorities in the same way. The effects of the third would depend on detailed changes in local authorities' assessed needs which vary as their circumstances change. The effects of the safety net would vary between authorities according to the size of their entitlement in relation to their overall expenditure. Authorities with a large safety net entitlement would have a stronger incentive to seek economies in order to offset its declining real value.

J.15 The size of an authority's safety net entitlement or contribution will depend on the extent of the change in income it would incur if the proposals in Chapters 2 and 4 were introduced without modification. Authorities that would otherwise face large losses will have a high safety net entitlement. Authorities that would otherwise enjoy large gains will be net contributors to the safety net.

J.16 Chapter 5 (paragraphs 5.7 and 5.8) sets out the characteristics of local authorities which would gain and lose if there were no safety net. The biggest reductions in income would arise in high poundage/high rateable value authorities: high rate poundages resulting from high levels of current spending in relation to GRE produce a very large yield from these authorities' large non-domestic rate base. They will stand to lose significantly from the reduction of their non-domestic rate income to the national per adult average, and so will have a large safety net entitlement. The biggest increases in income will arise in low spending, high domestic rateable value authorities which will benefit both from the increase of their non-domestic rate income to the national average per adult and from the change in the basis of grant from equalisation of domestic rate poundages to equalisation of rate bills. They will be contributors to the safety net arrangements.

J.17 The marked regional pattern of changes in local authorities' income in England illustrates the effects of these factors. Many authorities in the Northern region, Yorkshire and Humberside, and the North West have high spending levels and low rate bills and so would lose income. Many authorities in the South East, South West, East and West Midlands and East Anglia, where spending tends to be lower and domestic rate bills higher, would gain additional income. High spending authorities in Greater London and authorities which are large gainers under the existing arrangements which allow London's excess non-domestic rateable resources to be retained would tend on balance to lose, notwithstanding some gain from the ending of domestic resources equalisation.

J.18 The implied pattern of changes in income for authorities in each of the English regions which would result from full implementation of the new financial system is set out in Figure J3. The first three columns show the existing pattern of general grant and non-domestic rate income, and the next three columns show what the equivalent figures would be if the proposed new system were implemented without modification. The final column shows the safety net entitlement (negative in contributing areas) which would be necessary to compensate fully for any overall shortfall or surplus.

Figure J3: Implied changes in grant and non-domestic rate income, and safety net entitlements for local authorities (English regions: £m)

	Present system			New system			
	Grant (1)	Non-domestic rates (2)	Total (3)	Grant (4)	Non-domestic rates (5)	Total (6)	Safety net entitlement (3)-(6)
	£m	£m	£m	£m	£m	£m	£m
Northern	791	344	1,135	599	421	1,020	+115
Yorkshire and Humberside	1,239	512	1,751	933	663	1,596	+155
North West	1,569	707	2,276	1,351	868	2,219	+57
East Midlands	794	382	1,176	697	521	1,218	–42
West Midlands	1,046	552	1,598	1,051	699	1,750	–152
East Anglia	311	188	499	292	261	533	–54
Greater London	1,374	2,264	3,638	2,139	1,024	3,163	+475
South East (excluding Greater London)	1,394	1,124	2,518	1,586	1,402	2,988	–470
South West	789	392	1,181	658	606	1,264	–83

J.19 Similar redistributive effects would apply in Scotland and in Wales, though because the range of rateable values in both countries varies less between areas, the scale of changes would be less.

Effects for local domestic taxpayers of the replacement of domestic rates by the community charge

J.20 Within each local authority the distribution of the local domestic tax burden between residents will be affected by the proposals set out in Chapter 3. The general pattern of change will be the same in all areas. The analysis in this section considers these effects separately for households and for "tax units" — couples or single people who may form part of a larger household.

J.21 The broad pattern of redistribution between households resulting fom the replacement of rates with a community charge is described in paragraphs 5.18 and 5.19 of Chapter 5. The position of individual households will be affected by two main factors: the number of adults in the household; and the rateable value of the property relative to others in the area. Single adult households will pay less towards local services; large households with 3 or more adults will pay more; households with 2 adults will tend to pay about the same amount. This household composition effect will be overlaid by the rateable value effect. Households in high rateable value property will pay a reduced proportion of the total local domestic tax bill, while those in low rateable value property will pay more. For some households the rateable value effect could be larger than the household composition effect.

J.22 Among tax units, the main pattern of redistribution is from householder tax units to non-householder tax units, who at present do not pay any local taxes. The majority of the new local taxpayers would be young single adults aged 18-24.

J.23 These patterns of redistribution among households and tax units occur both within rating authorities in respect of the cost of district services, and within precepting authorities in respect of the cost of county services.

J.24 The distributional effects for households and tax units have been shown on two bases:

i. the effects in the first year of transition to the new system with the community charge introduced at a standard £50 per adult and the balance of local domestic tax revenue raised from rates (see Chapter 5, paragraphs 5.21 and 5.22);

ii. the effects if rates were completely replaced by a community charge (see chapter 5, paragraphs 5.23 and 5.24).

The assumptions on which the calculations are based are set out in paragraphs J.6-J.11 above.

(i) The effects in the first year of transition

J.25 As expected, with the modest shift from rates to the community charge envisaged, the effects for local domestic taxpayers in the first year are very small. This is a consequence both of the relatively small assumed level of the community charge in year 1 — £50 per head — and of the nature of the shift from domestic rates to the community charge which means that the typical two-adult household will tend on average neither to gain nor to lose.

J.26 Figure J4 sets out the pattern of gains and losses for households, in £ per week and as a percentage of net income.*

Figure J4: Households gaining and losing in the first year of transition from domestic rates to the community charge – by type of household (Great Britain, thousand households)

	Single pensioner	Other single adult	Two Adults	Three + adults	All Households
POUNDS PER WEEK					
LOSERS					
10+	–	–	–	–	–
5–10	–	–	–	0	–
2–5	–	–	–	275	275
1–2	–	–	575	975	1.550
0–1	425	475	6.325	1.175	8.400
Total losers	425	475	6.900	2.425	10.225
GAINERS					
0–1	2.100	1.475	4.625	275	8.475
1–2	200	325	875	50	1.475
2–5	75	50	275	25	425
5–10	0	0	0	0	0
10+	–	–	–	–	–
Total gainers	2.375	1.850	5.775	350	10.350
PERCENTAGE OF NET INCOME					
LOSERS					
10+	–	–	0	–	0
5–10	–	–	–	–	–
2–5	0	0	0	0	0
1–2	0	25	225	125	350
0–1	425	450	6.675	2.325	9.850
Total losers	425	475	6.900	2.425	10.225
GAINERS					
0–1	2.050	1.575	5.575	350	9.550
1–2	275	225	175	0	675
2–5	75	25	25	–	128
5–10	0	0	0	–	4
10+	0	0	0	–	2
Total gainers	2.375	1.850	5.775	350	10.350
Total Households	2.800	2.325	12,675	2.775	20.575

J.27 For the vast majority of households, the gains and losses are very small indeed. 82% of households would gain or lose less than £1 per week, and 97% would gain or lose less than £2 per week. Only 1% would lose more than £2 per week. For 94% of households the changes would represent less than 1% of net income. Only 2% of households would lose more than 1% of net income, and virtually all of them would lose less than 2% of net income. As expected there is a marked pattern by type of households; more than four-fifths of all single adult households gain, while 85% of households with 3 or more adults lose.

J.28 Figure J5 analyses these effects by tax unit types. Again, the effects are very small. 89% of tax units would gain or lose less than £1 per week. 98% would gain or lose less than £2 per week. Virtually no tax units would lose more than £2 per week, and only 1% would lose more than 2% of net income. The largest proportions of gainers are in the "single pensioner" and "one-parent family" categories.

Figure J5: Tax units gaining and losing in the first year of transition from domestic rates to the community charge – by type of tax unit (Great Britain, thousand tax units)

	Single Adults			Couples				
	Single pensioner	One parent family	Other single adult	no children	1 child	2 children	3+ children	ALL TAX UNITS
POUNDS PER WEEK								
LOSERS								
10+	–	–	–	–	–	–	–	–
5–10	–	–	–	–	–	–	–	–
2–5	–	–	–	–	0	–	–	–
1–2	–	–	–	500	175	125	50	825
0–1	1.250	150	4.675	3.900	1.225	1.250	600	13.000
Total losers	1.250	150	4.675	4.400	1.375	1.375	650	13.850
GAINERS*								
0–1	2.350	625	2.375	2.375	925	1.325	500	10.500
1–2	225	125	375	425	175	300	100	1.675
2–5	75	0	50	125	50	75	50	450
5–10	0	–	0	0	0	0	0	0
10+	–	–	–	–	–	–	–	–
Total gainers	2.650	750	2.800	2.925	1.175	1.700	650	12.650
PERCENTAGE OF NET INCOME								
LOSERS								
10+	–	–	0	0	–	–	–	0
5–10	0	–	0	0	–	–	–	0
2–5	25	–	325	25	0	0	–	375
1–2	75	0	1.675	250	50	25	0	2.100
0–1	1.125	125	2.675	4.125	1.325	1.325	625	11.350
Total losers	1.225	150	4.675	4.400	1.375	1.375	650	13.850
GAINERS*								
0–1	2.250	675	2.375	2.775	1.125	1.625	625	11.450
1–2	300	75	325	150	50	50	25	975
2–5	75	0	100	25	0	0	0	225
5–10	0	–	0	0	–	–	–	0
10+	0	–	0	0	–	–	–	0
Total gainers	2.650	750	2.800	2.925	1.175	1.700	650	12.650
Total Tax Units	3.875	900	7.475	7.325	2.575	3.050	1.275	26.475

*includes 900,000 tax units whose position is unchanged.

J.29 The largest proportion of losers is in the "other single adult" category. The losers are predominantly those that become liable for local tax for the first time as a result of the widening of the tax base to include non-householder resident adults. They are typically single adults aged 18 to 24. Figure J6 shows the extent to which losses are concentrated among non-householder tax units. Over half the losers in the "other single adult" category are non-householders.

Figure J6: Proportions of tax units losing in the first year of transition from domestic rates to the community charge who are non-householders (Great Britain)

	Single Adults			Couples				ALL TAX UNITS
	Single pensioner	one parent family	other single adult	no children	1 child	2 children	3+ children	
Losers (thousand tax units)	1205	134	4673	4347	1351	1351	632	13,693
Percentage who are non-householders	23%	36%	54%	1%	●%	●%	●%	21%

● results not statistically significant

(ii) The effects with full replacement of rates by the community charge

J.30 By the end of the transition from rates to the community charge the shifts would have become more marked as an increased proportion of the local tax bill fell to be met by non-householders who are not currently liable for domestic rates. Even so, the effects would be small for most people, since the majority of households include two adults and would be little affected.

*"Net income" includes income from employment, unearned income and state benefits (excluding the local tax element of housing benefit) net of income tax and national insurance contributions. Local tax payments are net of rebates. The new housing benefit system, with a 20% minimum payment, has been assumed to apply to the community charge as well as to rates.

J.31 Figure J7 shows, on the same basis as Figure J4, the pattern of gains and losses for households on the assumption that domestic rates had been completely replaced by the community charge.

Figure J7: Households gaining and losing with full replacement of domestic rates by the community charge – by type of household (Great Britain, thousand households)

	Single pensioner	Other single adult	Two Adults	Three + adults	All Households
POUNDS PER WEEK					
LOSERS					
10+	–	–	0	50	50
5–10	–	–	75	425	500
2–5	0	75	1.325	1.125	2.525
1–2	25	100	1.625	450	2.200
0–1	375	275	3.750	350	4.750
Total losers	400	475	6.800	2.375	10.050
GAINERS					
0–1	1.700	775	2.800	175	5.475
1–2	250	350	1.250	100	1.950
2–5	350	600	1.400	100	2.450
5–10	75	100	350	25	575
10+	25	25	50	0	100
Total gainers	2.400	1.850	5.875	400	10.550
PERCENTAGE OF NET INCOME					
LOSERS					
10+	0	–	0	–	0
5–10	0	0	25	0	50
2–5	25	100	600	475	1.175
1–2	50	100	1.525	925	2.600
0–1	350	250	4.650	975	6.225
Total losers	400	475	6.800	2.375	10.050
GAINERS					
0–1	1.300	675	4.000	300	6.300
1–2	500	550	1.350	75	2.450
2–5	450	550	525	25	1.550
5–10	125	75	25	0	225
10+	25	0	0	–	25
Total gainers	2.400	1.850	5.875	400	10.550
Total households	2.800	2.325	12.675	2,775	20.575

J.32 51% of households would be better off with the community charge. Three quarters of all households would either gain, or would lose less than £1 per week. 14% of households would lose more than £2 a week, and for 6% of households the losses would amount to more than 2% of net income. There is the same pattern of results between types of household as occurs in the first year of transition, but the extent of redistribution is greater with bigger gains to single adult households and bigger losses for large households with three or more adults. Among two-adult households, the extent of redistribution between households with high and low rateable value properties within an area is also increased.

J.33 Figure J8 shows how the gains and losses are distributed among tax unit types.

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Figure J8: Tax units gaining and losing with full replacement of domestic rates by the community charge — by type of tax unit (Great Britain: thousand tax units)

	Single Adults			Couples				
	Single pensioner	One parent family	Other single adult	no children	1 child	2 children	3+ children	ALL TAX UNITS
POUNDS PER WEEK								
LOSERS								
10+	-	-	-	0	-	-	-	0
5 - 10	0	0	75	100	25	0	0	200
2 - 5	75	25	2.050	975	350	275	100	3.825
1 - 2	100	35	950	1,050	350	325	150	2,950
0 - 1	1.025	100	1.625	2.250	625	725	375	6.700
Total losers	1,200	125	4,675	4.350	1.350	1.350	625	13.700
GAINERS *								
0 - 1	1.875	400	1.600	1.450	525	700	300	6.900
1 - 2	300	100	400	625	275	400	125	2,250
2 - 5	400	200	650	700	325	450	150	2.900
5 - 10	75	25	125	150	75	125	50	650
10+	25	0	25	25	0	25	0	100
Total gainers	2,675	750	2,800	2.975	1,225	1.700	650	12.800
PERCENTAGE OF NET INCOME								
LOSERS								
10+	0	-	25	0	-	0	-	25
5 - 10	25	0	700	25	0	0	0	750
2 - 5	125	25	2.100	550	150	100	25	3.100
1 - 2	250	25	800	1,075	350	300	125	2,900
0 - 1	800	100	1.075	2.675	850	950	475	6.925
Total losers	1,200	125	4.675	4,350	1.350	1,350	625	13.700
GAINERS *								
0 - 1	1.475	375	1,500	1.925	800	1.100	450	7.625
1 - 2	550	175	500	650	275	425	150	2.750
2 - 5	500	200	625	350	125	175	50	1.975
5 - 10	150	25	150	25	0	0	0	375
10+	25	0	25	0	0	-	0	50
Total gainers	2.675	750	2.800	2.975	1.225	1,700	650	12,800
Total Tax Units	3,875	900	7.475	7.325	2.575	3.050	1.275	26.475

* includes 900,000 tax units whose position is unchanged.

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J.34 The patterns seen in the first year of transition are again accentuated, with a wider spread of gains and losses. 48% of tax units gain, and 13% gain more than £2 a week; 52% of tax units lose, and 15% lose more than £2 a week. 69% of single pensioners and 85% of one-parent families gain, with 13% and 27% of these categories respectively gaining more than £2 a week. 62% of "other single adults" lose. Numbers of gainers and losers among couples with children broadly balance out. Losses which represent more than 2% of net income are heavily concentrated among the young single adults in the "other single adult" category who are paying no local tax now. Their contribution would be the same as that of single householders in the same authority.

J.35 The proportions of non-householders who would lose in the various tax unit categories would be the same as in Figure J6. Non-householder tax units are worse off because they are making a contribution to local services where they were making none before. This is precisely the effect that the widening of the tax base is intended to achieve.

The relationship between incomes and domestic rates or the community charge

J.36 The description so far of the types of household and tax unit which stand to gain and lose from the replacement of rates by a community charge has been mainly in terms of household composition and broad economic status. The other important dimension is income. What impact would the community charge have on the distribution of local tax payments across income groups?

J.37 *A priori* one would expect the introduction of a flat rate community charge to increase the overall regressivity of the local tax system. A flat rate charge necessarily represents a higher proportion of income for people with low incomes. However, any changes have to be assessed against the impact of the existing local tax system based on rates. The Allen Report of 1965 first drew attention to the regressive impact of domestic rates. In the absence of rebates, the lowest income households would now pay, on average, 10% of their income in rates, compared with less than 2% for the highest income households.

J.38 In fact a flat rate community charge would represent a smaller proportion of net income for the lowest income households than domestic rates. The chief reason for this is household composition: a disproportionate number of low income households have only one adult, and therefore benefit from the move from a tax on property to a per adult community charge. Higher income households also benefit from the introduction of a community charge, since the proportion of income paid in local taxes declines more rapidly than with domestic rates. Annex F contains further detailed analysis of these effects.

Effects on housing benefit

J.39 The local taxation proposals widen the tax base so that all adults over 18 become liable for local taxes. This results in a shift in the incidence of local taxes from householders to non-householders. Non-householders become liable for local tax for the first time.

J.40 The illustrations in this Annex assume that these new local taxpayers would become eligible for rebates in the same way as existing ratepayers. The new housing benefit system described in Cmnd 9691, with a minimum 20% payment towards local rates, has therefore been applied to the new local tax system. During the transition, it has been assumed that individual tax units would qualify for assistance on the same basis with their combined local tax bill from rates and the community charge. In practice, the detailed operation of the housing benefit system in this transitional period might need to be reviewed.

J.41 The widening of the tax base would inevitably produce a significant increase in housing benefit caseload. Complete replacement of domestic rates by the community charge would produce an increase in caseload in Great Britain of approximately 17%, but an increase in housing benefit cost of only 4%. More people would be entitled to help with their local tax bill, but the scale of the support required by existing ratepayers would be reduced.

J.42 Figure J9 shows the estimated increases both in year 1 of the transition and with full replacement of domestic rates. These estimates are based on estimated entitlements. Actual increases would be less to the extent that take-up was lower. The estimates are also sensitive to assumptions about who is currently eligible for housing benefit in multi-tax unit households. In modelling the benefit results, it has been assumed that *unrelated* tax units in multi-tax unit households are separately eligible for housing benefit in respect of contributions towards rates. If it were assumed that only the first tax unit in such households currently pays rates, this would suggest a larger increase in caseload, but from a lower base. The final caseload would be almost unaffected.

Figure J9: Estimated increases in housing benefit cost and caseload, resulting from the new local government finance system (Great Britain)

	In year 1 with £50 community charge	With full community charge
Caseload (thousand cases)		
– with domestic rates	6,520	6,250
– with new local tax system	7,400	7,660
increase	880 (13%)	1,140 (17%)
Cost (£m)		
– with full domestic rates	2,700	2,700
– with new local tax system	2,720	2,800
increase	20 (1%)	100 (4%)

J.43 In the first years of the new system, application of the housing benefit formula to the low initial levels of community charge would produce large numbers of very small rebates. The implications of this for the detailed design of assistance schemes will require further consideration.

Interactions with proposed changes to the social security system

J.44 In general, the interactions between the proposed changes to the social security system set out in Cmnd 9691 and the proposals in this Green Paper are limited. The Cmnd 9691 proposals are directed specifically at low income households. The proposals for modifying the local taxation system involve a general switch in local tax burden from householders to non-householders which produces gains and losses across all income groups. The critical factors are household composition and rateable value.

J.45 There are also differences in timing. The local finance proposals are likely to be implemented some years after the social security reforms, and the scale of gains and losses from the change in the local tax system will be damped down by the gradual transition towards the community charge.

J.46 Even if the proposals were to be implemented simultaneously there would be limited interactions. Young single-adult non-householders who comprise the vast majority of tax units who would pay local taxes for the first time are little affected by the social security proposals. In some cases, however, the effects of the two sets of proposals would be offsetting. Single householders — both pensioners and non-pensioners — tend to lose income support under the social security proposals but gain from the introduction of the community charge. Only in a few cases would the effects be reinforcing; for example, working lone parents would tend to gain and some pensioner couples — householders with low rateable value property — to lose, from both sets of proposals. But in general the scale of the changes implied by the local taxation proposals, even with a full community charge, would be modest.

Effects on work incentives

J.47 As explained above, if the system of rebates for the community charge were to be similar to that proposed in "Reform of Social Security" (Cmnd 9691) there would be an appreciable increase in the number of people receiving benefit, and some reduction in the average benefit payment to those currently paying rates.

J.48 Changes which affect entitlement to means-tested benefits affect the incentives of those in low paid employment to take up work. They do this by changing the relative levels of disposable income in and out of work. The measure of this relativity is called the 'replacement ratio'. They also change the effective tax rates of those with low incomes who are in work because income-related benefits are withdrawn as income rises.

J.49 Bringing more people into local tax and consequently increasing the number entitled to rebates would be expected to worsen incentives. Modelling these effects has shown, however, that although there is some worsening of incentives the effect on average is very small, even for those who become liable for local tax for the first time. Replacement ratios are little affected because even a maximum rebate of the community charge will generally represent a small proportion of net income in work. Moreover, most single young adults who qualify for unemployment benefit would not qualify for rebates because their income would be above the income support threshold. Among householders currently paying rates, there will be offsetting reductions in local tax payments, and consequently in rebate entitlements. Marginal tax rates would be virtually unaffected by the new local taxation system since, for the levels of community charge faced by most adults, there would be a very narrow range of income over which rebates would be withdrawn.

Summary

J.50 The main conclusions reached in this Annex on the effects of the proposed reforms to the local government finance system are as follows.

(1) As a consequence of the setting of a national non-domestic rate and the ending of resource equalisation authorities with high rate poundages (which reflect high spending levels) or low domestic rateable values (which lead to lower rate bills for any given level of spending) would tend to lose. They will have large safety net entitlements. Conversely authorities with low poundages or high domestic rateable values will tend to gain, and so will be contributors to the safety net.

(2) Changes in the local tax burden of households and tax units in the first year of the new arrangements would be very small. Even after the community charge had completely replaced domestic rates, the gains and losses would be modest for the great majority of households and tax units. The losses would be concentrated among the young single-adult tax units that would become liable for local taxes for the first time.

(3) The community charge would be somewhat less regressive than domestic rates for those with low incomes. This arises because of the large proportion of those with low incomes who are single-adult households. They would gain from the widening of the local tax base (see Annex F).

(4) The replacement of domestic rates by the community charge would ultimately lead, other things being equal, to an increase of 17% in housing benefit caseload and an increase of 4% in the cost of housing benefit.

(5) There would be little interaction between the proposals for change in the social security system set out in Cmnd 9691 and the reforms of local government finance described in this Green Paper.

(6) Any worsening of work incentives arising from the widening of the local tax base and the consequent widening of eligibility for housing benefit would be minimal.

ANNEX K: LOCAL GOVERNMENT FINANCE: INTERNATIONAL COMPARISONS

K.1 This annex summarises briefly some of the main features of local government and local government finance systems in other OECD member countries. Further detailed comparisons are available from a growing body of material from the OECD, Council of Europe and IMF sources on which this annex draws.

K.2 Figures K1 to K3 below demonstrate the diversity which exists in the organisational and financial arrangements for local government in a range of countries which share a democratic tradition. The diversity demonstrates the point made elsewhere in the Green Paper that there is no universally applicable model for local government or its financing. What is appropriate in any country will depend on a range of factors including:

- its history and traditions;
- the functions assigned to local government;
- the size of its local government units;
- the significance of local government in the national economy;
- current concerns with service and financial issues.

K.3 Figure K1 shows the variation in the proportion of GDP devoted to public expenditure within the 22 other member countries of the OECD. The table also shows the proportion of total public spending attributable to local government. For the 6 federal countries covered the share of spending attributable to state, regional or provincial government is shown separately. Public spending as a proportion of GDP ranges from 30% (Switzerland) to 61% (Sweden). Japan has the lowest proportion of public spending by central Government (37%), Greece the highest (95%). Table K1 also shows the range of local spending met by local taxes - rather than non tax revenues and grants. The range is from 1.7% in the Netherlands to 56% in Sweden.

K.4 Figure K2 shows the allocation of functions to tiers of government below the national level in the other 14 member countries of the Council of Europe. Practices are varied. In Italy, for example, many services are shared between 2, or all 3, tiers of sub national government. Shared responsibilities appear to be much less of a feature in the Netherlands and Sweden for example. Some services, like refuse disposal, are universally provided by local government. The administration of justice is provided below national level only in West Germany and Italy. In the UK magistrates courts are run through joint committees of local councillors and magistrates. There is an 80% specific grant. In some countries the supply of electricity remains a local government function. This can particularly distort comparisons of the proportion of local expenditure met from local taxes since there is a large element of income from charges associated with any substantial trading function.

K.5 Figure K3 shows the main types of taxes available to local government in the other member countries of the OECD. For the purposes of this table assigned shares of central taxes are treated as local taxes. Local income taxes are the main source of local revenue in Scandinavia. The tax base usually includes the income of companies but in Denmark only individuals' income is taxed. In some countries local government may receive a prescribed proportion of national income tax redistributed according to the tax raising capacity of the area (Austria, Germany) or as a grant according to need (Japan). Japan in addition has an inhabitants tax - accounting for 48% of local tax income - comprising a flat rate charge and an income related element.

K.6 Property taxes are common. But only local governments in Ireland and the UK rely on them exclusively. In New Zealand and Australia they account for over 90% of local tax revenue. Property taxes are assessed either - as in the UK - on rental values (for example, Eire, France and Spain), or on capital values (USA, Denmark, Germany and Sweden). Revaluations of property taxes take place at widely varying intervals - every 4 years in Denmark, every 5 in Sweden, and every 10 in Austria. In France domestic property values relate to 1947, while Eire has had no general revaluation since 1852.

Current concerns

K.7 The information set out in Figures K1-K3 can only show a snapshot of the situation at a particular time. It cannot reflect issues of current concern in local government matters which may lead to change in institutional or financial arrangements. One such issue is the growth of local government spending within the national economy. The OECD reported in 1981 that "central governments in theirmacro economic planning, are finding it more and more necessary to take account of the level of local and regional government expenditure and the effect this will have on the policies pursued by central governments. In view of this, and in an attempt to restrict the pressure of demand on scarce resources, the financial equalisation system in some countries is being used to limit the growth in public sector expenditure." Interest in this subject has not subsided since 1981. Preparations are now in hand for a special conference later this year of Ministers from member states of the Council of Europe at which one of the principal themes will be "public expenditure reductions versus local authority autonomy in the current economic crisis".

TABLE K1

ROLE OF LOCAL GOVERNMENT IN NATIONAL ECONOMIES

COUNTRY	TOTAL OUTLAYS OF GOVT. AS % OF GPD 1983	GOVT. EXPENDITURE BY LEVEL OF			LOCAL TAX INCOME AS PERCENTAGE OF TOTAL LOCAL SPENDING
		CENTRAL	STATE, REGIONAL OR PROVINCIAL	LOCAL	
FEDERAL COUNTRIES					
Australia	32.9	59.8	35.1	5.1	50.4
Austria	48.9	60.7	13.2	17.1	17.1
Canada	39.3	43.2	39.7	17.1	36.2
W Germany	47.6	56.0	24.8	17.2	31.3
Switzerland	29.9	47.1	30.2	22.7	50.7
United States	33	61.0	20.5	18.5	40.4
UNITARY COUNTRIES					
Belgium	49.4	87.0		13.0	26.6
Denmark	53.2	56.4		43.6	38.8
Finland	37.4	60.7		39.3	45.2
France	45.5	84.5		15.5	38.1
Greece	29.7	95.3[1]		4.7[1]	11.1[1]
Iceland	35.2	—		—	—
Ireland	47.7	75.1		24.9	4.4
Italy	45.5	—		—	—
Japan	31.6	37.2		62.8	—
Luxembourg	52.8	85.3[1]		14.7[1]	28.8[1]
Netherlands	58.0	69.0		31.0	1.7[2]
New Zealand	—	87.7[1]		12.3[1]	39.2[1]
Norway	50.9	66.1		32.9	45.8
Portugal	35.8	—		—	—
Spain	30.5	87.8[1]		12.2[1]	34.5[1]
Sweden	61.0	61.1		38.9	56.1

Sources: OECD Forward Look
Sources: IMF Government Finance Statistics Year Book Vol VIII 1984
Sources: Local Public Finance in Japan Jichi Sogo Centre, Tokyo, February 1982
Sources: [1] 1981 figures
Sources: [2] 1979

TABLE K2

ALLOCATION OF FUNCTIONS

Functional Classification	AUSTRIA	BELGIUM	DENMARK	FRANCE	FED. REP. GERMANY	IRELAND	ITALY	LUXEMBOURG	NETHERLANDS	NORWAY	PORTUGAL	SWEDEN	SWITZERLAND	TURKEY
Refuse collection and disposal	L	L	L	L	L	L	L	L	L	L	L	L	R,L	L
Slaughterhouses	L	L	L	L	L	L	L	L	L	L	LL	L	L	L
Theatres, concerts	R,L	L	R	L	R,L		R,L	L	L	L	LL	L	L	L
Museums, art galleries, libraries	L	R,L	R,L	L,D	R,L	L	R,L	L	L	L	LL	R,L	L	R,L
Parks and open spaces	L	R,L	L	L,R	L	L	R,L	L	R,L	L	L	L	L	R,L
Sports and leisure pursuits	L	R,L	L	L	R,L	L	R,L	L	R,L	L	L	L	L	
Roads	R,L	R,L	R,L	L,D	R,L	L	R,P,L	L	R,L	R,L	L	L	R,L	R,L
Urban road transport	L		L	L,D	R,L		P,L	L	L	L	L	R,L	L	L
Ports		L			R,L		L		L	L	L	L	R	
Airports					R		L		L	L		R,L	R	
District heating	L	L	L	L	L		L		L			L	R,L	L
Water supply	L	L	L	L	L	L	R,L	L	R,L	L	L	L	L	R,L
Agriculture, forestry, fishing, hunting	R	R,L		L,D	R,L		R,P,L		L	R,L	L	L	R,L	R,L
Electricity		R,L	L		L		L		R,L	L	L	L	R,L	L
Commerce	R,L	L		L	R,L		R,L		R,L		L	L	R,L	R,L
Tourism	R,L	R,L		L,D	R,L		R		L	L	L	R,L	R,L	R,L
Financial assistance to local authorities	R	R		R,D	R		R		R				R	R

CONTINUED ⟶

ALLOCATION OF FUNCTIONS

TABLE K2
(CONTINUED)

Functional Classification	AUSTRIA	BELGIUM	DENMARK	FRANCE	FED. REP. GERMANY	IRELAND	ITALY	LUXEMBOURG	NETHERLANDS	NORWAY	PORTUGAL	SWEDEN	SWITZERLAND	TURKEY
Security, police	L	L		L	R, L		L	L	R, L		L		R, L	L
Fire protection	L	L	L	L,D	L	L		L	L	L	L	L	L	L
Justice					R		R, L							
Pre-school education	R, L	L	L	L	L		R, L	L	L	L		L	R, L	
Primary and secondary education	R, L	R, L	R, L	L[1]	R, L		R, L	L[2]	L	R, L	L[2]	L	R, L	R
Vocational and technical training	R	R, L		L	L		R, L		L	R, L		R, L	R, L	
Higher education		R, L			R		R, L						R	
Adult education	L	L	L	L	R, L		R		L	R, L		R, L	R, L	
Hospitals and convalescent homes	R, L	R, L	R	L, D	R, L		R,P,L	L	R, L	R, L		R	R, L	R, L
Personal health	R, L	L	R, L	L	R, L		R,P,L	L	L	L	L	R	R	R
Family welfare services	R, L	R, L	L	L, D	R, L		R, L		L	L	L	L	R, L	L
Welfare homes	R, L	L	L	L	L		R, L	L	L	L		L	R, L	R, L
Housing	R, L	L		L	R, L	L	R, L	L	R, L	L	L	L	L	L
Town planning	L	L	L	L	L	L	R, L	L	R, L	L	L	L	R, L	L

(1) Mainly primary education
(2) Primary education only
R = State, Regional Government
L = Local Government
D = Departments in France
P = Provinces in Italy
Source: Council of Europe "Financial Apportionment and Equalisations" 1981

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TAX REVENUES FROM THE MAIN LOCAL TAXES AS PERCENTAGE OF TOTAL TAX REVENUES OF LOCAL GOVERNMENTS, SELECTED COUNTRIES, 1982

TABLE K3

Taxes out:	Income & profits 1982	Payroll	Property 1982	General consumption 1982	Specific goods & services 1982	Taxes on use 1982	Other 1982
Federal Countries (excludes state, regional or provisional figures)							
Australia	—	—	96.7	—	—	3.3	—
Austria	39.2	11.6	10.6	21	11.7	1.5	4.4
Canada	—	—	85.5	—	—	1.1	13.4
Germany	77.6	—	21.4	—	0.3	0.4	0.3
Switzerland	86	—	13.7	—	0.2	0.1	—
USA	5.9	—	76	9.9	4.5	3.8	—
Unitary Countries							
Belgium	67.2	—	—	—	—	14	18.8
Denmark	89.7	—	8.8	—	0.05	0.1	1.3
Finland	90.3	—	0.9	—	—	0.07	8.8
France	16.5	—	28.9	—	3.3	2.3	49
Greece	—	—	—	—	—	—	—
Ireland	—	—	100.0	—	—	—	—
Japan	—	—	—	—	—	—	—
Italy	45.5	—	0.4	—	20	3.9	30.2
Luxembourg	37.6	—	4.2	8.8	—	1.0	48.4
Netherlands	—	—	68.4	—	—	23.2	8.4
New Zealand	—	—	92.7	—	2.6	4.7	—
Norway	86	—	4.9	—	—	0.4	8.7
Portugal	—	—	4	5.3	9.2	3.6	77.9
Spain	37.6	—	11.6	39.3	—	—	11.5
Sweden	93.4	—	—	—	0.3	0.06	6.2
Turkey	46.1	—	6.1	—	30.9	0.5	0.2

Source: OECD Financial Statistics 1965-82

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Figure 1: LOCAL AUTHORITIES' CLAIM ON THE TOTAL TAX BURDEN
UNITED KINGDOM 1984/85

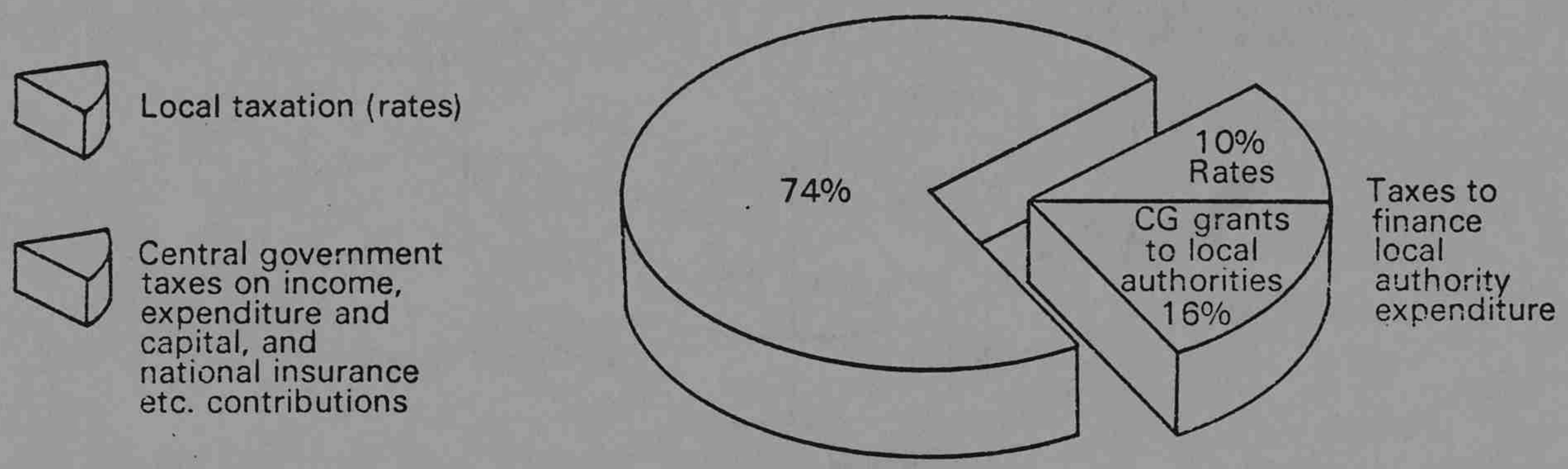

Figure 2: TRENDS IN LOCAL AUTHORITY EXPENDITURE AND MANPOWER
ENGLAND 1960/85

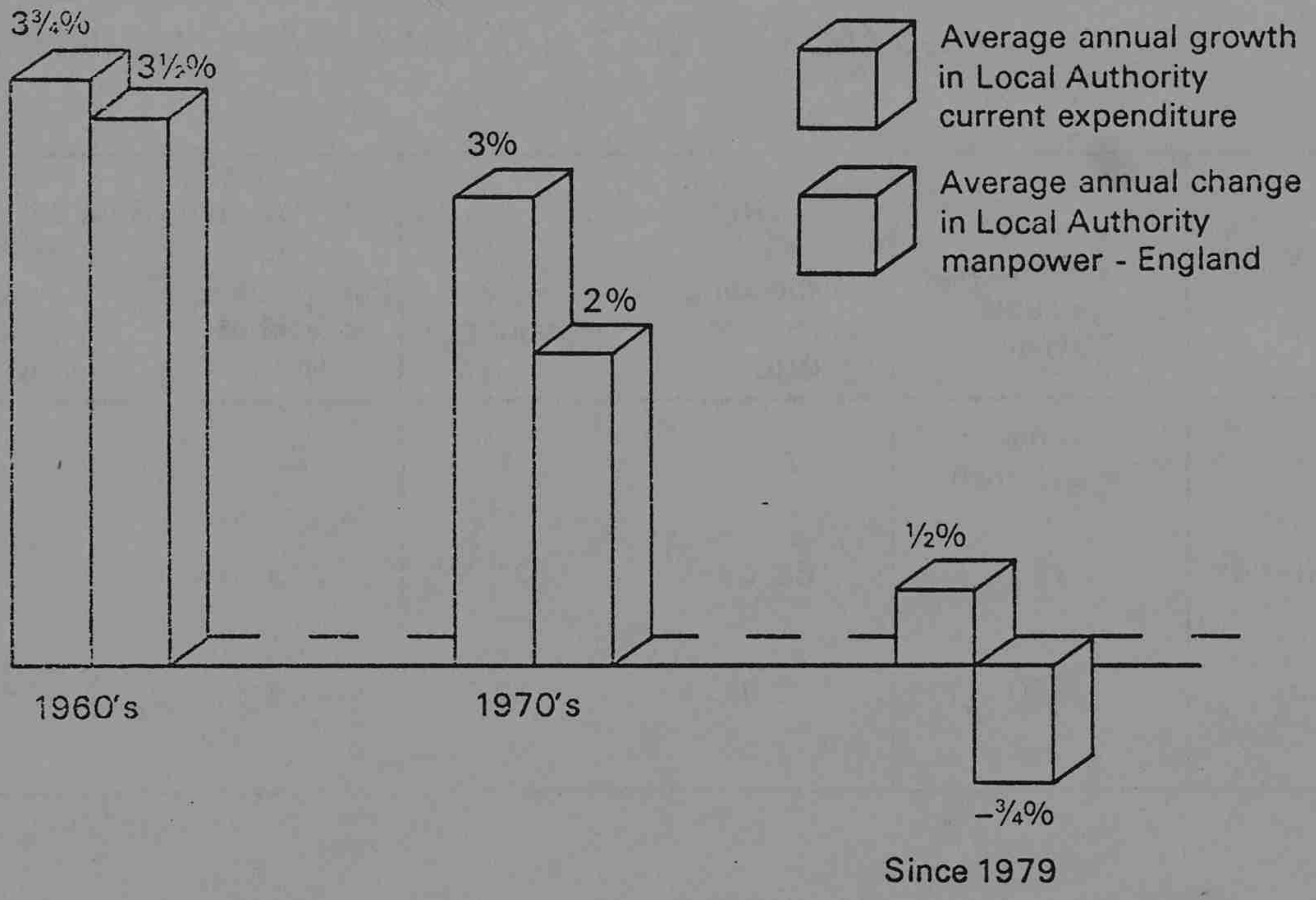

Figure 3: SOURCES OF RATE INCOME — ENGLAND 1984/85

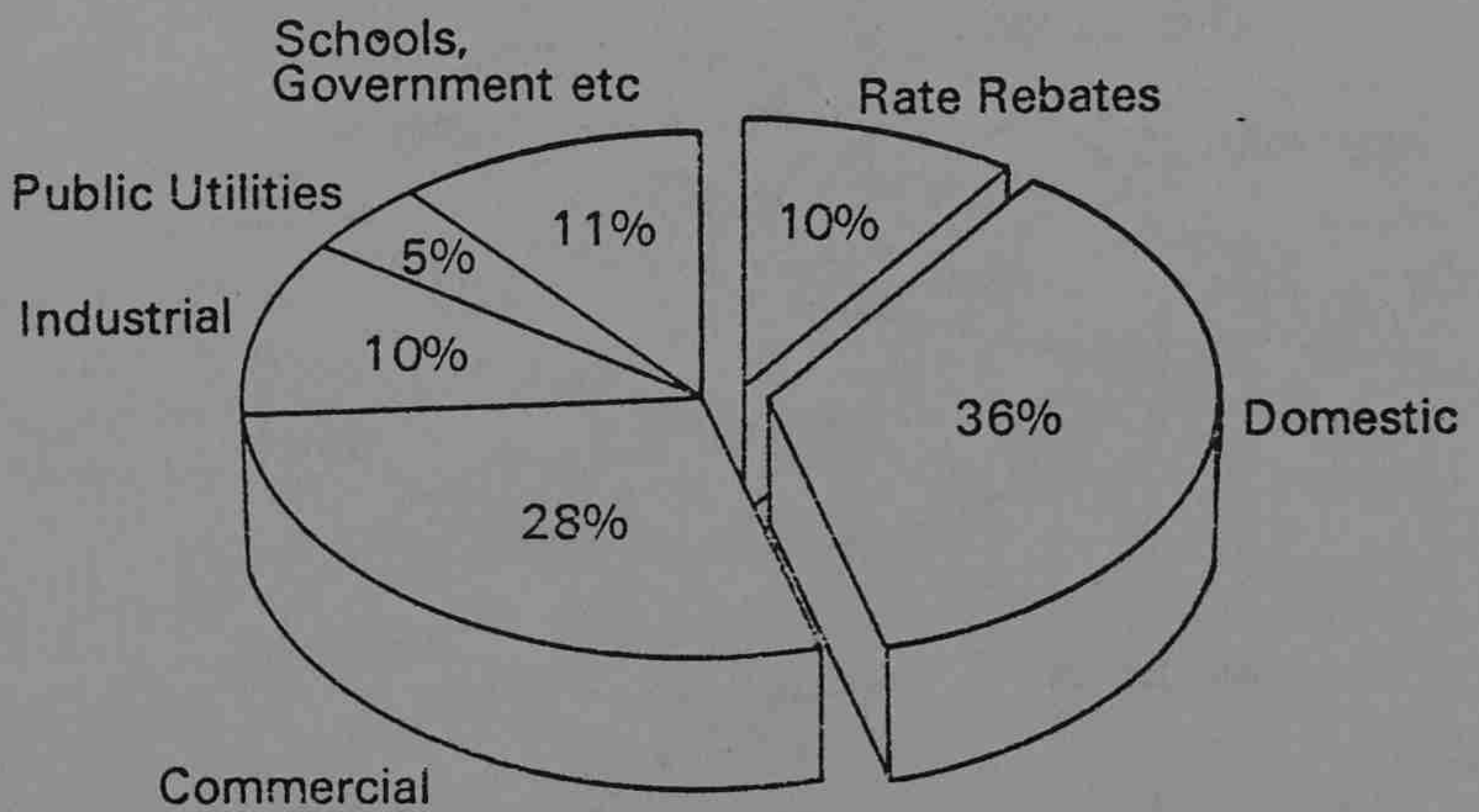

Figure 4: PROPORTIONS OF THE ELECTORATE PAYING FULL OR PARTIAL RATES ENGLAND 1984/85

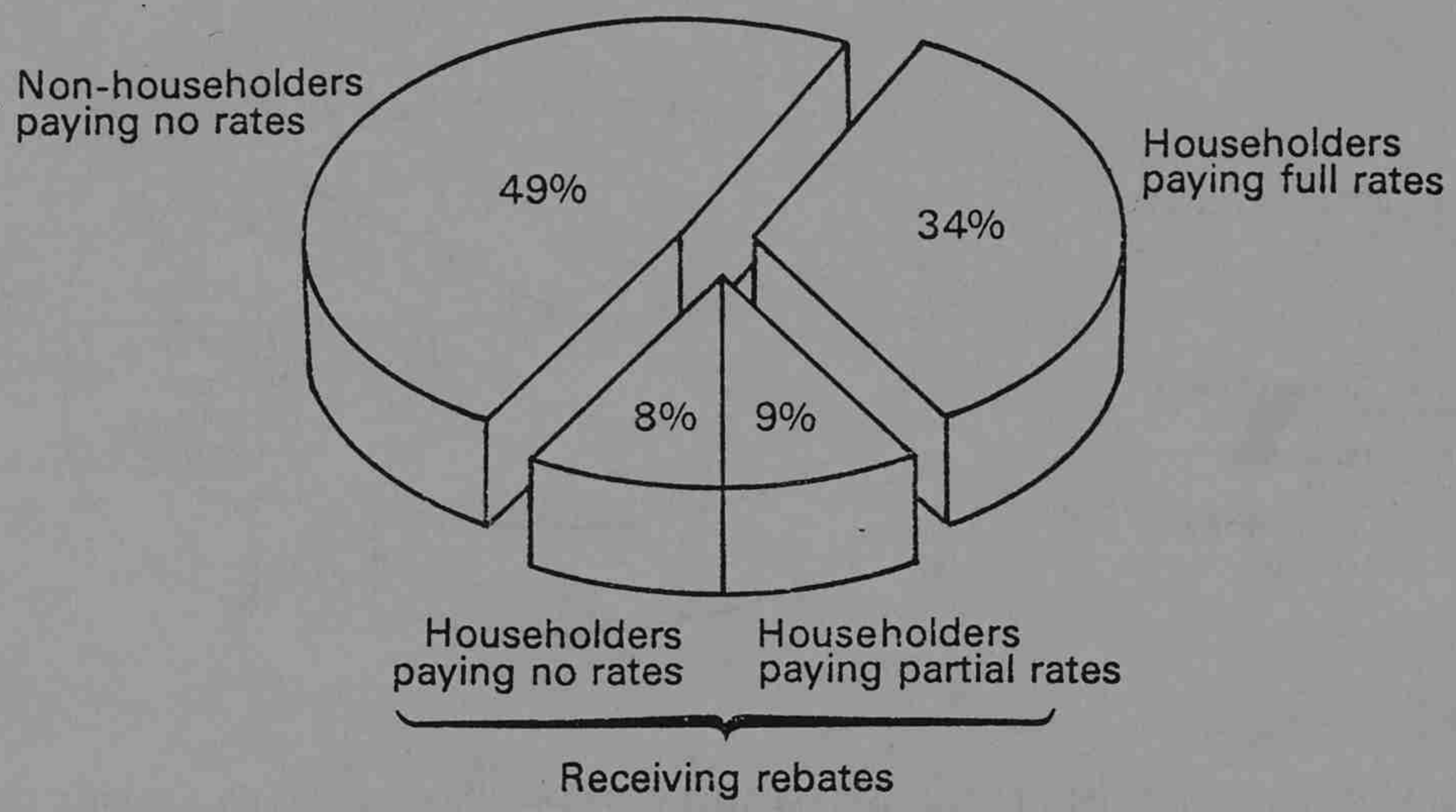

Figure 5: RATE POUNDAGES AND RATE BILLS IN LUTON AND CARLISLE 1984/1985

	Average domestic rateable value	Rate poundage		Average Rate Bill	
		For spending at level of GRE	Actual poundage levied	For spending at level of GRE	Actual poundage levied
	£ per hereditament	p	p	£	£
Carlisle	136	168.5	171.5	229	233
Luton	240	168.5	152.7	404	366

Figure 6: NON-DOMESTIC RATE REVENUE BY SECTOR ENGLAND AND WALES 1984/85

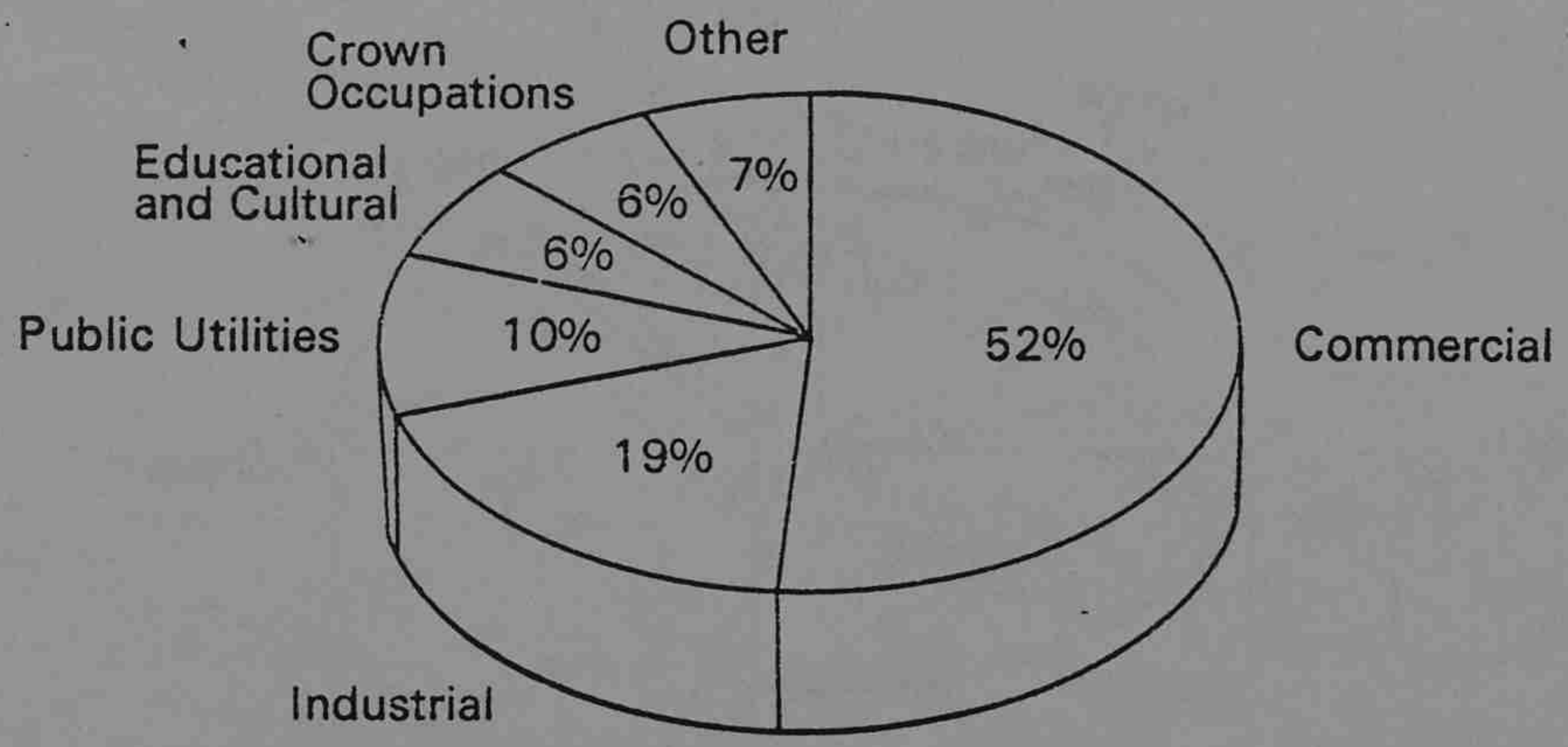

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Figure 7 : TAXES ON BUSINESS
1975/76 – 1984/85

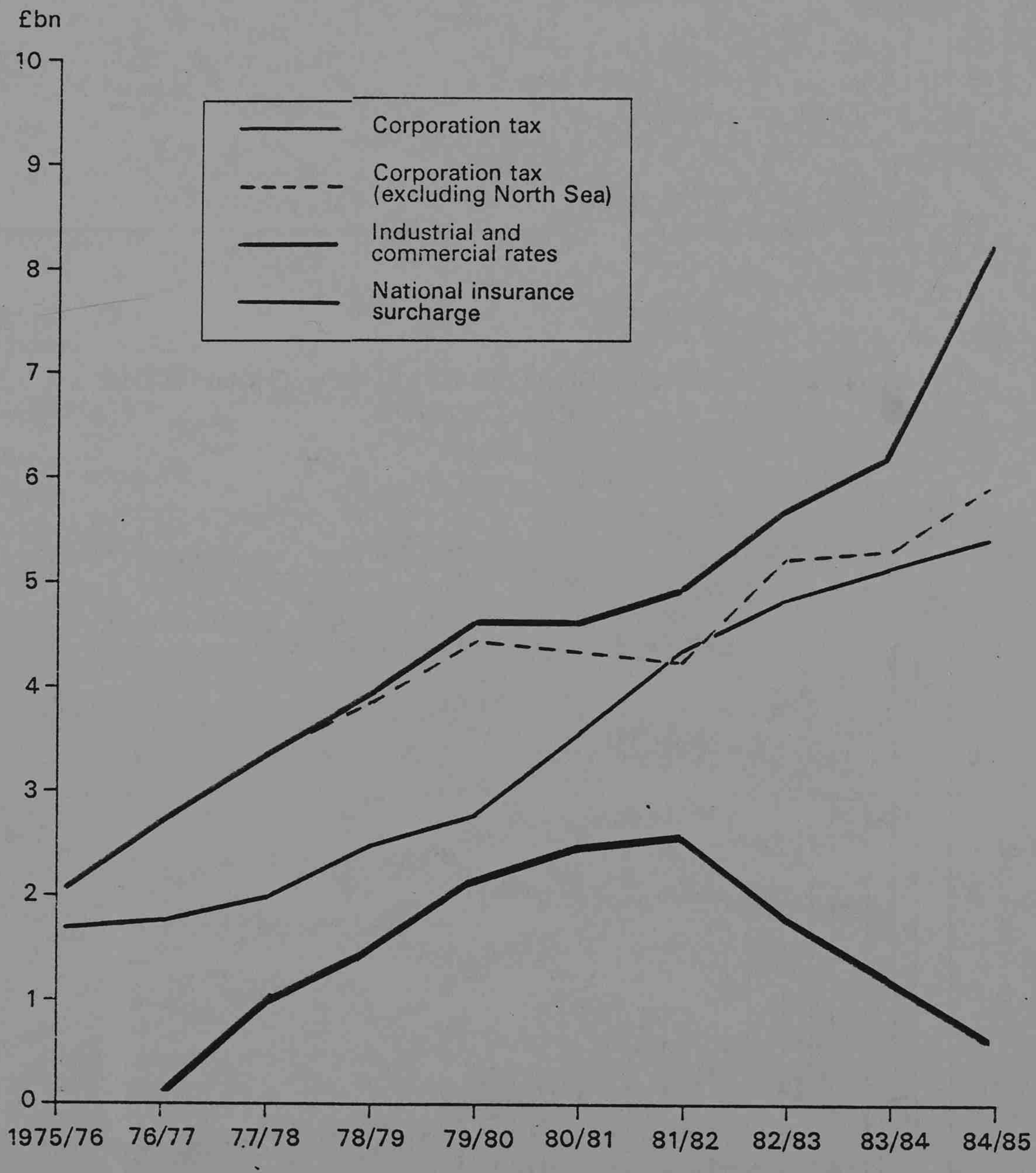
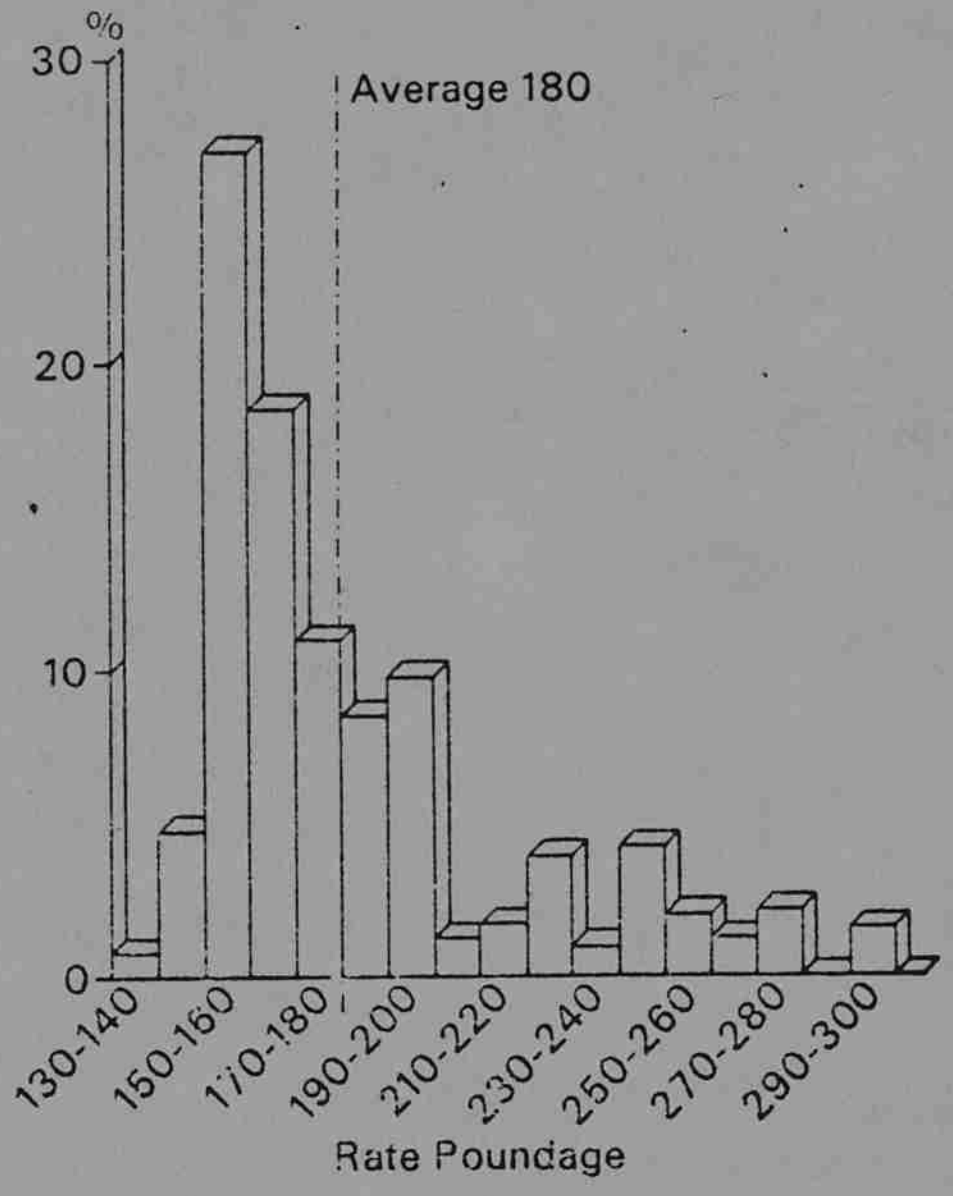


Figure 8: VARIATION IN NON-DOMESTIC RATE POUNDAGES 1984/85

(a) ENGLAND



(b) GREATER MANCHESTER

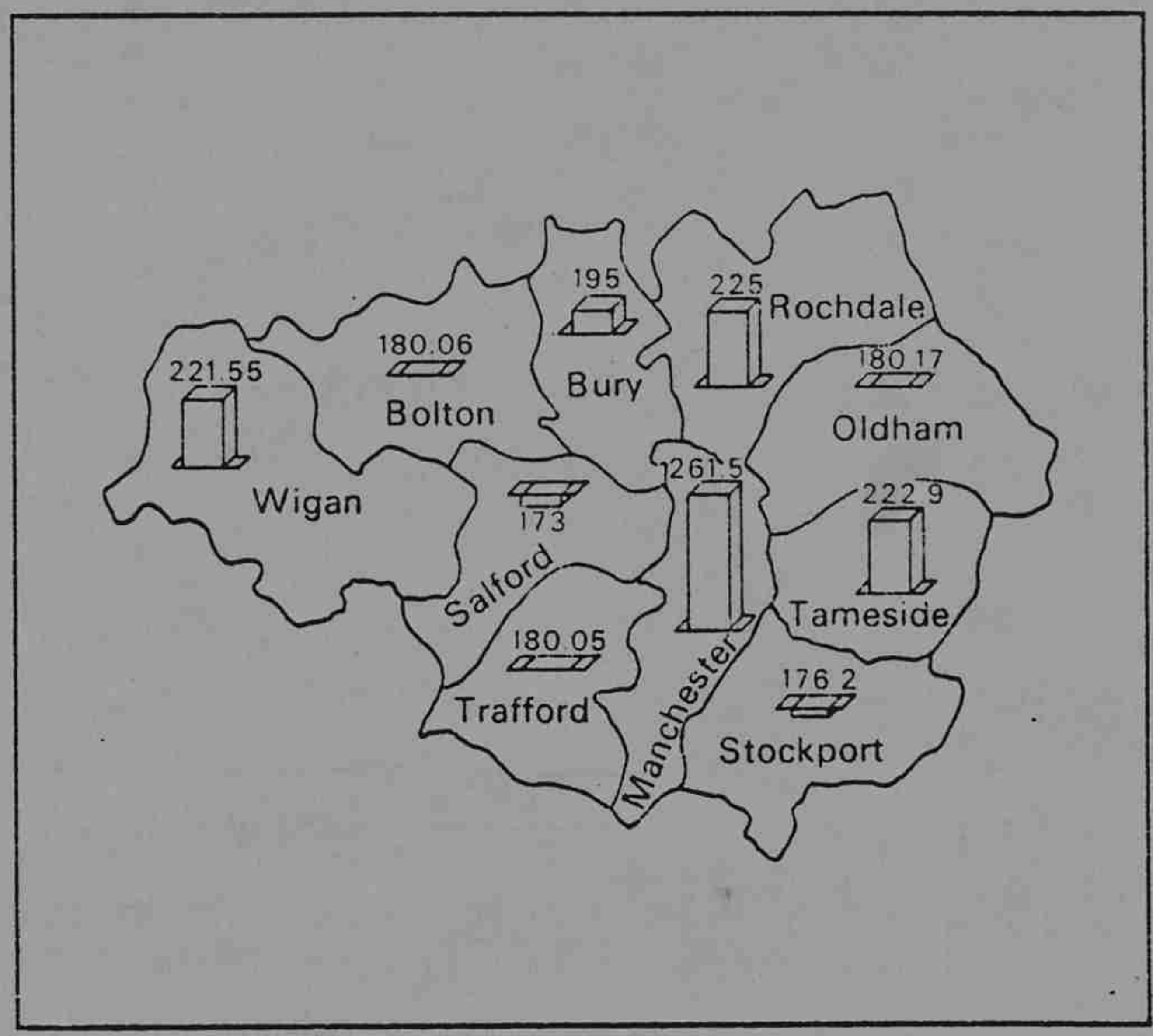
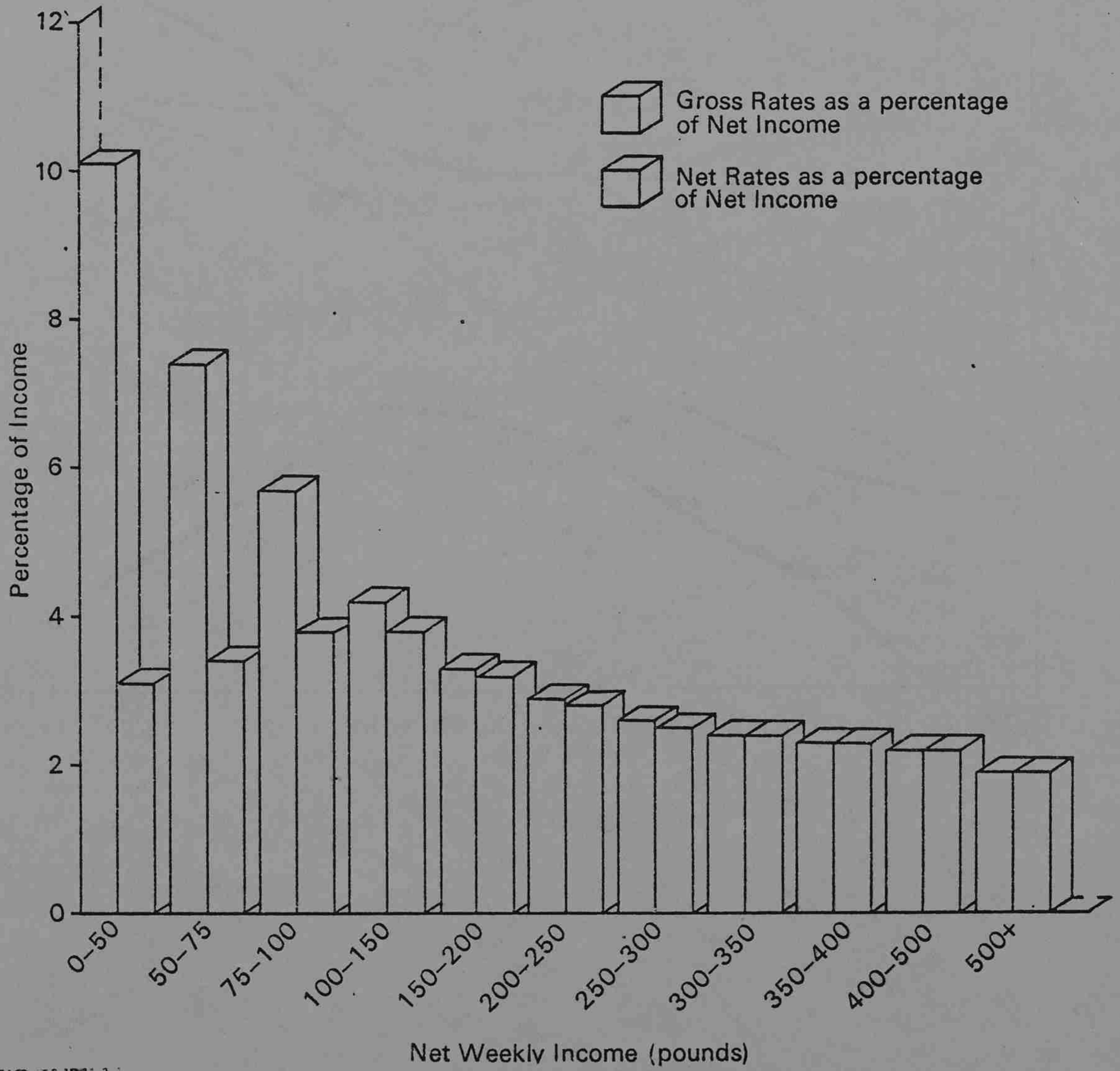


Figure 9: RELATIONSHIP OF RATES TO NET HOUSEHOLD INCOME IN GREAT BRITAIN



C M C CONFIDENTIAL

Figure 10: SHOPPING FLOOR SPACE PER ADULT IN N.E.ENGLAND (PERCENTAGE OF NATIONAL AVERAGE)

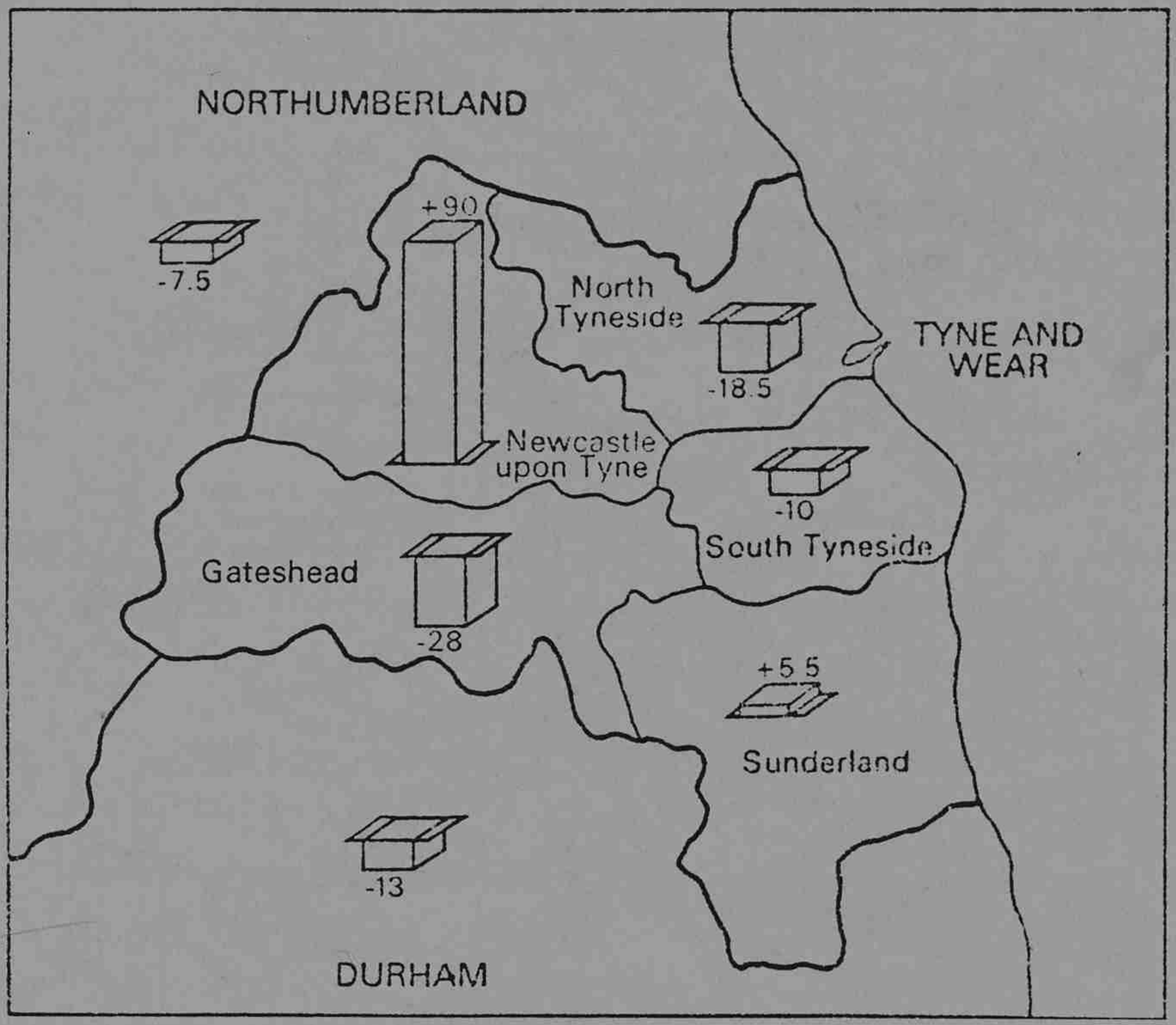
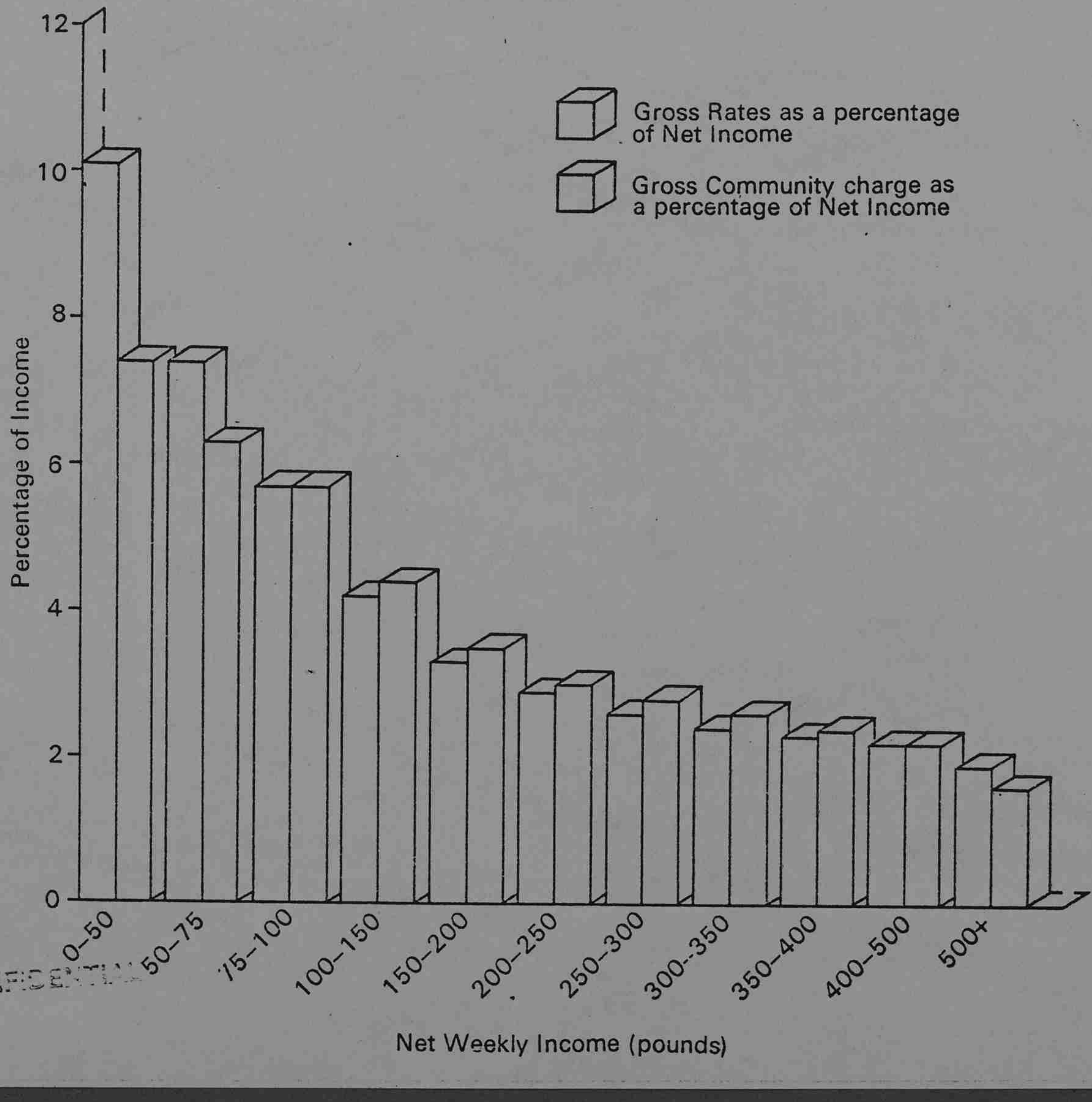


Figure 11: RELATIONSHIP OF RATES AND FULL COMMUNITY CHARGE – BEFORE REBATES – TO NET HOUSEHOLD INCOME IN GREAT BRITAIN



C M C CONFIDENTIAL

Figure 12: INTER-REGIONAL TRANSFERS THROUGH RESOURCE EQUALISATION ENGLAND 1984/85

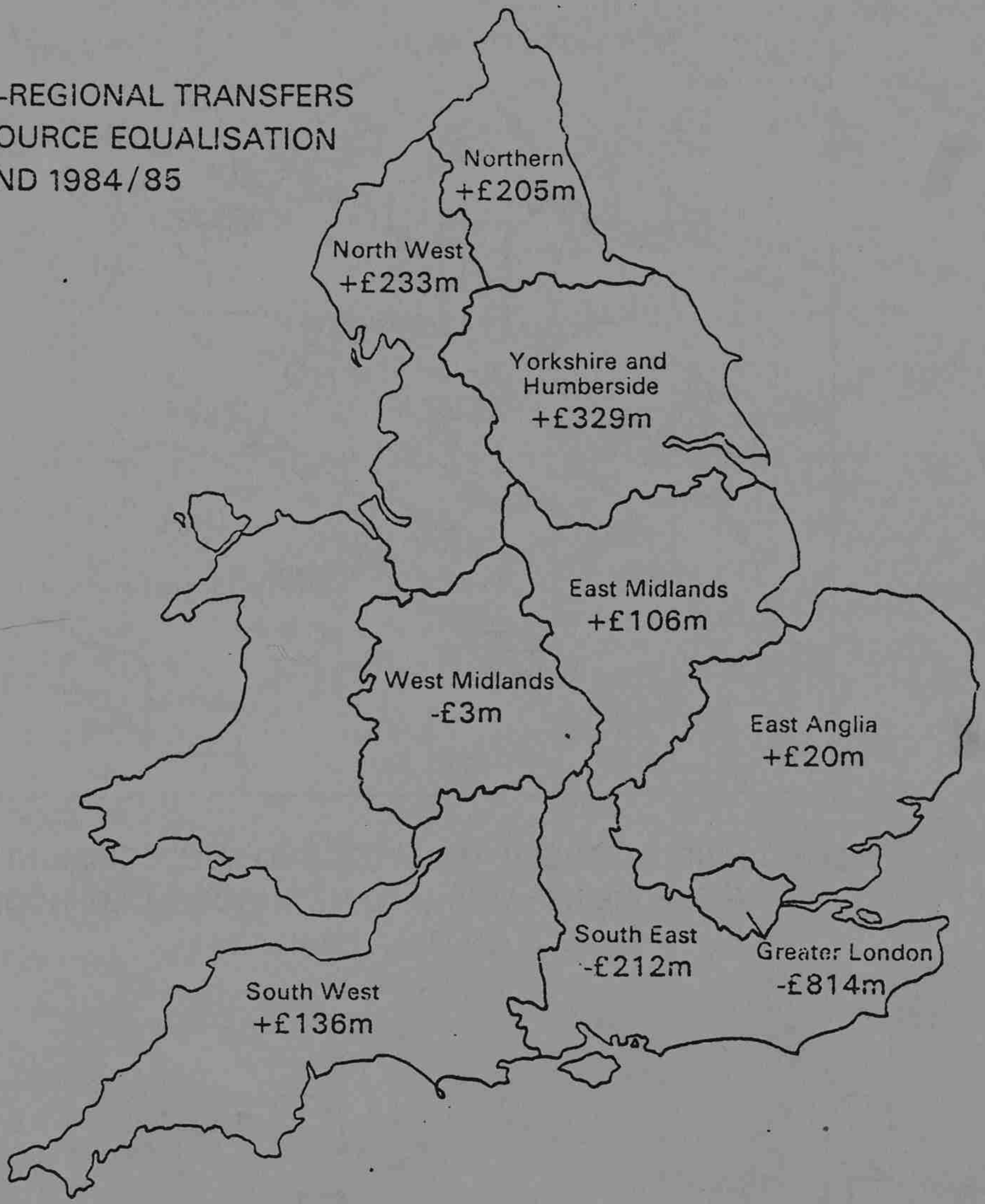


Figure 13: AVERAGE DOMESTIC RATEABLE VALUES AND AVERAGE INCOMES IN ENGLISH REGIONS

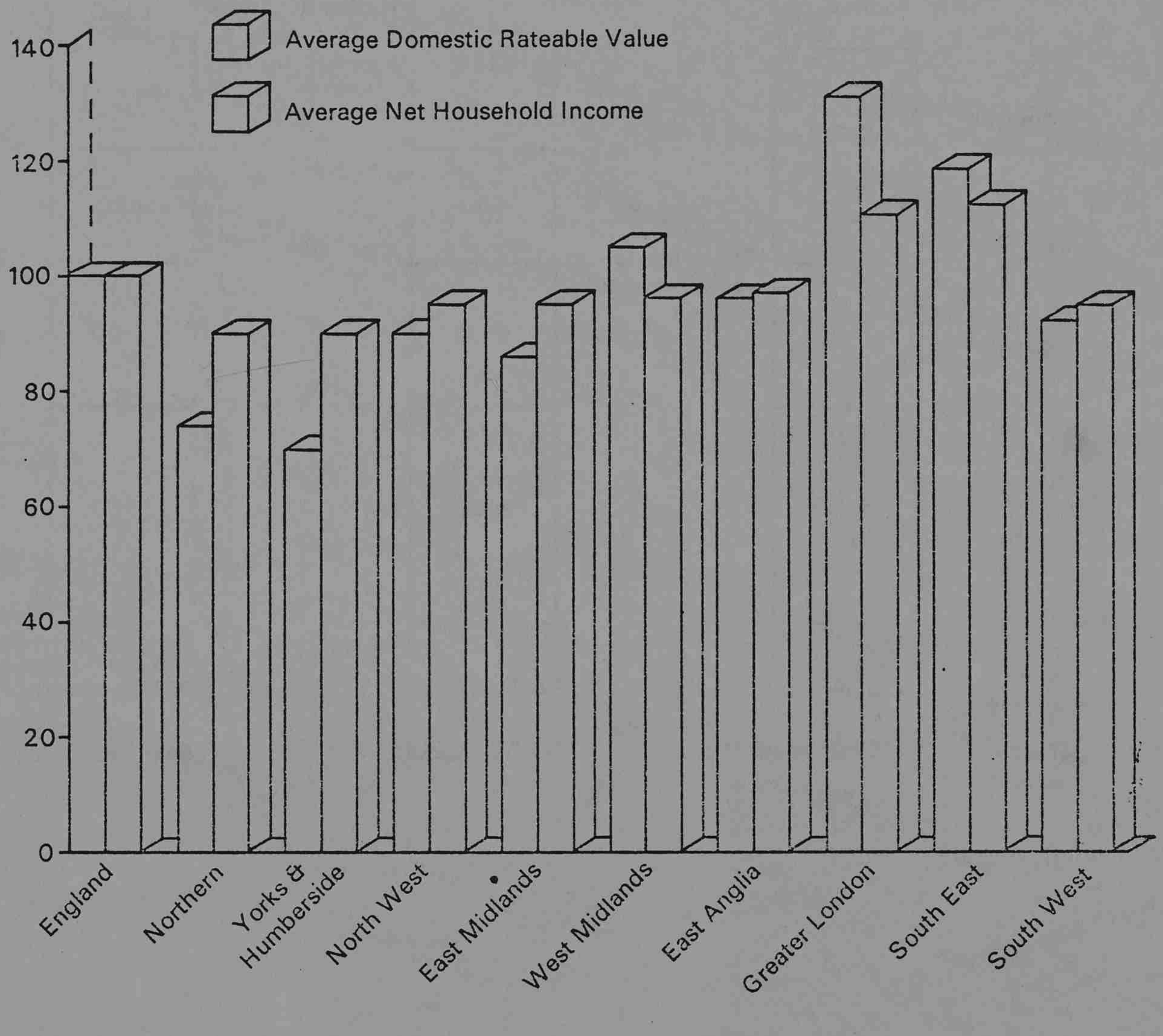
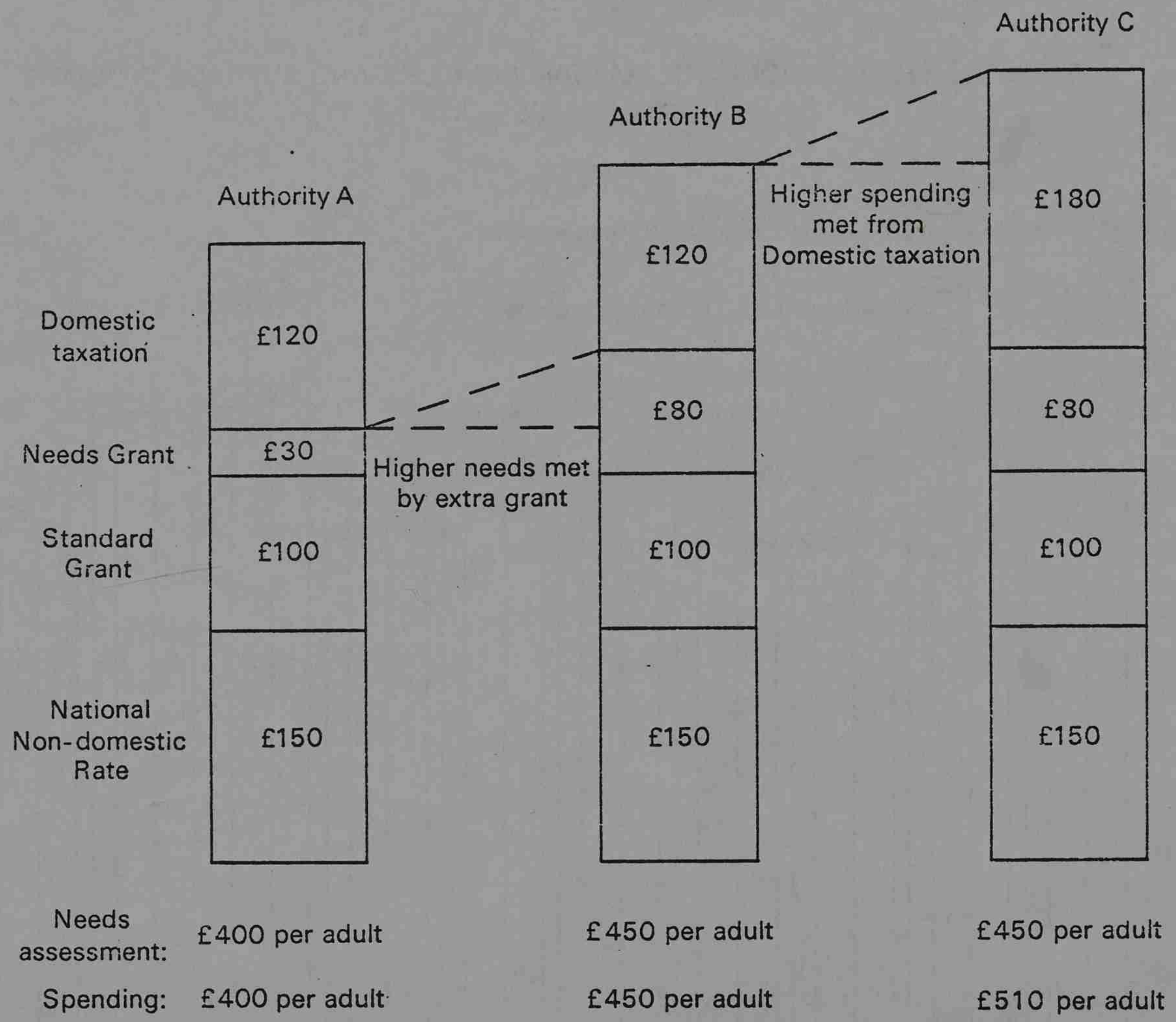


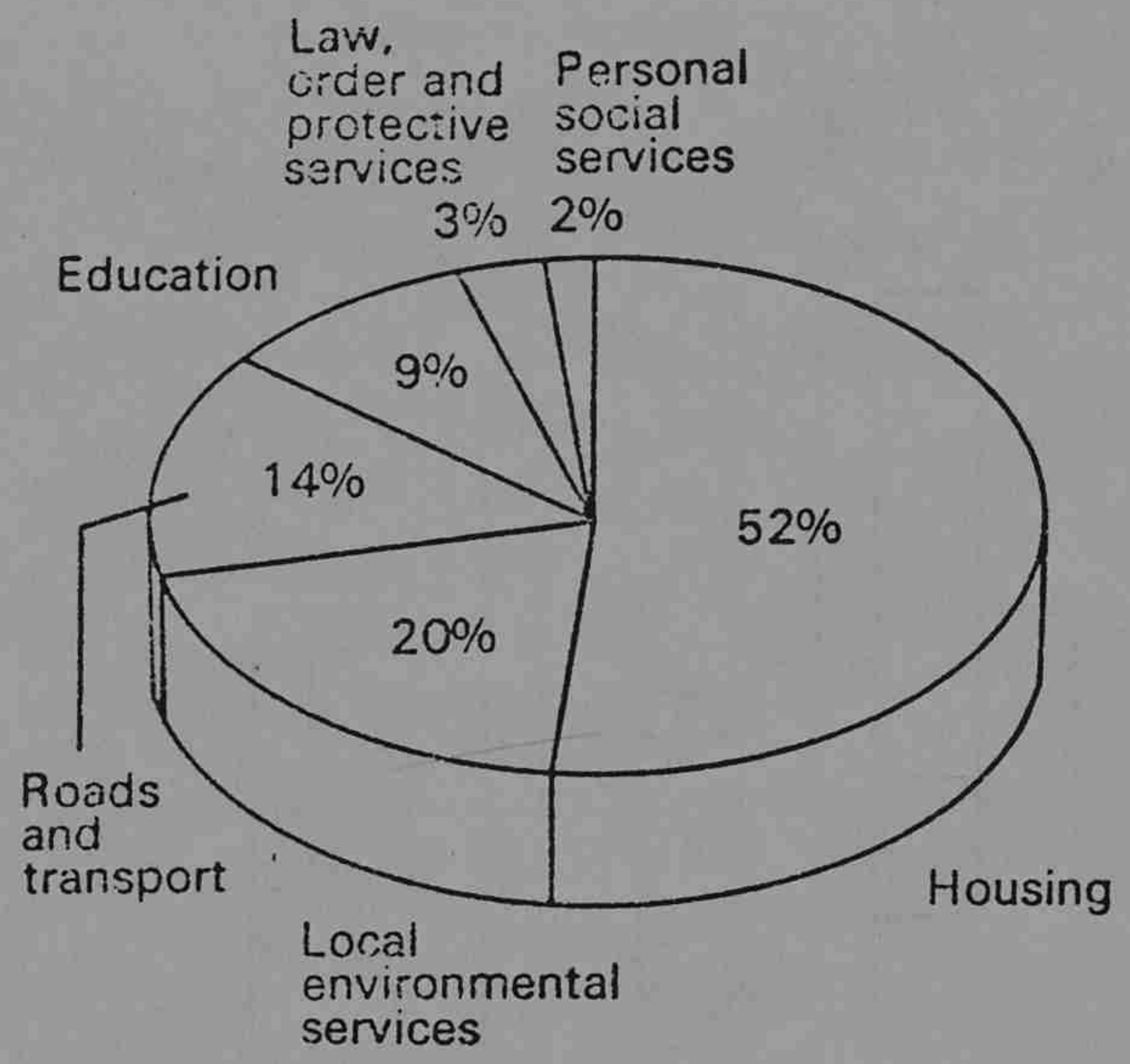
Figure 14: THE GRANT SYSTEM AND DOMESTIC TAXATION



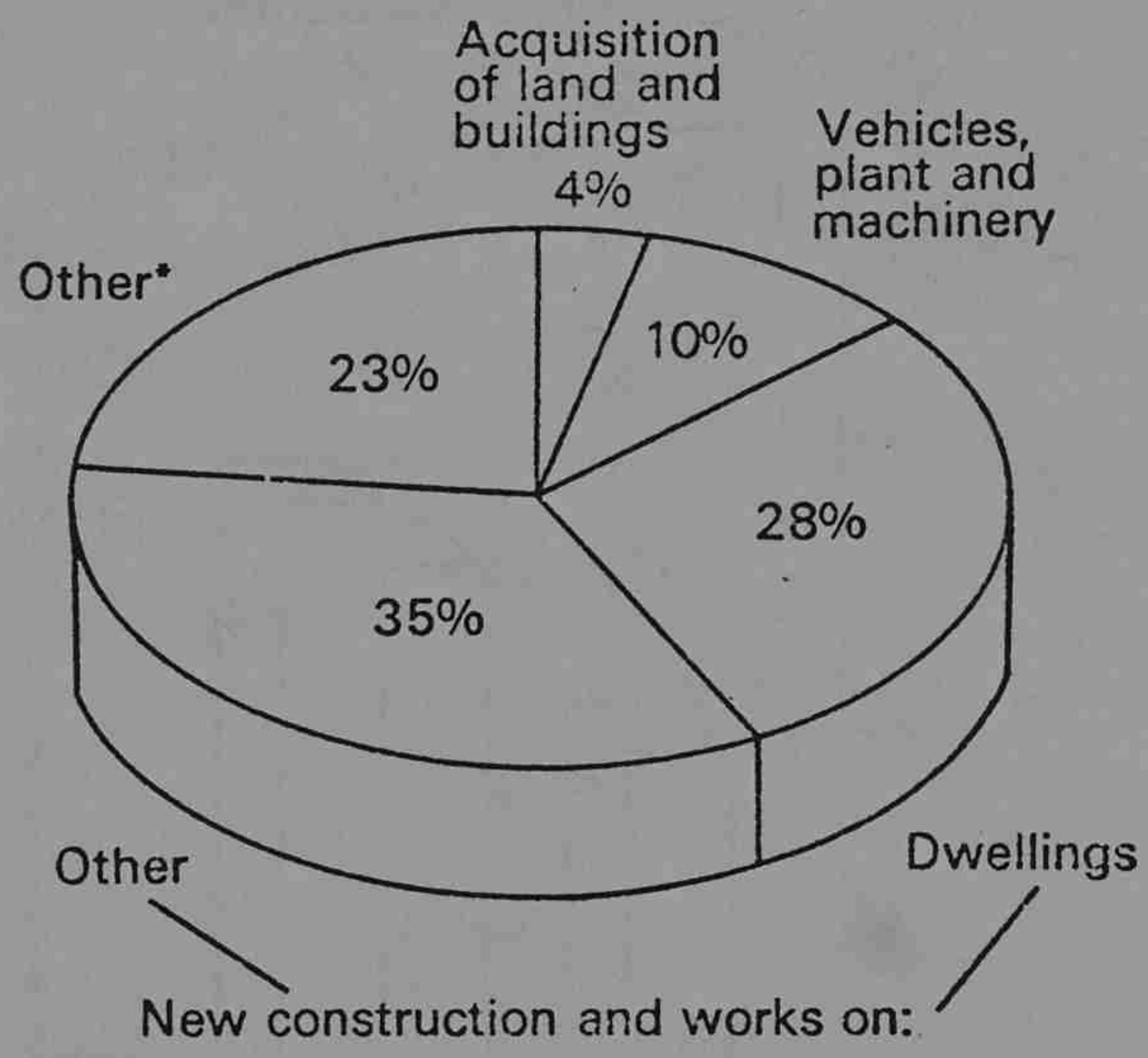
All figures are per adult

Figure 15 : LOCAL AUTHORITY GROSS CAPITAL EXPENDITURE
ENGLAND AND WALES 1984/85
£6.3 billion

By service

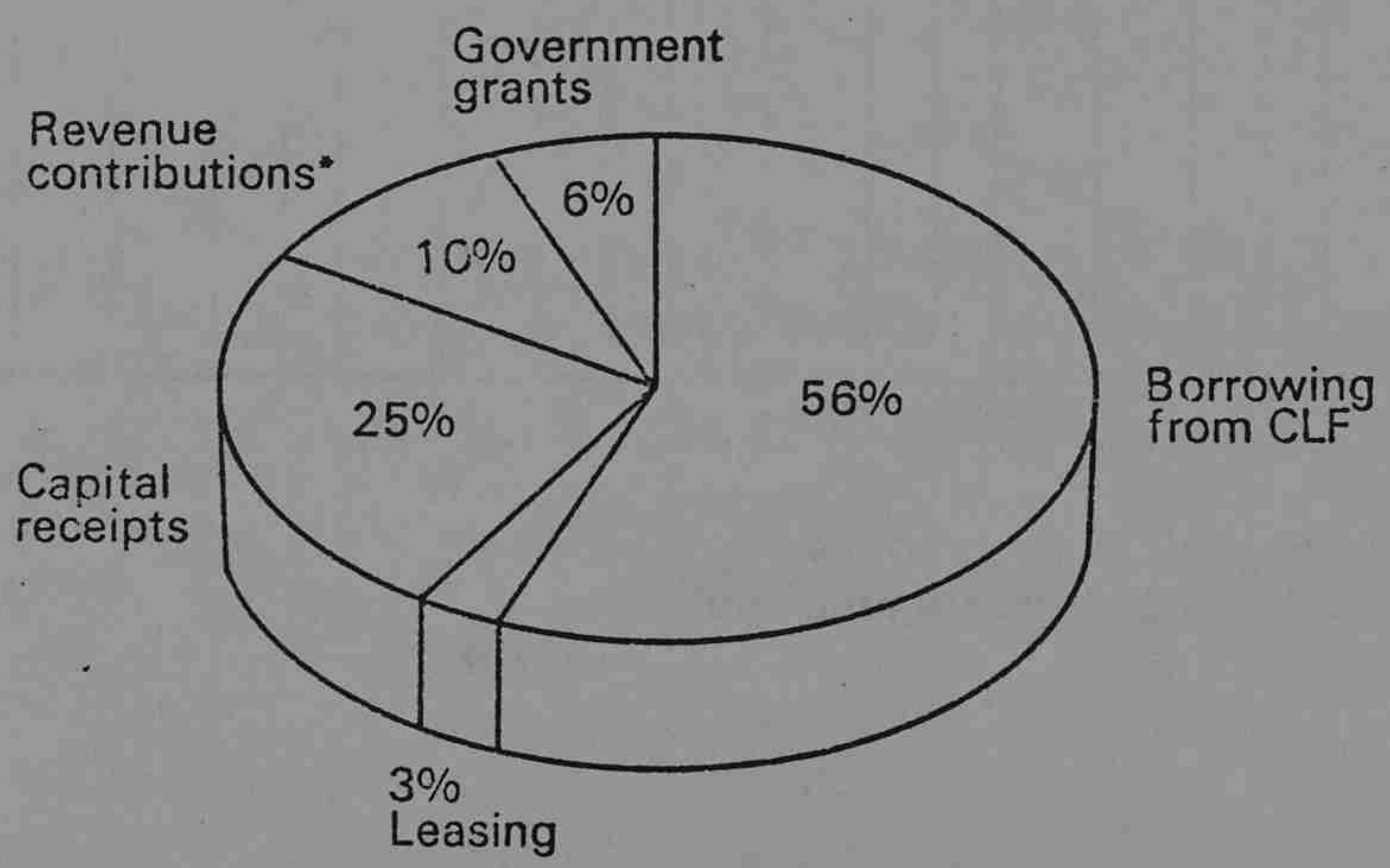


By Economic Category



* mostly housing grants, advances and mortgages and capital contribution to Passenger Transport Executive

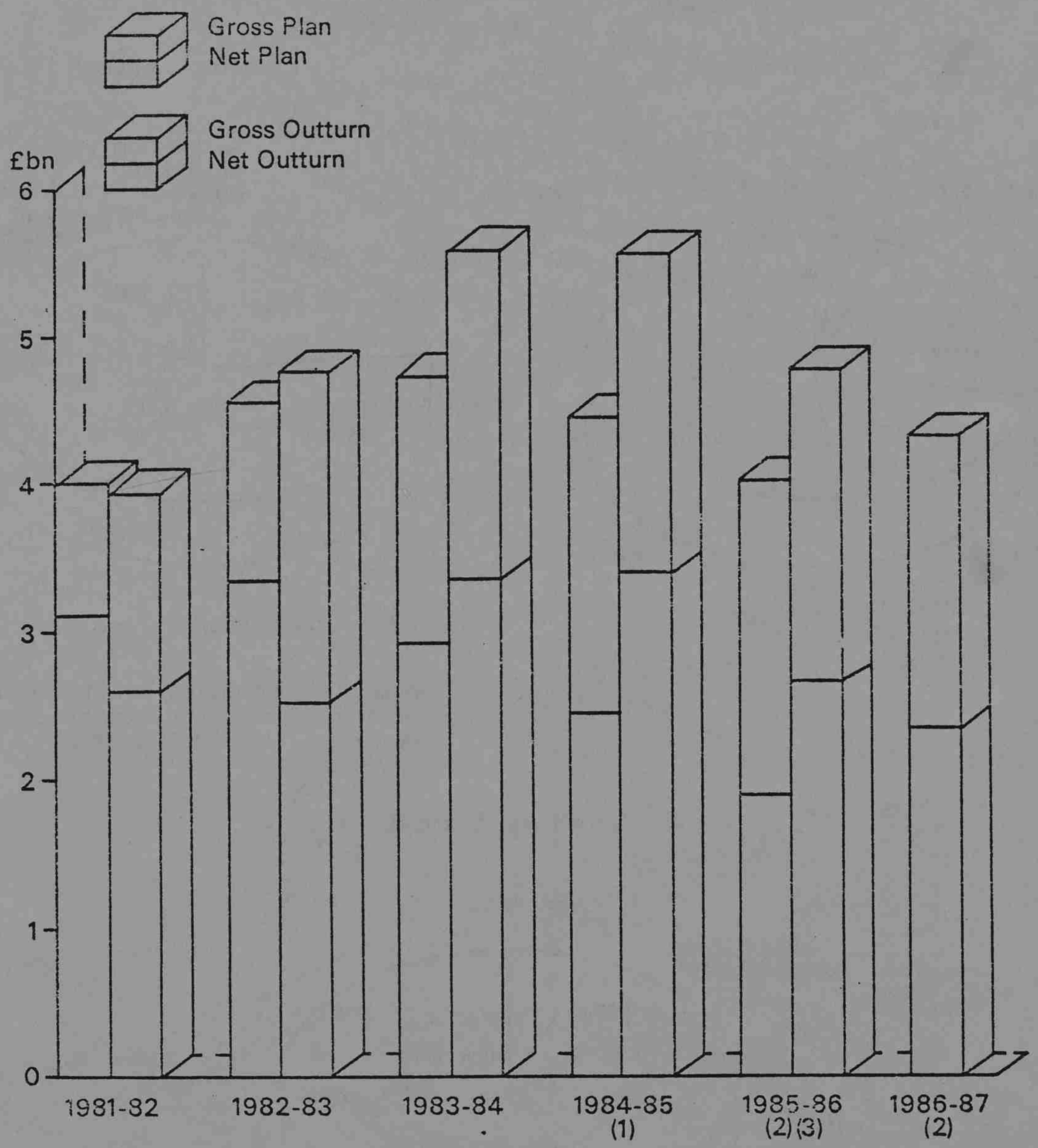
How it was financed



* including transfers from special and capital funds

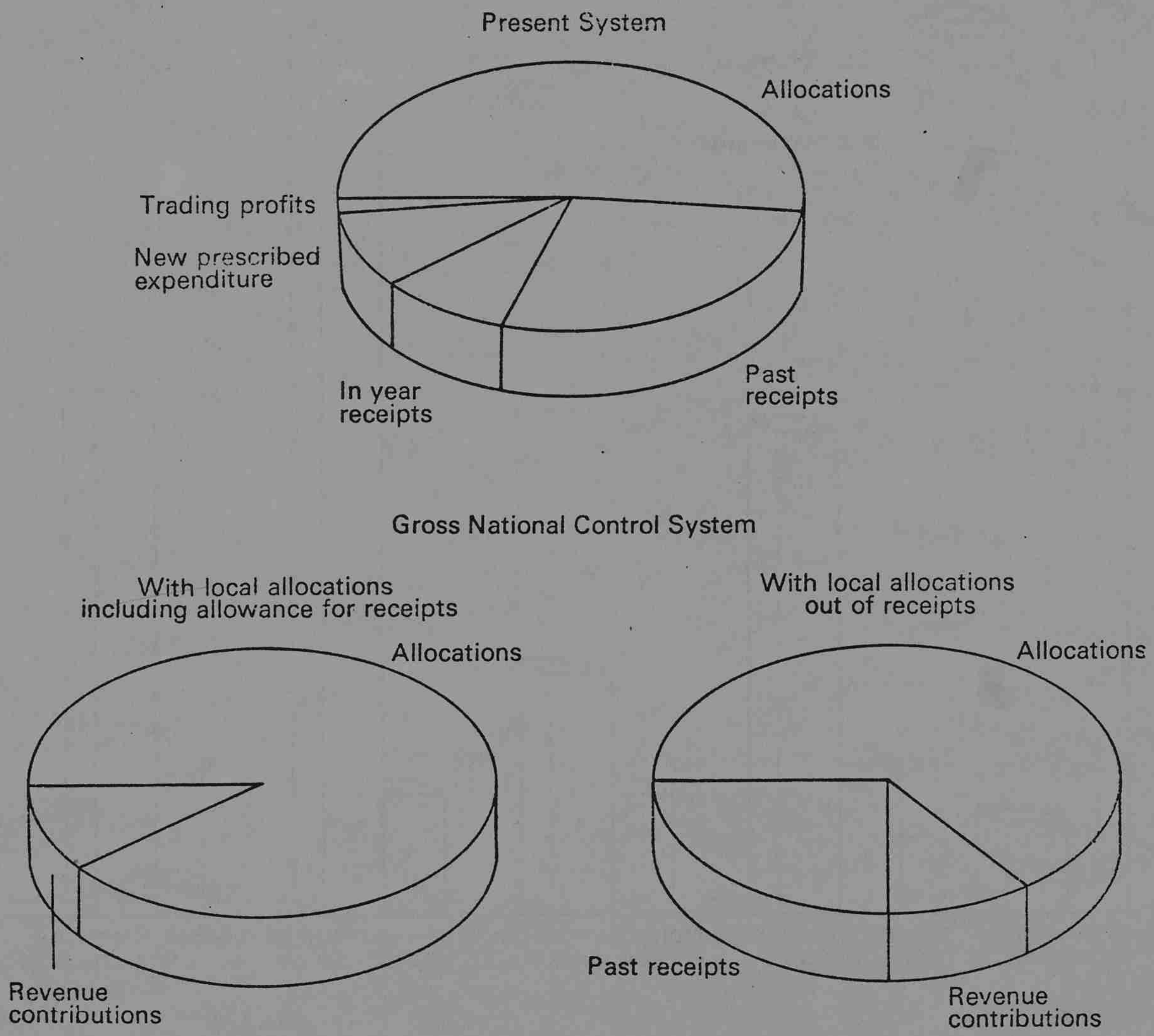
Source: Capital outturn returns from local authorities

Figure 16: PLANNED AND ACTUAL CAPITAL EXPENDITURE AGAINST THE MAIN CASH LIMIT ENGLAND 1981/82 TO 1986/87



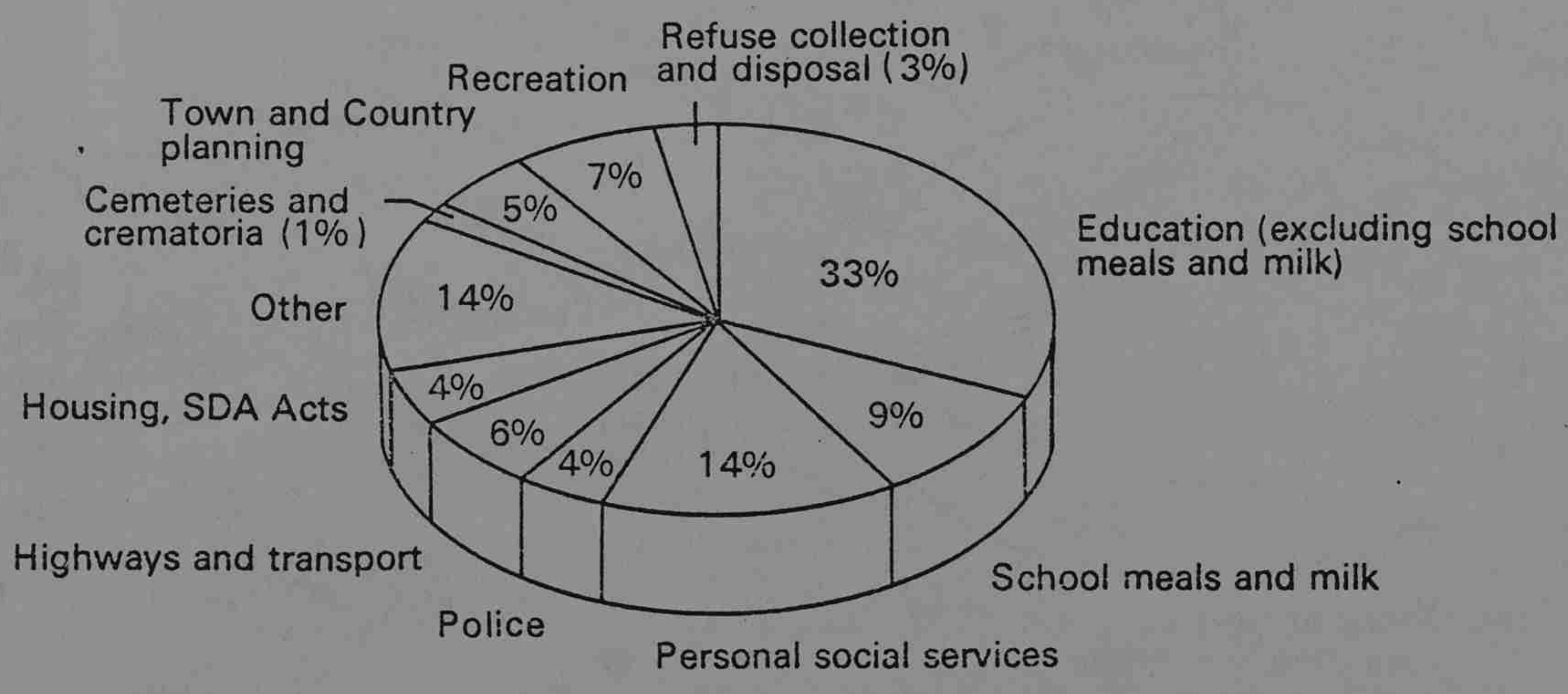
(1) Excluding Urban Programme
(2) Excluding Urban Programme and LRT
(3) Forecast

Figure 17: SOURCES OF SPENDING POWER UNDER THE PRESENT CAPITAL CONTROL SYSTEM AND UNDER A GROSS EXPENDITURE CONTROL SYSTEM



The relative importance of the different sources of spending power shown is purely illustrative

Figure 18: SALES FEES AND CHARGES BY MAIN SERVICE HEADINGS



Sales fees and charges in 1984/85 = £2600m

Figure 19: PERCENTAGE OF RATE FUND REVENUE EXPENDITURE FINANCED BY FEES AND CHARGES — 1983/84 (CLASS MINIMUM AND MAXIMUM)

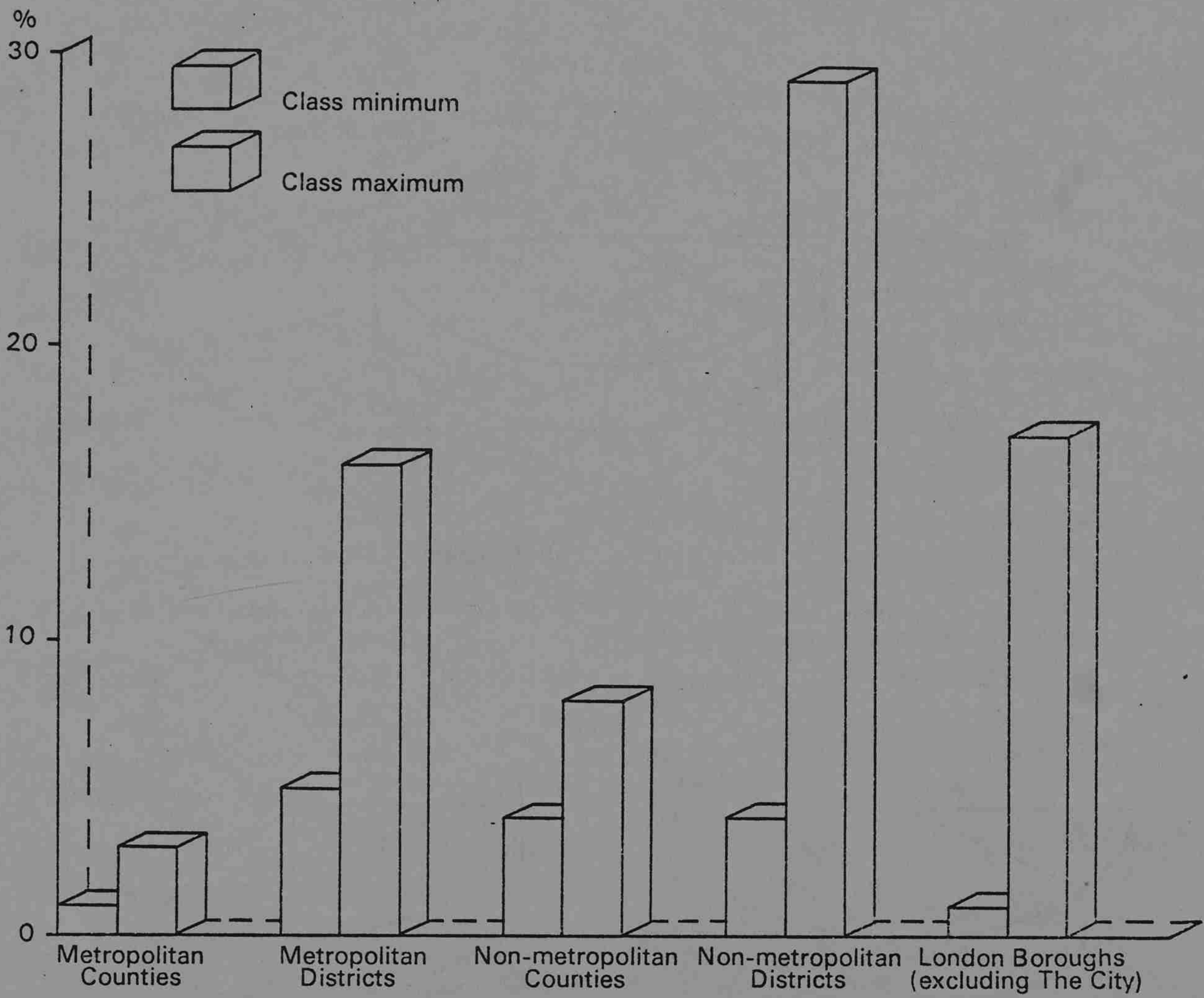


Figure 20: SOURCES OF FUNDING OF LOCAL GOVERNMENT SCOTLAND 1985/86

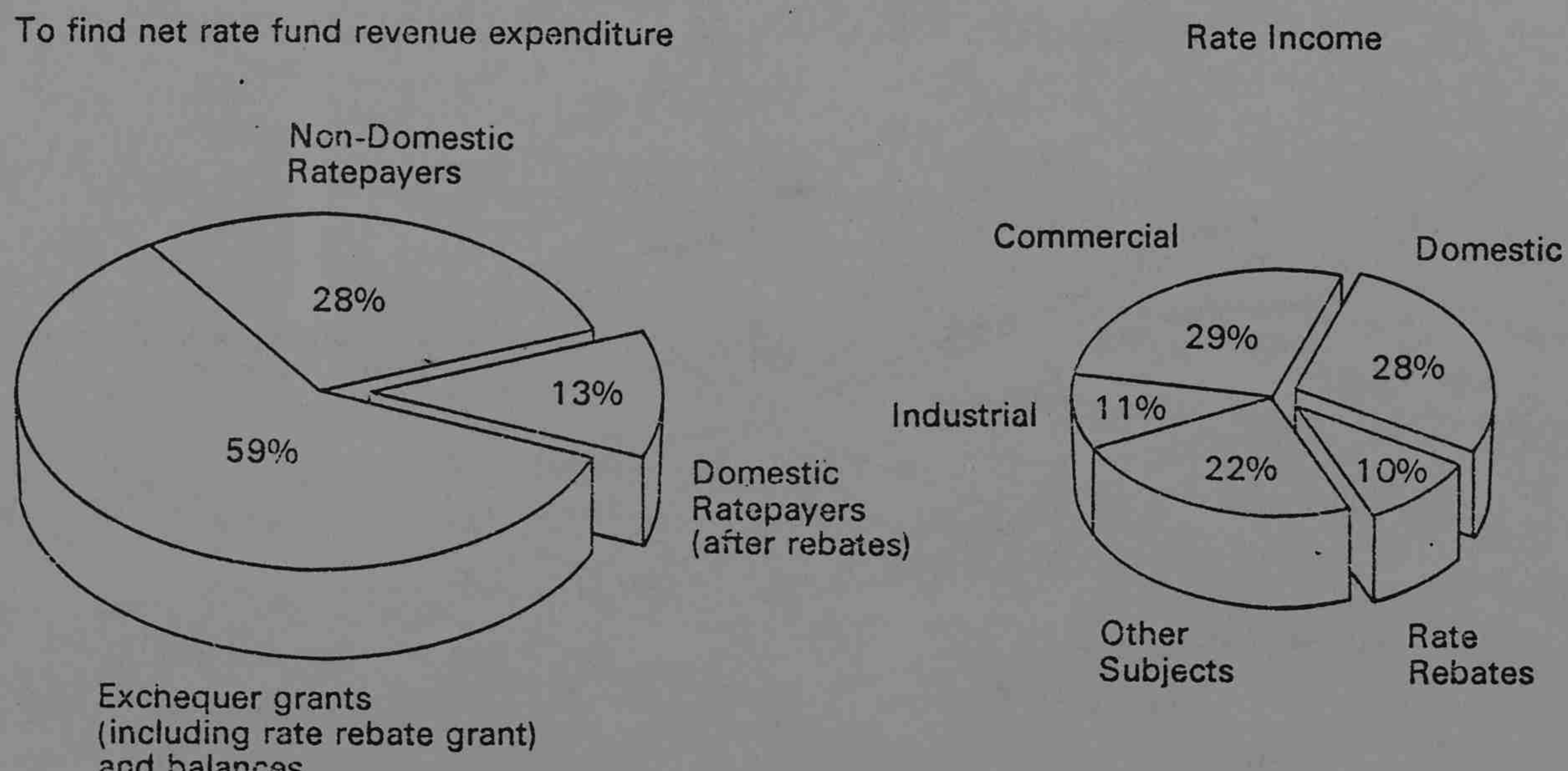


Figure 21: SOURCES OF RATE INCOME

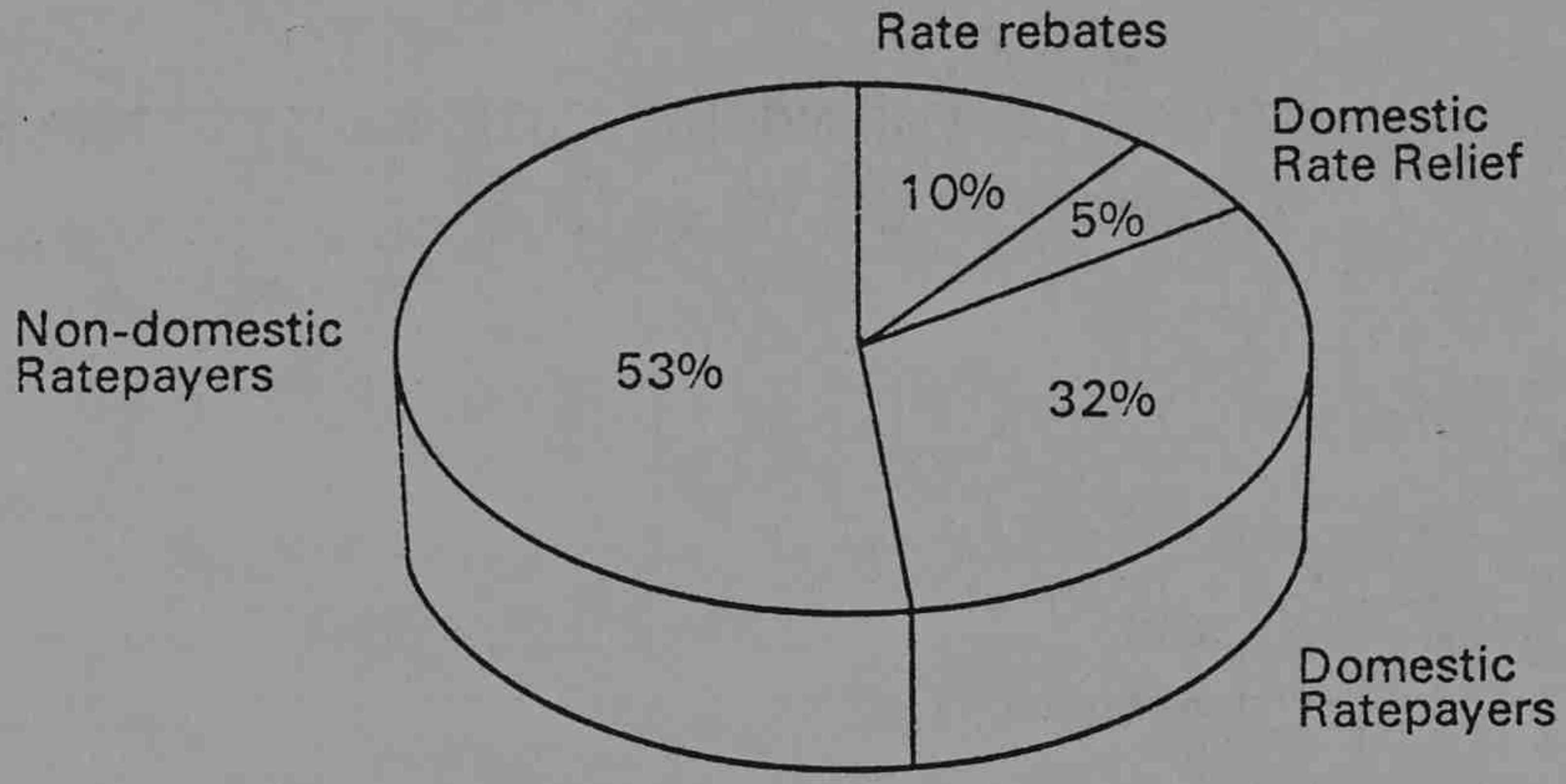


Figure 22: SHIFT IN NON-DOMESTIC RATE PAYMENTS

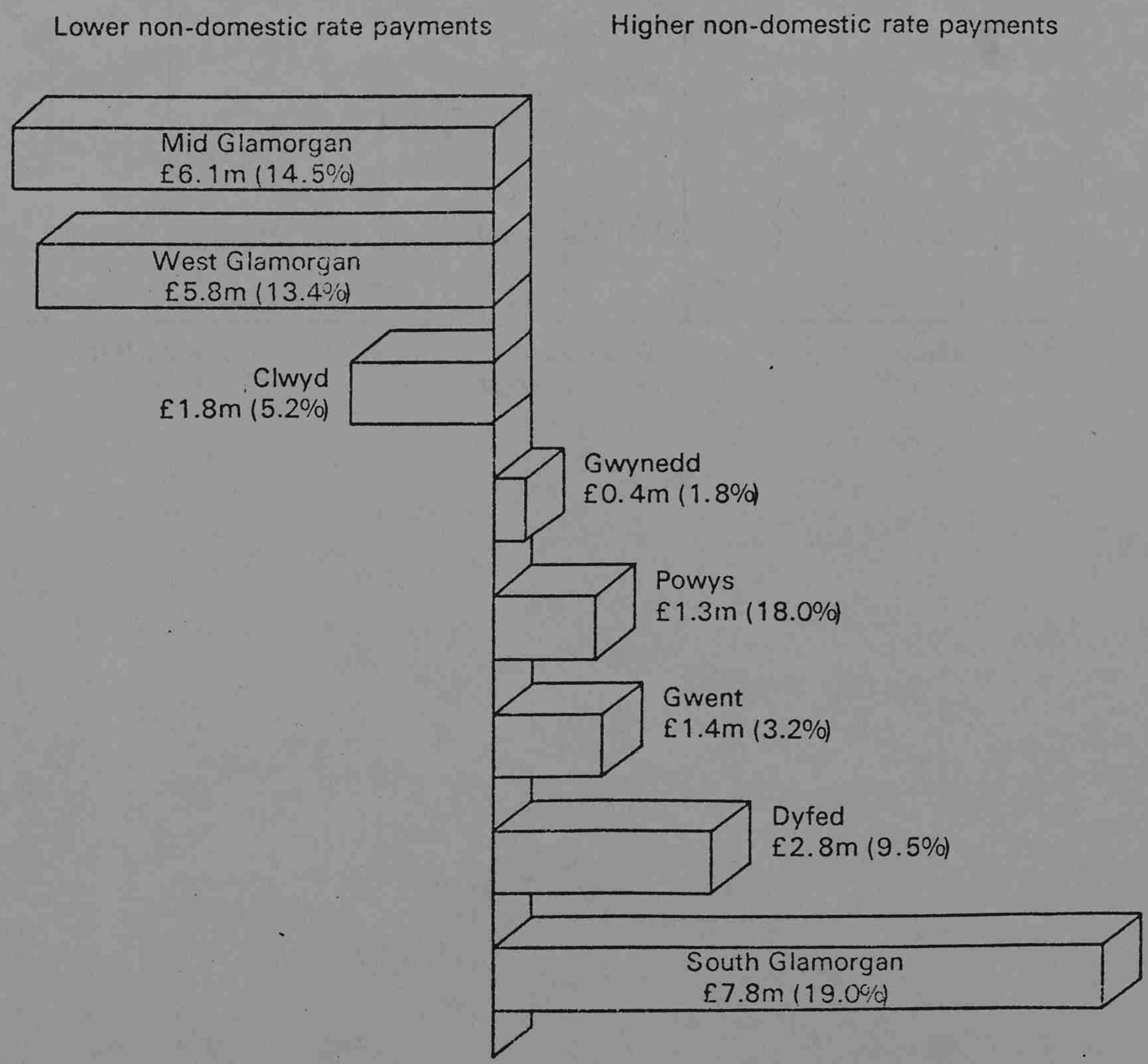


Figure 23: MISMATCH BETWEEN SPENDING, DOMESTIC RATE POUNDAGES AND DOMESTIC RATE BILLS

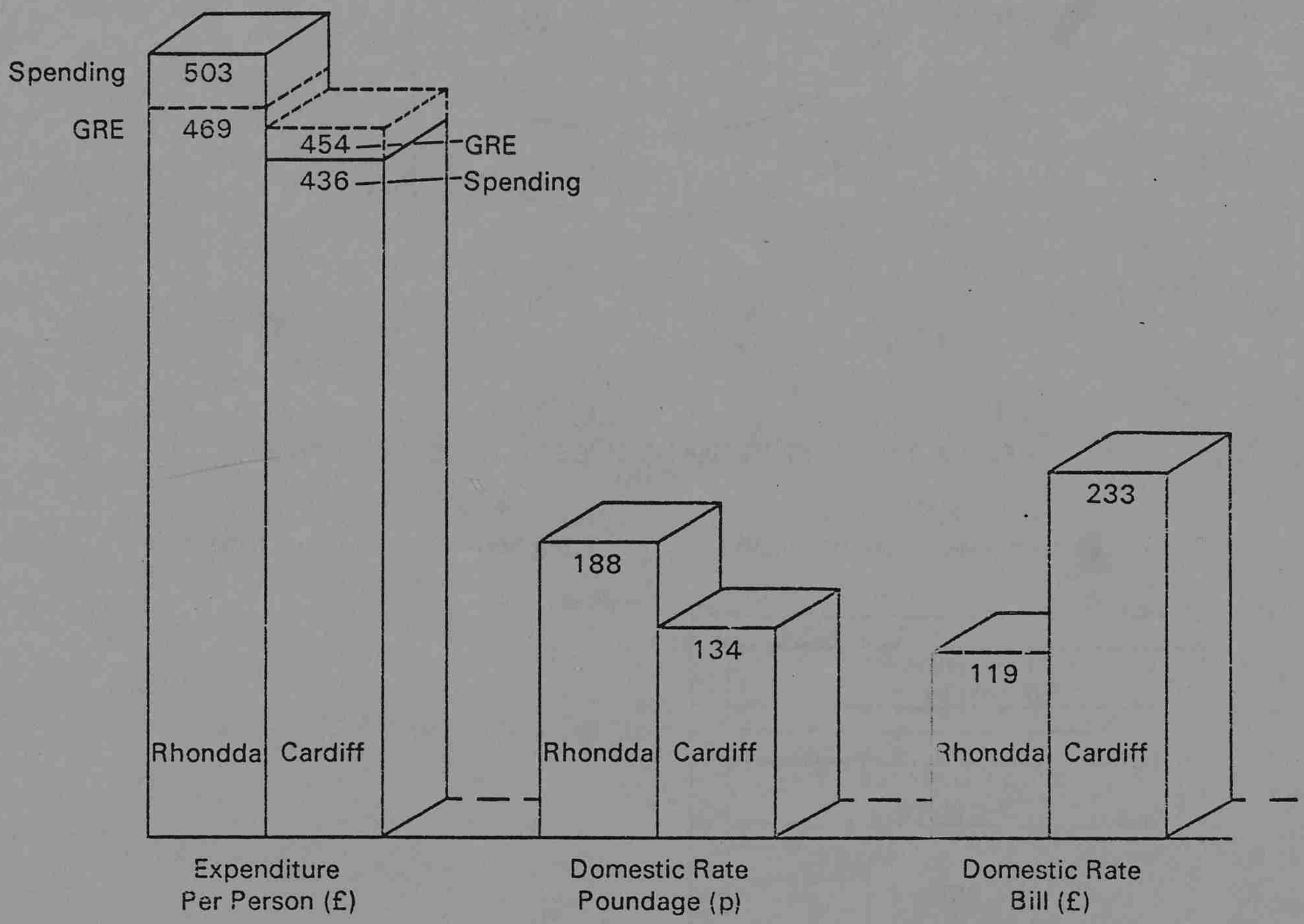


Figure A1 : LOCAL GOVERNMENT GROSS EXPENDITURE BY SERVICE
ENGLAND 1984/85

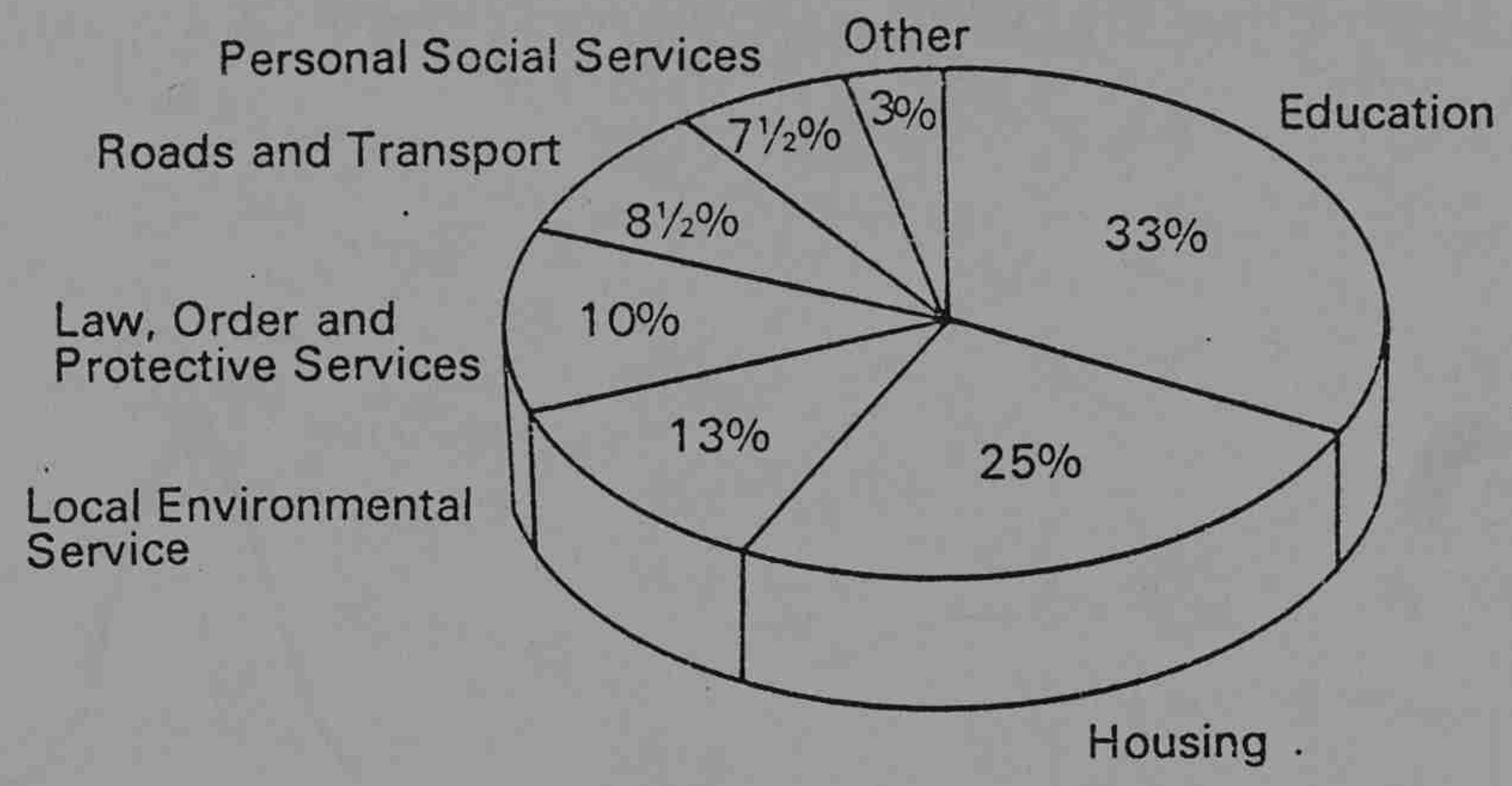
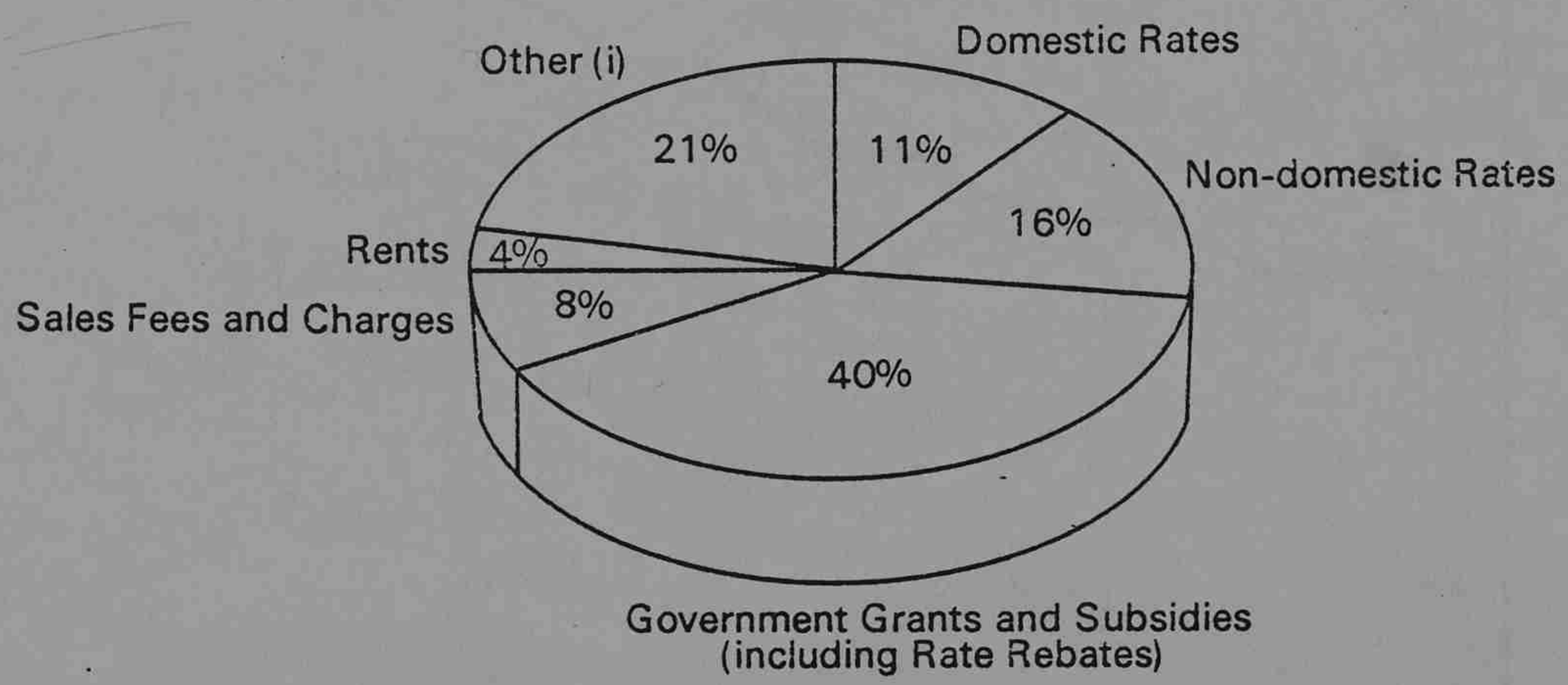
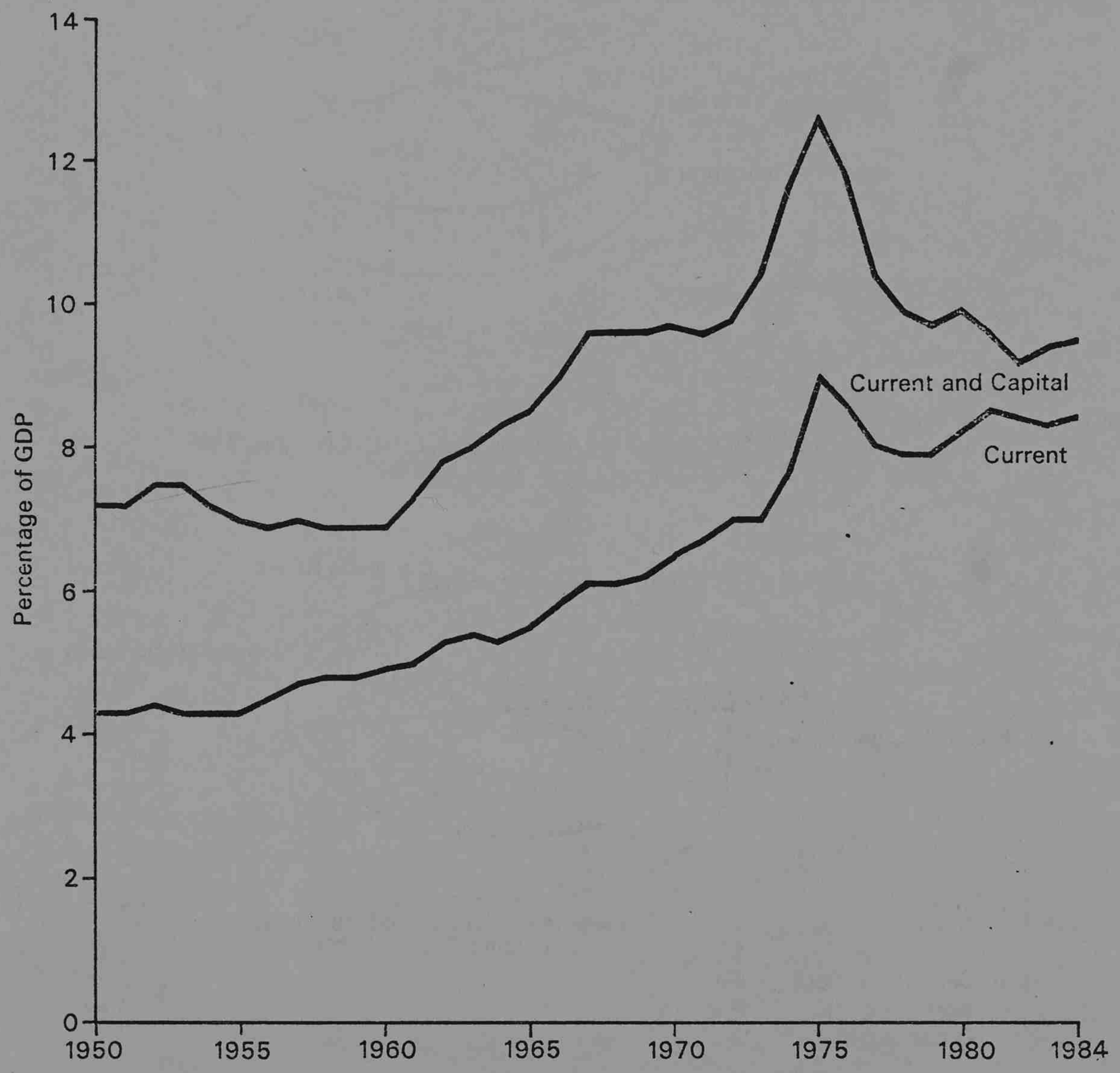


Figure A2 : SOURCES OF LOCAL GOVERNMENT INCOME
ENGLAND 1984/85



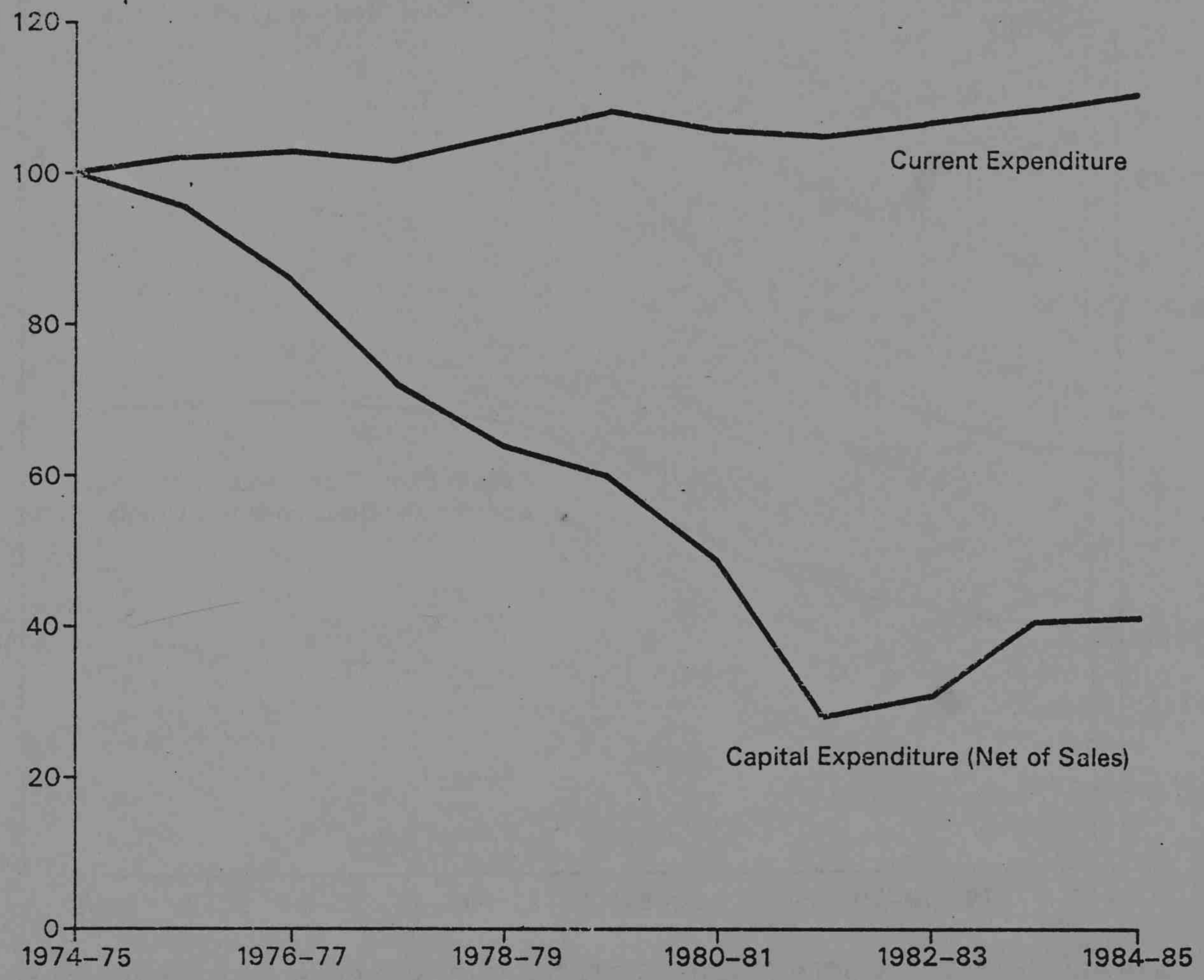
(i)	Capital Receipts	6%
	Borrowing	5%
	Other	10%

Figure A3: LOCAL GOVERNMENT CURRENT EXPENDITURE ON GOODS AND SERVICES AND GROSS DOMESTIC FIXED CAPITAL FORMATION AS A SHARE OF GDP



(Note: United Kingdom, National Accounts basis
Source: Central Statistical Office)

Figure A4: LOCAL GOVERNMENT CURRENT EXPENDITURE ON GOODS AND SERVICES AND GROSS DOMESTIC FIXED CAPITAL FORMATION AT 1980 PRICES



(Note: United Kingdom, National Accounts basis
Source: Central Statistical Office)

Figure A5: RATE FUND REVENUE ACCOUNT
ENGLAND AND WALES RATES AND GRANTS

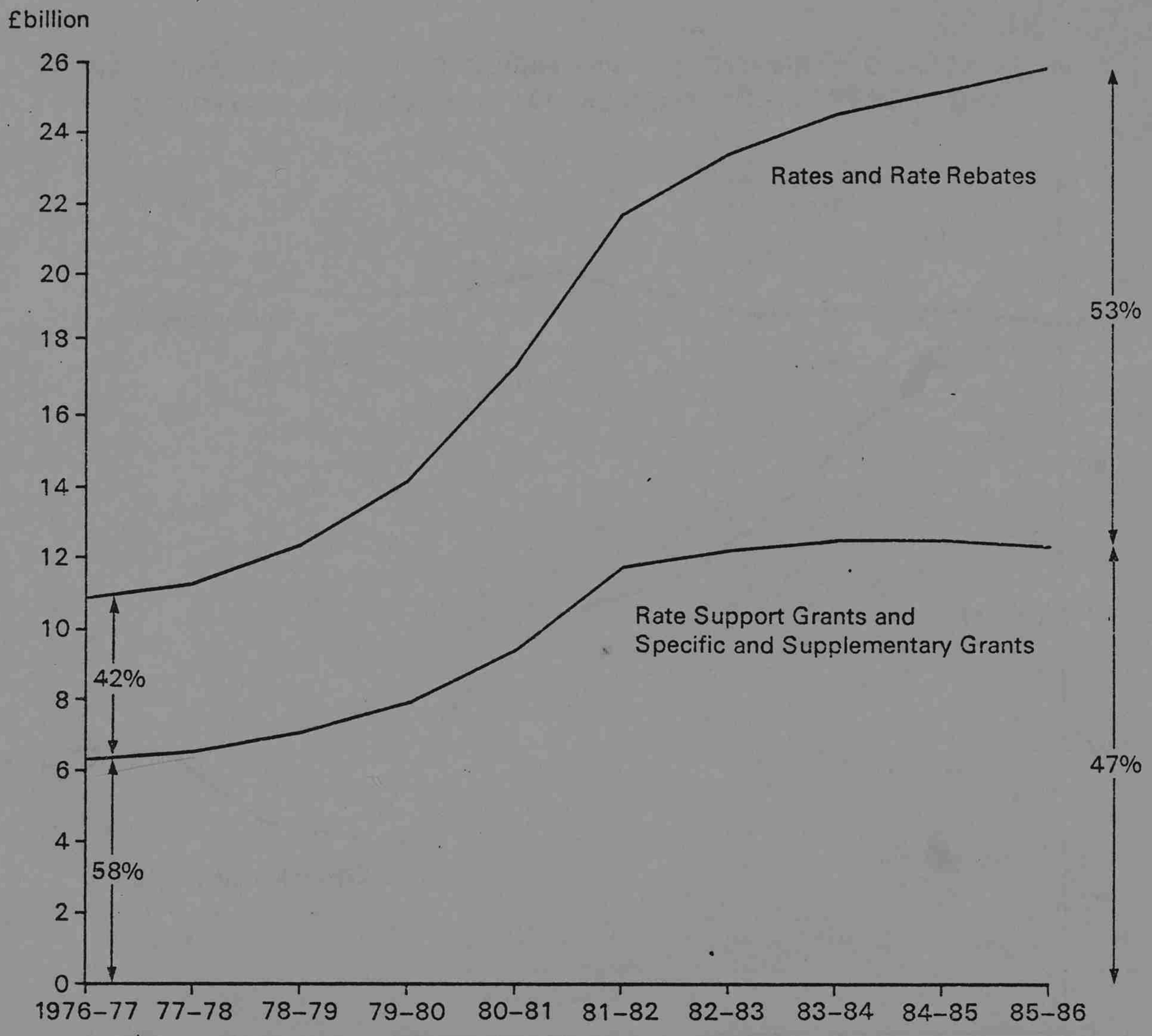


Figure A6: CHANGES IN DOMESTIC RATE BILLS IN ENGLAND COMPARED TO INFLATION

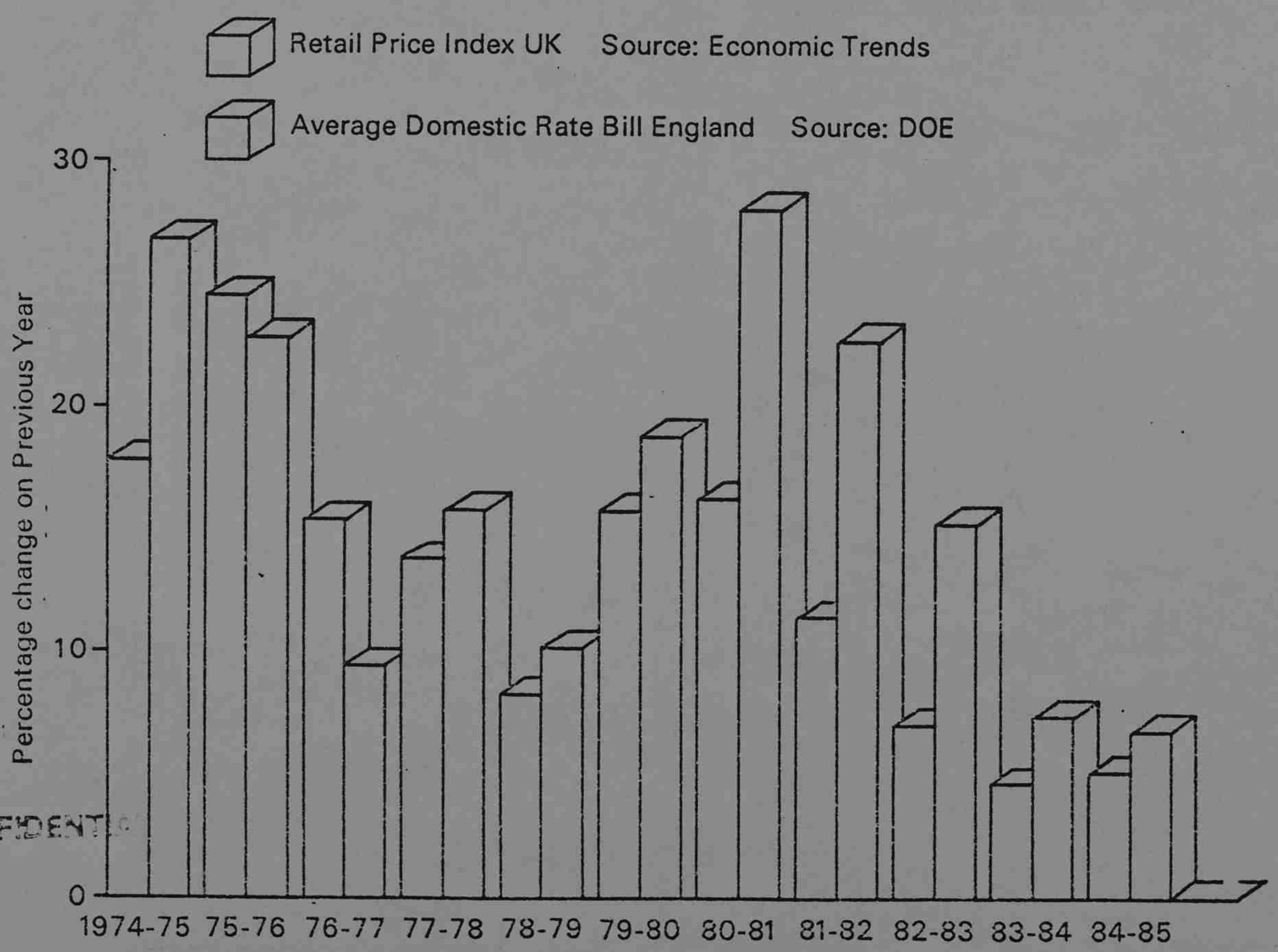
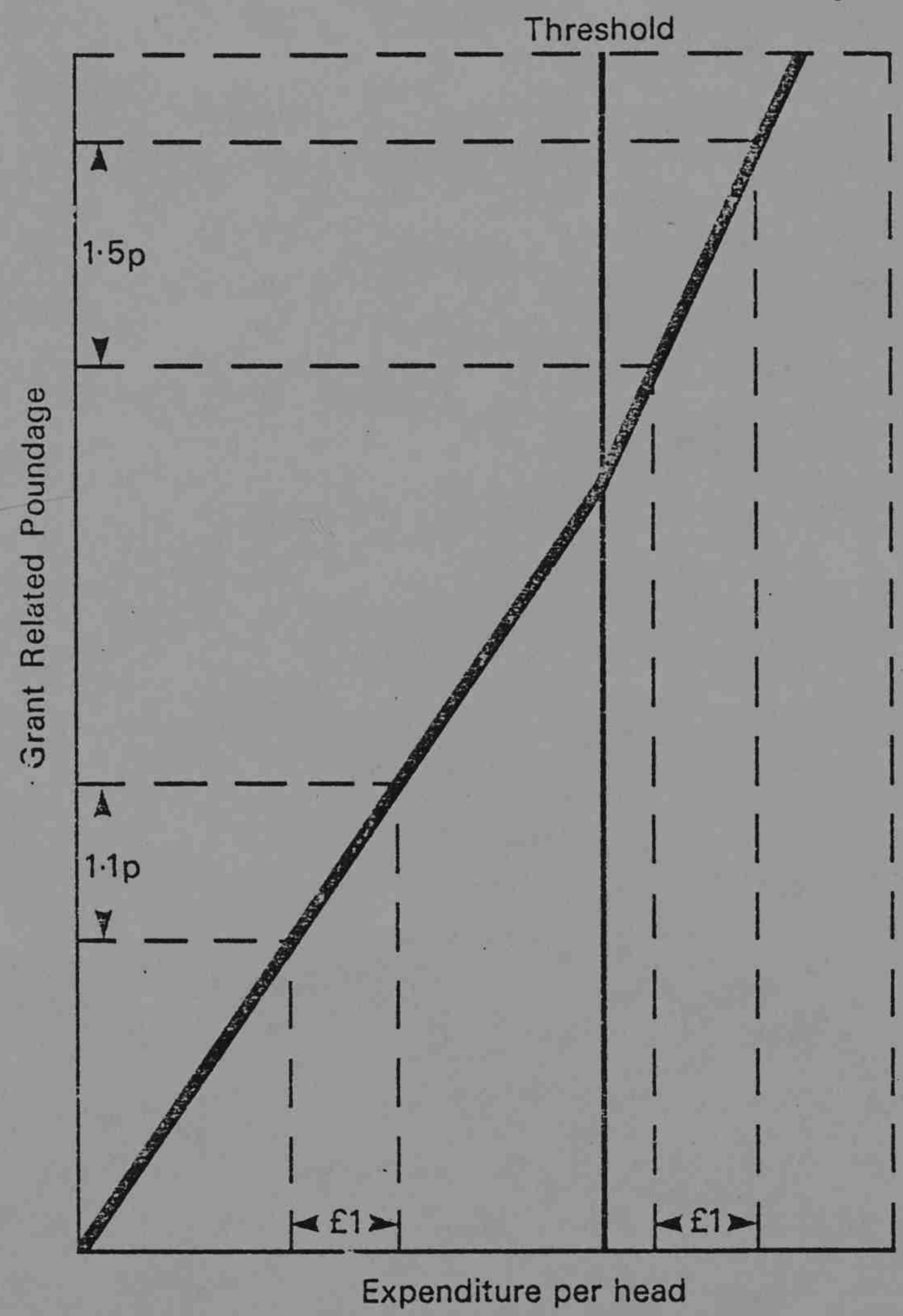


Figure B1: THE BLOCK GRANT SCHEDULE
ENGLAND 1986/1987



Not to Scale

Figure D1 : DISTRIBUTION OF NON-DOMESTIC RATEABLE VALUE PER ADULT
ENGLAND 1984/85

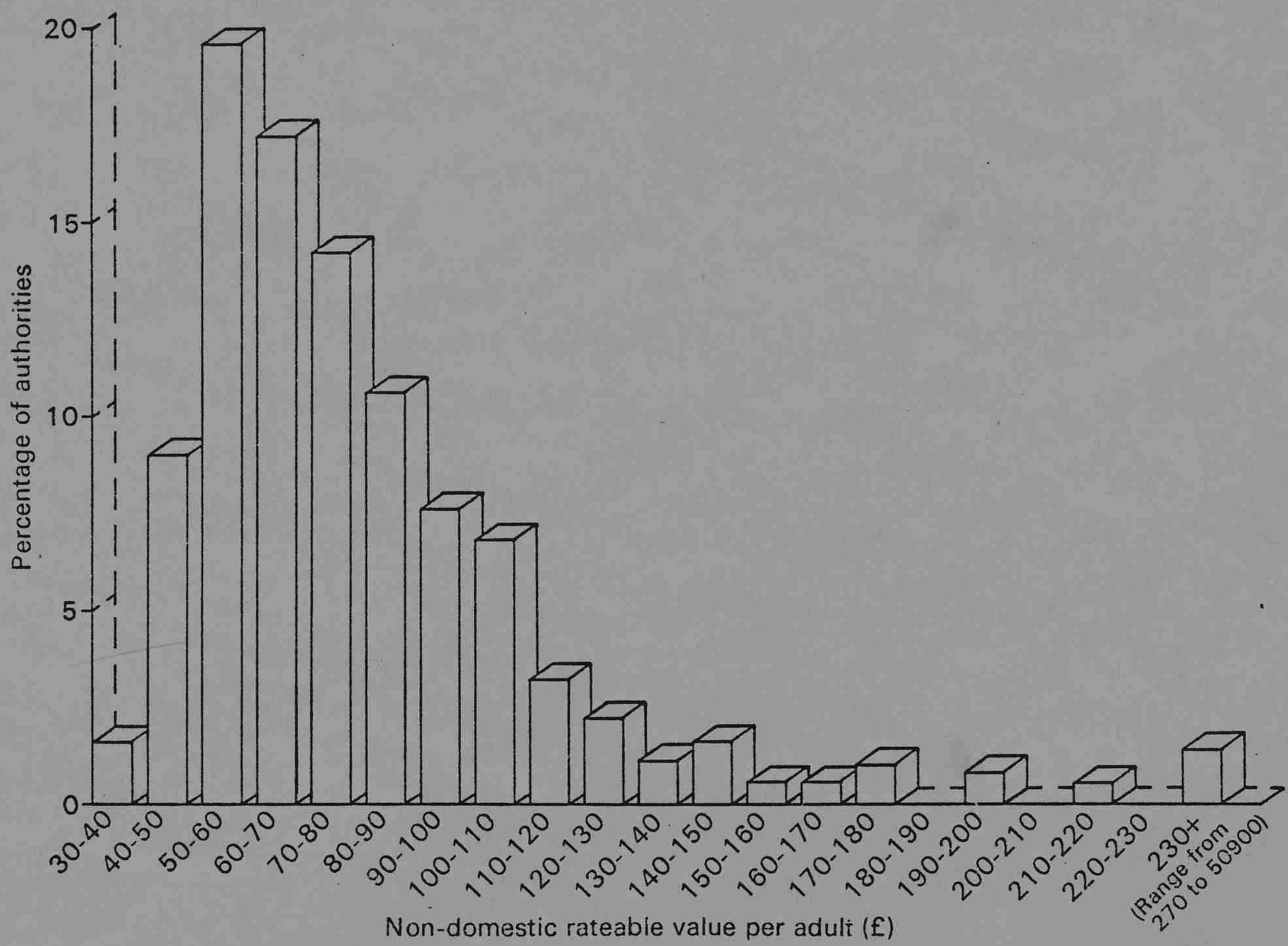


Figure D2: PERCENTAGE OF HEREDITAMENTS GAINING AND LOSING
FROM A NATIONAL NON-DOMESTIC RATE - ENGLAND 1984/85

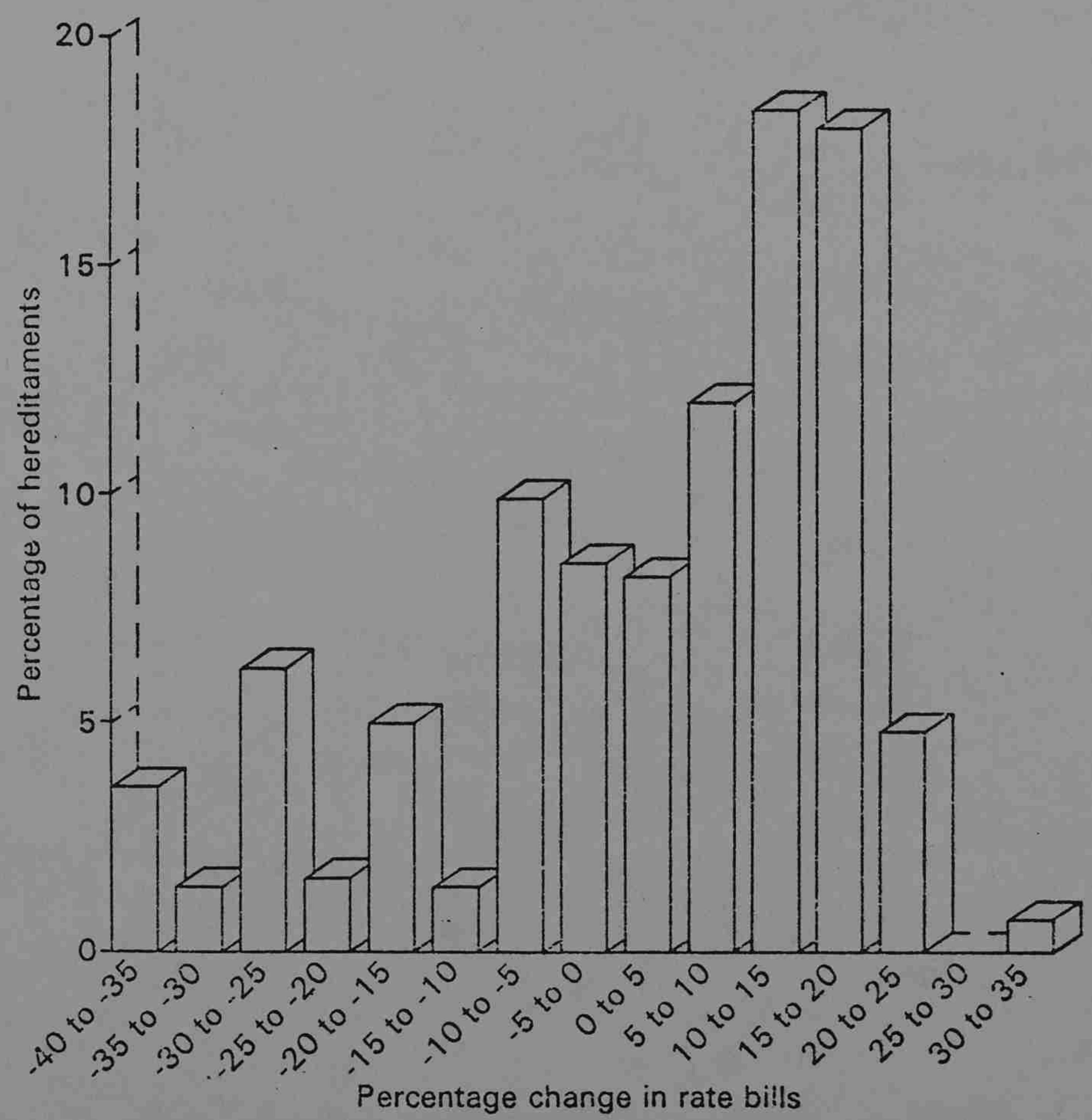


Figure F6: RELATIONSHIP OF NET RATES AND NET COMMUNITY CHARGE TO NET HOUSEHOLD INCOME BY EQUIVALENT INCOME BAND

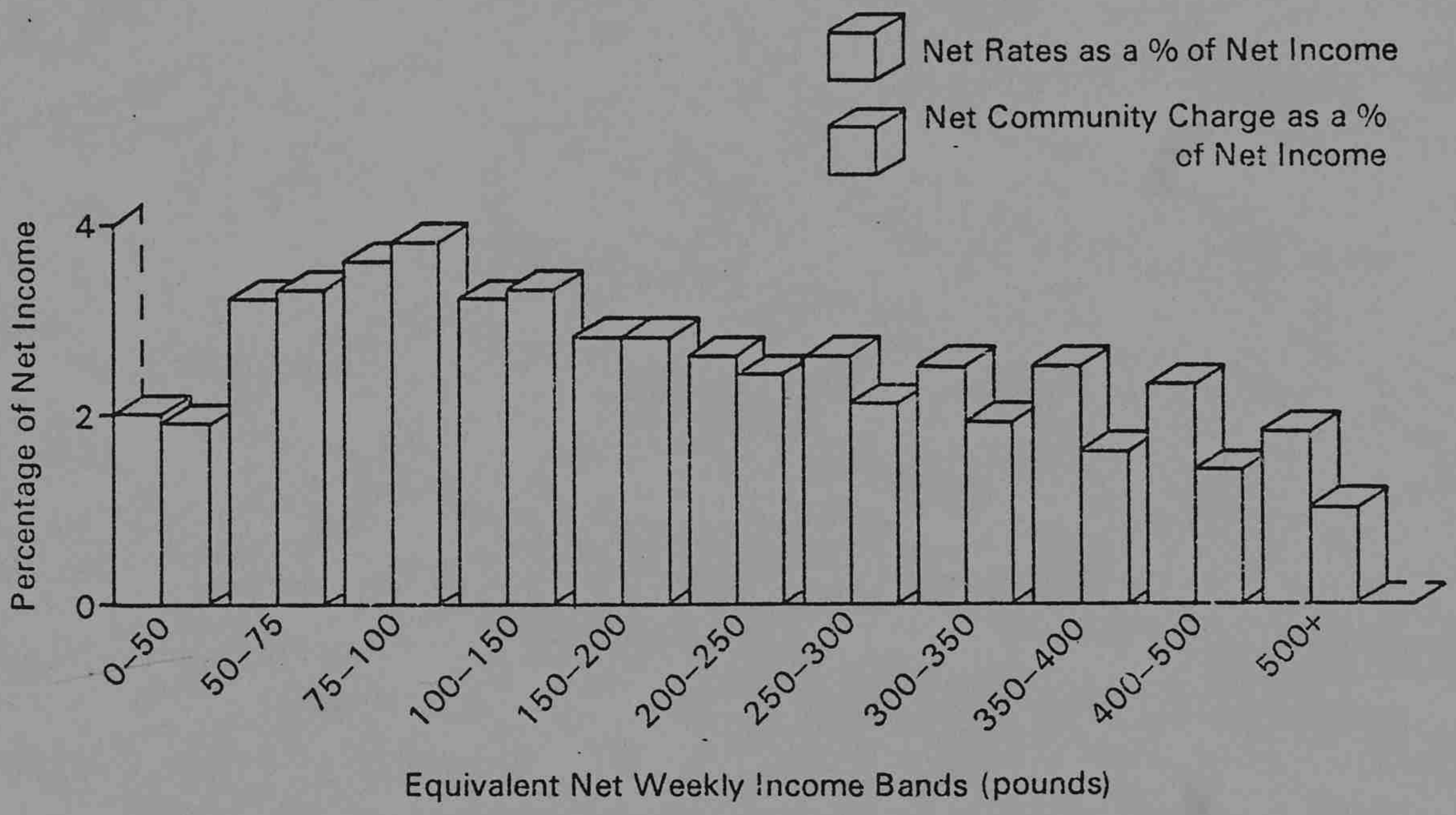


Figure F7: RELATIONSHIP OF GROSS RATES AND GROSS COMMUNITY CHARGE TO NET HOUSEHOLD INCOME BY EQUIVALENT INCOME BAND

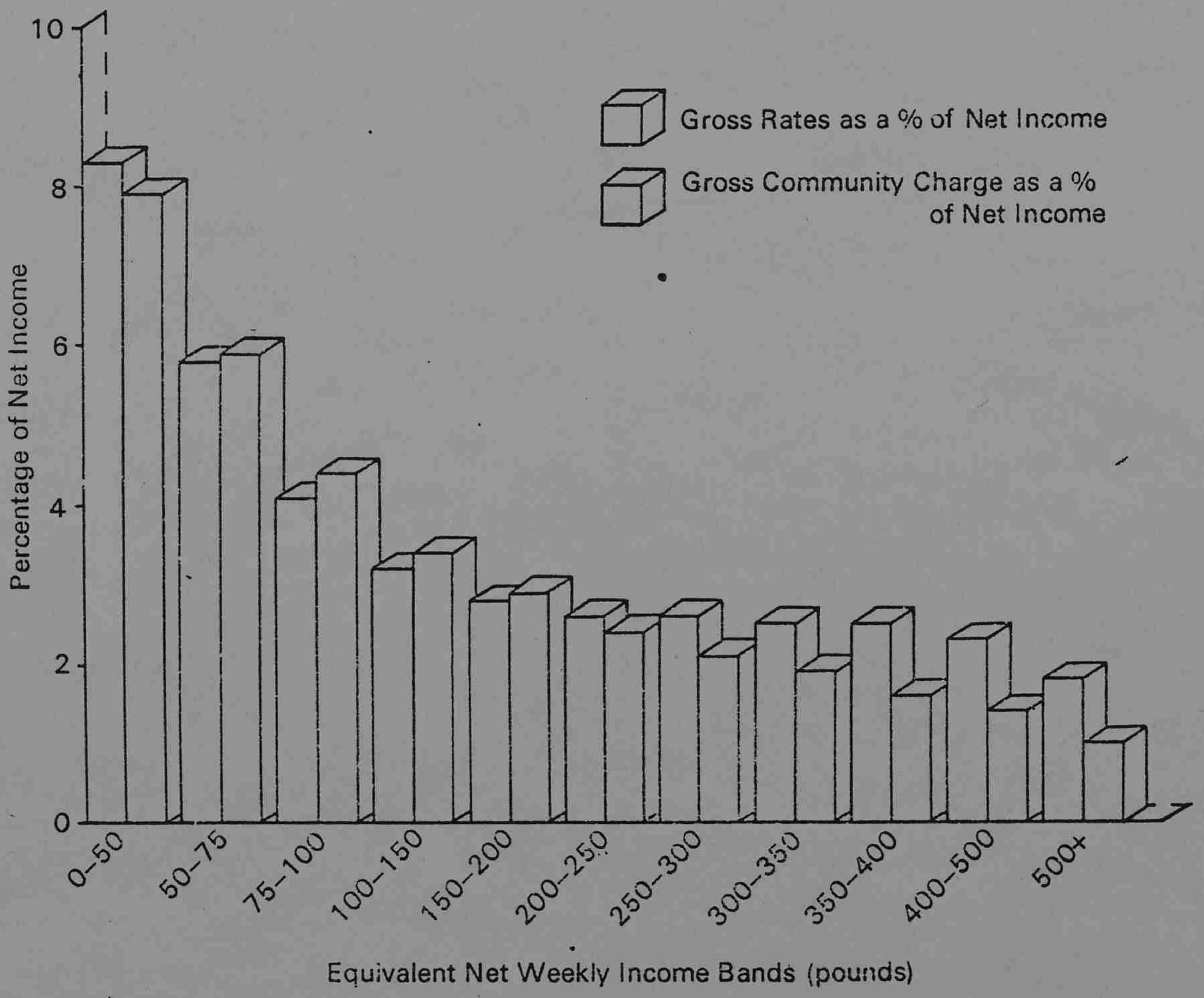


Figure J1: DISTRIBUTION OF AVERAGE DOMESTIC RATES FOR SPENDING AT GRANT RELATED EXPENDITURE
ENGLAND 1984/85