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Intergovernmental financial relations in the United Kingdom

A R Prest

Research Monograph No. 23

Centre for Research on Federal Financial Relations
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A.R. Prest

September 1977

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R.L. Mathews

March 1978
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I INTRODUCTION

In this introductory chapter we shall discuss successively the reasons why a monograph on intergovernmental finances in the United Kingdom is called for, the general way in which it will be organised and the particular emphases and omissions which will be found in it.

Reasons for Monograph

We must emphasise right at the outset that lack of previous discussion is not a reason for writing this monograph. The merest glance at the historical study by G. Rhodes \(^1\) will give some idea of the enormous volume of publications covering this field over the years. To mention some of the most important only, among official publications there are the several reports of the Royal Commission at the beginning of the century, \(^2\) those of a Departmental Committee published in 1914 \(^3\) and latterly the voluminous report of Royal Commissions concerned with local government reorganisation \(^4\) and the massive documentation springing from the Layfield Committee. \(^5\) These reports themselves were based on many individual submissions and much oral evidence. Thus it is reported that the Layfield Committee received over 1,000 submissions in the 18 months or so of its effective working life. So that is evidence enough of the great interest aroused by the subject among a number of very different organisations, groups and individuals.

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\(^5\) Local Government Finance, op. cit. and Appendices 1-10.
If we turn to major legislation in this area, there has been a whole series of Acts of Parliament during the last hundred years, which have modified and changed the pattern of local finance, sometimes in accordance with recommendations made by official committees and sometimes not.

Nor has interest been confined to official levels. Beginning with the path-breaking work of the Webbs and Edwin Cannan, there have been many other books and monographs which have been published. Examples of those published in recent years are easy enough to find.

So there is in the United Kingdom a sustained record of discussion at many different levels over many different periods, even if (inevitably) of very uneven quality, particularly in later years. As the writer has been wont to remark to students: 'most of what there is to be said on this subject is to be found in the Royal Commission Reports of 1901 - and the rest in the Departmental Committee Report of 1914'. That may still be true when this monograph is completed!

And yet ... there are some reasons for arguing that the avalanche of literature has not completely exhausted the topic or the readers. Thus it might be thought that the terms of reference of the Layfield Committee were wide enough to cover everything of relevance; but such is not the case. First, there was a very curious procedure, for reasons known only to God and politicians, by which a really major revision of U.K. local authority boundaries and structure was enacted in 1972 before any discussion of the financing

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6 Principally, those of 1888, 1929, 1948, 1958, 1966 and 1974. This list excludes Acts primarily concerned with local authority boundaries and local authority internal organisation.


9 'To review the whole system of local government finance in England, Scotland and Wales and to make recommendations', op. cit., p. iii.
of the new structure. So before it started to move the Layfield horse was condemned to trail behind a cart that had already travelled a long way.

Secondly, there has for nearly half a century been some kind of regional policy in the United Kingdom. This has taken many different forms at different times, but the crucial point for our immediate purposes is that the impact of public revenues and expenditure has varied from one locality to another not simply on account of policies of local jurisdictions but also because of regional differentials. It follows that if, for instance, one is concerned about the 'equal treatment of equals' in different parts of the country one must pay attention to regional as well as local differentials. Nevertheless, most commentators have paid little or no attention to these interconnections, thereby leaving a very obvious gap in their coverage of the subject.

In recent years, the regional problem has become entangled with that of devolution of power from Westminster to Scotland and Wales. This has raised many far-reaching political and economic issues, the most relevant one for our purposes being the way in which the prospective new regional assemblies are to be financed and the way in which the financing of local authorities will fit into that scheme. Once again, there has not been any co-ordinated description of such matters; the Layfield Report acknowledged that


11 This is just as true of writers on regional matters as of experts in local finance. Thus, to take two examples of many books on regional matters (G. McCrone, Regional Policy in Britain, Allen and Unwin, London, 1969; and A.J. Brown, The Framework of Regional Economics in the U.K., Cambridge University Press, London, 1972) we find no mention of local authority financial affairs; the Layfield Report (op. cit.) has very little to say on regional matters and in the mass of printed evidence there is only one piece (the Liberal Party) which recognises the connected nature of the two topics.

12 The ramifications would be even more extensive if the interest of the European Community in inter-regional differentials within the Community were to increase as a result of the MacDougall Report (Report of the Study Group on the Role of Public Finance in European Integration, Vols. I and II, Commission of the European Communities, Brussels, 1977).

another range of issues then comes up but, in effect, ducked its head and hurried past as quickly as it could. And one can search the various official White Papers on devolution issues in vain for any worthwhile discussion of local authority matters.

On a priori grounds, one would have thought that there were lessons to be learned from the de-centralisation of powers of a unitary government (we avoid the emotive term 'break-up') in much the same way as there are lessons to be learned from the post-war federations which failed (e.g. the British Caribbean and Central Africa). This, in fact, brings us to another more general reason for still one more attempt to distil lessons from British experience. It seems to be assumed by some writers that the public finances of federally governed countries are utterly and entirely different from those of countries with unitary constitutions. We shall argue that this is simply not the case; that, for instance, questions whether grants from superior governments should or do promote equalisation of fiscal capacity on a geographical basis are essentially the same whether a federal structure is involved or not. Therefore lessons to be drawn from British experience during a long period of experimentation may be very relevant for a federal country like Australia despite the constitutional differences.

So, to summarise this section, we must be conscious all the time that there has been a vast outpouring over the years on local authority finances in the United Kingdom. But some of it is more distinguished for size than intellectual content. Very little attention has been paid in the literature to matters of regional policy or devolution of central powers; and practices evolved in unitary states are far from being irrelevant to federal states.

Plan of Monograph

We shall, in effect, operate at two different levels. Chapter II is intended to be a short but self-contained summary of the current local financial position in the United Kingdom. Historically, the financial operations of local authorities have attracted most attention and we shall set those out first. We shall follow that description with a brief account of the current situation and likely developments in respect of the major regions of the country. The hope is that this chapter will bring out the

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By 'unitary' we shall throughout this monograph mean countries with one government which has a clearly established precedence over all other government bodies within the country; that is, we do not imply that there is literally one government only.
major features of the United Kingdom local scene to those who are otherwise unfamiliar with it.

Subsequent chapters will be devoted to exploring particular issues in some detail. It must be made absolutely clear that we shall not attempt to cover everything; we are selecting only those issues which are of most interest. To reduce the width of the gap between the whole wood approach of Chapter II and the subsequent individual tree approach, we shall spend some time in Chapter III discussing some principal themes which come up time after time in British experience, such as Treasury resistance (and the reasons for it) against any ideas of giving more revenue-raising powers to local authorities.

Chapter IV will discuss the system of local property taxation (rates) in the United Kingdom, the major controversies which recur, prospective changes and their advantages and disadvantages. Chapter V will be devoted to the alternative source of local revenue which has received most attention, i.e. a local income tax. This chapter in particular will call for some international comparisons. Chapter VI will set out the major features of the grant system from central government to local authorities, its historical evolution, criticisms of the present system, its prospective development and so on. Finally, Chapter VII will concentrate on the plans for devolution of power to Scotland (and Wales) and the financing thereof.

Emphases and Omissions

One special point must be made at the beginning. The details of local authority structure and financing differ slightly in Scotland and Northern Ireland from that found in England and Wales. We shall be primarily concerned with the latter in our exposition but will make reference to the former at key points as necessary. The same remarks apply to the rather special treatment of London.

Discussion of local finances has attracted a lot of attention in a lot of countries in recent years and as a result many issues have emerged which are a source of animated debate among the cognoscenti. Obvious illustrations are the normative aspects of government organisation - how many different governments should there be in a country and what should be their respective powers and spheres of influence; or can one construct theories of local government behaviour and test them against available data on incomes per head, grants received, expenditure patterns and so on?

15 Emulating the Layfield Report, op. cit., in this respect.
It is beyond the scope of this monograph to enter into these popular current-day pursuits (or should it be sports?).

There is also a number of very mundane topics which we must omit. Very short-term problems arising from the sharp inflation in the early 1970s played a major part in the Layfield Committee's thinking; we shall leave these on one side and concentrate very deliberately on more enduring longer term matters of local finance. Similarly, there is a whole range of issues, connected with budgetary procedures and attempts by such methods as operational research or planning-programming-budgeting-systems to get better value for money, which will be left on one side. Nor shall we be much concerned with the intricacies of local authority debt structure, methods of borrowing and the like.

Finally, when it comes to policies which discriminate geographically but not through local authority financial devices, we shall pay most attention to the question of devolution rather than policies of regional assistance by central government.
We shall take local authority finances first and discuss in succession the structure of local authorities, their pattern of expenditure and the system of financing it. Brief mention will then be made of one or two other characteristics. Up to that point we shall have described the system as it is currently or as it will be, taking into account legislation which has already been passed. Subsequently, we shall review some of the main suggestions which have recently been made for future changes. Finally, we shall say a little about the financial aspects of regional policies in the United Kingdom and the likely financial implications of the devolution proposals for Scotland and Wales.

Local Authority Structure

We shall concentrate initially on the position in England and Wales (excluding London) and then mention briefly how other parts of the country differ. As a result of the Local Government Act 1972, the first majorchanges in local authority boundaries, structure and functions since 1888 came into effect in April 1974.

The main point to grasp about these very new arrangements is that a double distinction underlies them. First, there is a division of functions between two tiers of authorities; the top tier consists of 53 counties and the lower tier of 369 districts. Second, counties are not all equal; nor are districts. Counties are divided into metropolitan counties (covering major conurbations, e.g. the Greater Manchester area) and non-metropolitan, there being six of the former and 47 of the latter. The same distinction applies to the districts in areas covered by counties, so that there are 36 districts in metropolitan county areas and 333 in non-metropolitan

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1 With the exception of the reorganisation of local finance in London in 1965, stemming from the London Government Act 1963.

2 There is, in addition, one single-tier authority for the Isles of Scilly.
county areas.3

The division of functions between upper and lower tiers is tied in with the metropolitan/non-metropolitan distinction. Whereas counties are responsible for some 85 per cent of combined county and district expenditures in non-metropolitan areas, it is the other way round with metropolitan areas, where the districts take up some 80 per cent of the combined total. The difference in spending patterns occurs because such major functions as education, personal social services and libraries are associated with metropolitan districts but with non-metropolitan counties. Many functions (e.g. land planning) are shared between county and district. Although there is a vague distinction between strategic responsibilities (allocated to counties) and the remainder, the arrangements leave a great deal to be desired if there was ever any intention of minimising bickering and recrimination between the different levels.4

It should be added that the new structure was in no sense one which minimised differences between authorities in respect of population, geographical area, etc.5 Inevitably, it was the outcome of previous boundary drawing and a great deal of pressurising, lobbying and the like. At the same time the reform was a very substantial one, with the number of authorities being reduced from over 1,400 to just over 400.

London is also governed by a two-tier system, the Greater London Council being at the top; 32 metropolitan boroughs and the City of London complete the picture. The division of functions between the two tiers differs from that found elsewhere in England and even differs between inner and outer London in respect of education (outer London boroughs, but not inner ones, being their own masters in this respect). But we shall not go further into these details.

Scotland was a year behind England and Wales in the

3 There is in fact a still lower form of local life (parish councils in England, community councils in Wales) but their functions are not sufficiently important to need description here.
4 For a short account of the high danger points see N.P. Hepworth, *op. cit.*, Chapter 1; a full account of the functional division is to be found in *ibid.*, Appendix 1.
reorganisation process, but when changes came in 1975 they took a simpler form. Although the double tier structure is found throughout Scotland, the metropolitan and non-metropolitan distinction is missing. The upper tier, called regions, is responsible for 85 per cent of the combined total of expenditure of regions and districts and so resembles the non-metropolitan parts of England and Wales. Finally, Northern Ireland is different again in consisting of one purpose authorities only (26 in all).

Local Authority Expenditure

Details on U.K. local authority expenditures can be obtained from two main sources: the local government financial statistics for the different constituent countries and the U.K. National Accounts. Our main emphasis will be placed on the latter in that it is a combined set of figures and is also more up to date. But we shall refer to the former where necessary.

Taking local authority current expenditure first, we find that it was of the order of £15 billion in 1976, compared with a central government total of current account expenditure (less grants to local authorities) of £36 billion and a G.N.P. total of some £123 billion at market prices. By far the most important constituent was education which absorbed about one-third of the total, the exact ratio depending on whether one treats housing expenditure as a trading activity rather than as 'general' expenditure. Other functions include personal social services, police, fire, environmental services etc.

Capital expenditure was a little over £4 billion in 1976 (compared with central government a little over £1 billion). It can therefore be seen that in this respect local authorities play a greater role relatively to central government than on current account. This reflects their participation in all kinds of building activity, from houses to schools, street works, sewerage, highways, etc., sometimes with their own direct labour force and sometimes through contractors.)

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6 Apart from three island areas where there are single authorities.

7 Data are available from other sources, such as the annual White Paper on Public Expenditure, but we shall not refer to these other sources here.

8 There is in fact a number of trading activities but, housing apart, the only ones of any importance at all are passenger transport and corporation trading estates and even they are rather minor (Layfield Report, op. cit., pp. 134-5, shows the details).
There have been conflicting influences on local authority expenditure over the years. On the one hand, there has been a strong pressure to increase expenditures in real terms on such major items as education and housing; on the other, local authorities have lost a number of the trading services for which they were formerly responsible (e.g., electricity, gas, some passenger transport, some water) usually to new nationally organised bodies though, in form at any rate, independent of central government. Other 'general' functions which have been largely taken over by organs of central government have been poverty relief and health. But the net result is still a substantial growth in real terms over the years, whether one takes a base date before or after World War II, though a smaller rate of growth than that of central government.9

Local Authority Revenue

On the revenue side, the constituents on current account are central government grants (about £9 billion in 1976), rates (£4½ billion) and trading and property income (£2½ billion). Borrowing for capital purposes takes a number of different forms - partly from central government, partly from market sources in the U.K. and partly from overseas. But it must be clearly understood that, very short-term situations aside, borrowing can only be for capital, as distinct from current, purposes. Deficit budgeting as commonly understood is not an option open to local authorities in the United Kingdom.10 Historically, the most important change has been the growth of grants relatively to the other two forms of revenue. Whereas thirty years ago each source contributed about one-third of the total, the grants total is now greater than the other two combined.11 There have been many changes in the constituent elements of borrowing, depending on central government policy at different times, but we do not propose to describe them here.

What we now have to do is to explain in some detail the constituents of the revenue total. Beginning with rates, we should note that this is an ancient form of tax linking directly with the

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9 For further details, see Layfield Report, op. cit., Annex 10.
10 The opposite policy, that is generating a surplus on current account, is permissible and indeed inescapable in the sense of setting aside sufficient funds annually to repay loans and compensate for depreciation of capital assets.
Poor Rate of the seventeenth century and, more indirectly, with even older taxes. Rates in their modern form are paid on the 'ratable value' of property which is, in principle, equal to the yearly rent which would be acceptable to landlord and tenant, on the assumption that the latter pays for insurance, repairs to the property and maintenance generally.

Ratable values are determined in England and Wales at intervals of time by the Inland Revenue valuation department; the nominal interval is five years but in fact there have only been three revaluations since World War II. The date for the next one recedes further into the distance every time anyone asks about it. The general procedure is to make a judgment about a reasonable gross annual value based on the assumption that the landlord bears costs of repairs, etc. and then to make (somewhat arbitrary) deductions to arrive at a figure corresponding to ratable value. Having obtained a measure of ratable value, the actual amount of rates payable in a year is derived by applying a rate poundage which varies from year to year depending on the financial needs of the local authority concerned. Thus a house might have a ratable value of £600 and if the rate poundage is fixed for the year at 75 p. in the £ the rates actually payable would be £450 that year (usually in instalments, at the very least two instalments each of £225 and perhaps as many as ten instalments each of £45).

So one distinguishing characteristic of the U.K. system of local property taxation is that it is based on rental rather than capital values. Another is that it is a tax levied on occupation and not on ownership; historically, this meant that if a property was unoccupied no rates were payable, but this position has been modified somewhat in recent years. It should also be understood that the tax applies to a wide range of commercial, industrial and other properties as well as to domestic ones and in fact the latter only contribute about 50 per cent of the total ratable value of the country. It is therefore totally misleading to think of the whole of the tax as being directly imposed on tenants and owner-occupiers of houses.

One must note a number of exceptions to the idea that rates are a tax applying in a uniform manner to all kinds of immovable property. The most important example of de-rating is that of agricultural land and buildings, which for many years have been fully de-rated. Charities are 50 per cent de-rated; Crown properties are not ratable in law but the distinction there is a purely formal one in that they make equivalent contributions in lieu. Until recent years, all types of property in a given area were charged at the same rate percentage, but since 1967 there has been a differential element in that domestic ratepayers are now charged at a lower rate than non-domestic. The economic, as
distinct from the political justification for this concession is not easy to formulate and we shall have occasion to discuss it again in Chapter IV. Another subject to which we shall return is the vexed question of the buoyancy of rates as a tax. All we need to do at the moment is to note that between the last two revaluations, in 1963 and 1973, the compound annual rate of growth of ratable value was $12\frac{1}{2}$ per cent for all types of property in England and Wales.\(^{12}\)

It should be noted that counties are not rating authorities as such and they finance themselves by making demands (known as 'precepts') on the districts in their area. The component units of the lower tier therefore levy rates both to finance their own expenditure and to meet the demands of the upper tier. This does not make for clarity of exposition to the taxpayer, as can be seen from Appendix A to this chapter, which reproduces the explanation of the rate levied by a London borough in 1977-78. This particular rate demand notice is in fact further complicated by an equalisation scheme unique to the London area.\(^{13}\) However, even if this is left out of account, one could hardly blame a ratepayer who was unable to answer a question on how much of his payment was to the lower-tier and how much to the higher-tier authority. This is another subject to which we shall return.

Finally, we should make it clear that the description above only relates in its entirety to England and Wales. The main ways in which the system in Scotland differs are:

(a) valuations are the responsibility of local assessors and not the Inland Revenue;

(b) revaluations have been more frequent;

(c) there are no precepting arrangements but, for convenience, the regional authorities collect both demands together;

(d) industry is still de-rated by 50 per cent.

\(^{12}\) There are in fact further complications, in that the domestic differentiation is greater in some areas than others (e.g., Wales compared to England). And there is, in addition, a scheme of rate rebates whereby local authorities make concessions to domestic ratepayers on a means-tested basis. See Layfield Report, op. cit., p. 148.

\(^{13}\) See below, p. 16.
The next topic is the grants component of local authority revenues. In one form or another, central government grants have played a role in local authority budgets for many years, even though in earlier years it was a much more limited one. Towards the end of the nineteenth century, there was an attempt to introduce a system of assigned revenues (i.e. earmarking specific central revenues for local use) into the U.K. system, but for various reasons it was not a very satisfactory innovation. The next major change was in 1929 when for the first time block grants, not tied to specific expenditures, made their appearance. There have been many changes since that date but their broad direction has been towards increasing the role of block grants and diminishing that of specific grants.

The main basis for the present system is an Act of 1967, which introduced the notion of a Rate Support Grant. This is by far the most important constituent of the grant system today. The major part of the grant (about 90 per cent) is of a block nature, the remaining 10 per cent being a 'domestic element' designed to compensate local authorities for the loss of revenue due to the partial remission of rates in respect of domestic ratepayers.\textsuperscript{14}

The main part of the grant is in turn divided into two subparts - a needs element and a resources element, the former being about twice the size of the latter. The needs element is designed in principle to compensate authorities in England and Wales (Scotland being slightly different) according to needs as measured by a number of indicators - primarily population but also other ingredients such as numbers of children, numbers of old people, housing factors and so on. The exact formula is very complicated and very changeable, e.g. a damping factor based on previous year allocations was introduced in 1976-77. Regression analysis became the basis for it in 1974 but, as we shall see later, this would seem to be no more than a veneer, the number of 'judgmental corrections', to use the politest of phrases, being legion.

The other element in the rate support grant is the resources element. The general idea here is to compensate authorities which are deficient in financial resources rather than overburdened with needs. The precise mechanism in England and Wales (Scotland again being slightly different) is to calculate a national standard ratable value per head; then the central government acts as a ghost ratepayer so as to bring all authorities below the national ratable value average per head up to that average, i.e. if the national average figure is £x and ratable value per head for any one authority is £y, a grant is paid on the basis of £(x-y) multiplied by its population. Two further points should be noted.

\textsuperscript{14} See above, p. 11.
The relevant poundage to apply to the 'ghost' ratable value is that being charged by that particular authority. So it follows that the higher the local poundage, the greater the amount of grant per head for any given ratable value deficiency. Secondly, the process is asymmetrical in the sense that those authorities with ratable values per head above the standard figure (mainly in London, in fact) do not suffer negative grants.

We said earlier that the rate support grant was by far the most important component of all grants paid. The measure of its importance depends, however, on a curious point of definition. If we confine ourselves to what are called grants in official terminology, we find that rate support takes up something approaching 90 per cent of the total, the remainder consisting of a series of specific grants (police being by far the most important)\(^\text{15}\) and what are called 'supplementary grants' (very largely for transport purposes). The main difference between the specific and supplementary categories is that the former are open-ended\(^\text{16}\) whilst the latter are in effect not so.

For reasons which, one suspects, are buried in a misleading analogy with the misleading distinction between direct and indirect taxes, the large sums paid from central government to local authorities for housing purposes are classified as subsidies and not as grants. We do not propose to discuss the exact basis on which such subsidies are paid,\(^\text{17}\) but merely remark that they are of the same order of magnitude as specific grants each year. Therefore, if they were included in the total, the share of the rate support grant would drop to something approaching 80 per cent. But having made this point, we shall confine ourselves to grants as officially defined in the remainder of this chapter.

The next subject is the determination of the total amount of grant each year. This is a tortuous matter, far more reminiscent of haggling in the inner recesses of the bazaar in Istanbul than of the market economics of Adam Smith. Very briefly, and with some deliberate simplification, the process is to determine 'relevant expenditure' of local authorities which in turn is current expenditure from the rate fund account less fees and charges and less whatever excuses the government can think of for cutting it down further. The total grant is then determined by applying a percentage to the expenditure total - but the percentage is itself

\(^{15}\) For more detail, see Layfield Report, \textit{op. cit.}, p. 455.

\(^{16}\) That is, no formal overall total is set by the central government.

\(^{17}\) See N.P. Hepworth, \textit{op. cit.}, pp. 169 ff, for an account of recent legislation governing these outpayments.
liable to be pulled alternately upwards and downwards as a result of local authority and central government pressures. Once the total grant is determined, deductions are made for the domestic element of the rate support grant and for supplementary grants, these being unambiguously determined at central government level; and an estimate of the specific grants total is deducted. Finally, we come to the division between the resources and needs elements. In a sentence which would seem to be a leading contender for the supreme understatement to be found in all the books in the Library of Congress, the Layfield Report declared:

'The balance struck between the needs and resources element depends on the exercise of a political judgment'.

What seems to happen, if some of the details are omitted, is a trial and error process of allocating so much to the needs total, seeing what the effect would be for the national standard ratable value per head (the level of which would need to be adjusted to make the residual amount available fit the resources element formula), look at the effects on local authorities, individually and by groups, anticipate the howls of rage which would come from any losers in the game, and then carry on repeating the calculations on somewhat different bases until one finds a 'satisfactory' solution in the sense of causing least offence to the least number of authorities. In brief, everyone must have a prize.

A few other points are worth recording about grants procedures. The determination of the level and composition of the rate support grant is an annual process, usually resulting in a determination in November each year of the grant for the financial year commencing in the ensuing April. Increases are subsequently made for changes in pay and prices which take place after November when the original figure was determined. Latterly, these increases have been constrained by the system of 'cash limits' which has been imposed as a general means of keeping down the level of government expenditure in the U.K.

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18 *Ex-ante*, it can only be an estimate insofar as these grants are open-ended. More generally, see Layfield Report, Appendix 2, *op. cit.*, pp. 470 ff. for an amount of the negotiating procedure.


As the reader might suspect by this stage, there is no simple system such as paying each type of grant to each authority with any claim on it. In England and Wales, the needs element is paid to non-metropolitan counties and metropolitan districts (including London boroughs) only; the expenditure needs of other authorities have to be met on a 'pass-through' basis. On the other hand, the resources element is paid to all districts which qualify (including London boroughs) but not to counties at all; the counties precept on the districts as they deem appropriate. Once again, we have a system which can only be understood in terms of historical development rather than logical arrangement. Mercifully, the situation is much simpler in Scotland with, broadly, all authorities receiving needs and resources elements in their own right.

Finally, it should be mentioned that there is a further degree of complication in London, with an element of horizontal redistribution from inner London boroughs (including the City) to outer London boroughs.21

We must for the sake of completeness refer to the third source of local authority revenue, i.e. trading and property income. Historically, this was extremely important but with the whittling away of commercial functions of local authorities over the years it is much less so today. In terms of total receipts from this source, housing is far the most important, though it could be argued that such revenue is sui generis and not really to be compared with operations which are meant to be of a commercial character. One or two prospective developments in this area should be noted. As a temporary arrangement, rating authorities are collecting charges on behalf of new water authorities set up in 1974; it cannot be expected that this situation will last long.22 On the other hand, as a result of the Community Land Act of 1975 the expectation is that eventually local authorities will have a monopoly of land purchases for development purposes and will be able to realise substantial profits by buying at current use value and selling at market (development) value. It is provided in the legislation that 40 per cent of such profits will go to the central government, 30 per cent to the local authority generating the surplus and 30 per cent to other local authorities.23

22 Once again, Scotland is different.
Procedural Matters

It would take us too far afield to discuss the details of procedural arrangements for local authority finance, but there is one general point of great importance. It should not be thought for one fraction of one second that there is not a whole host of ways, other than those already mentioned, in which local authorities can be influenced, steered and nudged by central government. Some are on a formal basis - whether by statute, by circular from a Ministry (e.g. about rules for performing certain services), by the loan sanction system (whereby authority to raise finance for a capital project must be given by the relevant Ministry), by inspectorates (e.g. for schools) or by auditing procedures. Some are much more informal - such as in the grant negotiations on the recently established Consultative Council which provides for regular meetings of local and central representatives. Overall, there is no danger whatever that central wishes, ideas and prejudices will not register with local authorities. The more cynically minded might be inclined to contend that it is only the fact that such methods of 'persuasion' have grown and multiplied over the years that has permitted the long-term changeover from specific to general grants.

Potential Changes in Local Authority Finances

The most important changes under discussion spring from the Layfield Report and the Government's reactions thereto.\textsuperscript{24} We shall give a brief account of the main issues under discussion, developing some of them further in later chapters. Before doing so, however, one other potentially important proposal should be noticed. In the October 1974 general election, the Conservative Party proposed the abolition of domestic rates. As far as is known, this is still their policy and if that remains the case and the Conservatives win the next election, this will create a new situation for those engaged in local authority financial reform. But we do not propose to speculate further in this monograph about such possibilities.

The following were the major propositions and proposals of the Layfield Committee:

(a) The fundamental weakness in present arrangements was said to be a lack of accountability. This is a slippery concept and the Committee gave the appearance of being

more concerned to talk round it than to formulate it with any precision. The most plausible interpretation is that the Committee felt that the link between taxing and spending decisions was tenuous, if not invisible on many occasions - the very opposite, if one can put it that way, of the famous Wicksell principle that expenditure and revenue decisions must always be taken simultaneously. Such features as the overall ratio of grants to expenditure, the lack of direct linkage between some spending authorities and the grant-giving authority and the system of indirect rating demands (precepting) all contributed to this lack of complete and proper accountability.

(b) The Committee, subject to one note of reservation, felt that a parting of the ways had been reached. *Either* the system could move in a more centralist direction with local authorities becoming little more than agencies of central government; *or* it could move in a more localist direction which would mean a major accretion to locally raised revenues and a corresponding reduction in grants. The note of reservation by Professor Day (with partial support from Professor Cameron) took the view that a compromise between these two polar extremes was possible on the lines of central identification of and support for minimum standards of services, with local 'topping-up' from local revenue sources, if so desired. The divergence between the majority and minority views stemmed from disagreements about the ease of identification and measurement of minimum standards.

(c) The need to retain a local property tax was accepted but various suggestions were made for improving the present system: notably the general re-rating of agriculture and the transformation of the base for valuation of domestic property from rental to capital values in England and Wales.

(d) Many possibilities for raising more local revenue were explored, the favourite being a local income tax. There was also some feeling in favour of a review of local authority fees and charges for services performed.

(e) The block grant principle was endorsed but the idea of integrating the present resources and needs elements of rate support into a unitary grant was favoured. Various other proposals such as taking local incomes (as distinct from ratable values) into account for levelling up purposes, streamlining the flow of grants and so on were also made.

18
(f) There was a large number of other recommendations on matters of detail, procedural issues and so on but we shall omit these for brevity.

The Government's response came in May 1977:25

(a) As might have been predicted, the need for a clear choice between a more centralist and a more localist solution was side-stepped by a series of woolly platitudes about the need for both central and local views to be heard.

(b) The general notion of simplification so that ratepayers could understand what was happening and cast their votes on an informed basis was endorsed.

(c) The retention of the rating system was endorsed and the need to change the basis of domestic valuation in England and Wales was accepted - but not the proposal for the re-rating of agriculture.

(d) The local income tax idea was rejected, largely on grounds of administrative costs.

(e) The idea of the unitary grant was welcomed but not that of adjustments for differences in personal income levels; specific and supplementary grants were to be retained.

(f) Among other miscellaneous changes, one of the most important was a proposal for simplifying the present system of controls on capital expenditure.

As we have said, we shall come back to some of these issues in much greater detail later; all we are doing in this section is to give a general picture of possible developments in the nearer future. One final point should be added. The Layfield Committee was not much concerned with housing finance, even though this is a major local authority activity. In 1977 the Government published a document26 setting out its views on housing policy generally. The upshot is that the extensive and expensive subsidy program to local authority tenants is to continue, though with some changes in the basis on which payments are made from central government to local authorities.

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25 Cmd 6813, op. cit.

Regional Policies

We made the point earlier that some have fallen into the trap of discussing geographical differentials purely in terms of local authority ratable values and central government grants to local authorities. It is quite clear that this canvas is far too restricted. Levelling devices among local authorities might result in equal treatment of equals in cities A and B but not compared to city C; this would happen if cities A and B happened to be in one region and city C in another and there were differential transfers from central government to regions totally separate from those to local authorities.

Such in fact has been the position in the United Kingdom for many years. Starting in the 1930s there has been such a growth in the variety and total of regional assistance over the years that it would be out of the question to describe it in detail here. One leading authority on the subject has classified assistance in the following forms:

(a) financial measures - grants, loans, tax relief, subsidies, etc. to producers and factories (e.g. special grants for those building factories in particular areas, wages subsidies in some areas, grants to unemployed to undertake retraining);

(b) regionally directed public expenditure on goods and services (provision of infrastructure, angling of defence contracts to particular areas);

(c) negative controls (licences to build new factories granted in some areas but not others).

It should be understood that the machinery for assistance of these kinds has been totally different from the local authority one, there being regional offices of the main departments of State, local advisory councils (central government appointees) and so on.

Unfortunately, there is no means of putting the equalising tendencies of this mechanism in perspective against those operating through local authorities. There are both conceptual and empirical difficulties standing in the way of any such overall assessment. But there can be no doubt that there is very considerable regional differentiation due to public expenditure patterns, over and above that which is implicit in the pattern of grants to local

authorities. Regional equalisation would seem to be much more a function of the expenditure side then of the revenue one, as it would appear that revenue assistance makes little or no impact when taken as a whole.

Devolution Proposals

It can be argued that local authorities are governments in their own right, and that transfers between central and local governments are therefore a different and distinguishable subject from those made by central government direct to individuals because they happen to live in particular areas. In one case we are dealing with matters of multi-level government; in the other with single-level government. Therefore, it might be said, the preceding section on regional redistribution should not appear in a monograph concerned with intergovernmental financial relations.

Matters are not as clear-cut as that, however. It seems highly likely that before very long there will be some regional levels of government in the United Kingdom - especially Scotland but very possibly Wales as well. This will mean that various functions of the central government will be transferred to the new Scottish and Welsh elected Assemblies; this immediately raises a number of new financial questions. There will be first the relationships between Westminster and Edinburgh (or Cardiff), e.g. the assessment of any grant from the U.K. Exchequer to undertake devolved functions. Then there is the question of separate revenue-raising powers for

28 A.J. Brown, op. cit., p. 64. Data (relating to 1964) are given for the effects of transfers in cash, expenditure on goods and services which is explicitly beneficial to regions and that which is implicitly so. See also V.H. Woodward, *Regional Social Accounts for the United Kingdom*, National Institute of Economic and Social Research, Cambridge University Press, London, 1970.

29 Report of Study Group on the Role of Public Finance in European Integration, op. cit., Volume II, Chapters 5, 8 and 9 show that for the U.K. there was (in 1964) a very considerable redistribution of purchasing power between regions as a result of public expenditure policy (whatever the precise measure of redistribution) but virtually none from the revenue side.

30 There is a previous history of regional government in the U.K., involving Northern Ireland, but we shall not discuss that at all as it does not form part of the current devolution proposals.
the Assemblies and whether room is to be created at the national level (e.g. a regional surcharge on income tax) or at the local level (e.g. a regional surcharge on local rates). Then there is the relationship between regional and local finances: on what basis will any grants from centre to region be passed through to the local level, for instance?

There is obviously a whole host of questions here, the answers to which must necessarily be speculative at this stage. What cannot be said, however, is that they fall outside the subject of intergovernmental financial relations, even if they do involve other matters such as regional economics. It is for this reason that we shall return to this subject in a later chapter, rather than proceeding further with the discussion of U.K. regional public sector redistribution as such.\(^{31}\)

\(^{31}\) It might be thought that one should also bring the European Communities into the picture too, especially in view of all the proposals in the recent two-volume report on public finance and integration (MacDougall Report, \textit{op. cit.}). But there is no proposal as yet that the European Communities should have powers to deal directly with the prospective Assemblies; any regional aid from the Communities would be channelled through the U.K. Government. And we certainly regard financial arrangements between the European Communities and the United Kingdom as outside the scope of this monograph.
The Council of the London Borough of Merton have made a General Rate in respect of the year ending 31st March 1978. Details are given below of the amount in the pound levied, the reduced rates payable on dwellings and mixed hereditaments and details of the requirements of the Borough Council, precepting Authorities and the Sewerage and Services Charge of the Thames Water Authority.

<table>
<thead>
<tr>
<th>PARTICULARS</th>
<th>RATE REQUIRED FOR</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>London Borough</td>
<td>Greater London Purposes</td>
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<tr>
<td>Estimated Product of a 1p Rate £</td>
<td>286,000</td>
<td>18,700,000</td>
</tr>
<tr>
<td>Administration of Justice</td>
<td>.08</td>
<td></td>
</tr>
<tr>
<td>Baths</td>
<td>1.41</td>
<td></td>
</tr>
<tr>
<td>Cemeteries and Crematorium</td>
<td>.36</td>
<td></td>
</tr>
<tr>
<td>Education</td>
<td>68.81</td>
<td></td>
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<td>Fire Service</td>
<td>2.71</td>
<td></td>
</tr>
<tr>
<td>Highways and Bridges</td>
<td>2.37</td>
<td></td>
</tr>
<tr>
<td>Housing</td>
<td>8.57</td>
<td></td>
</tr>
<tr>
<td>Land Drainage</td>
<td>.56</td>
<td></td>
</tr>
<tr>
<td>Libraries</td>
<td>2.43</td>
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<tr>
<td>Public Transport</td>
<td>5.01</td>
<td></td>
</tr>
<tr>
<td>Petty Sessions and Probation</td>
<td>.24</td>
<td></td>
</tr>
<tr>
<td>Recreation and Arts</td>
<td>.92</td>
<td></td>
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<td>Public Health</td>
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<td>Police</td>
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<tr>
<td>Refuse Disposal</td>
<td>1.05</td>
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<tr>
<td>Social Services</td>
<td>17.29</td>
<td></td>
</tr>
<tr>
<td>Town Planning and Development</td>
<td>.91</td>
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</tr>
<tr>
<td>Other services and expenses</td>
<td>3.11</td>
<td></td>
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<tr>
<td>Contingencies</td>
<td>.04</td>
<td></td>
</tr>
<tr>
<td>Provision for Balances</td>
<td>.05</td>
<td></td>
</tr>
<tr>
<td>GROSS RATE</td>
<td>136.98</td>
<td>25.49</td>
</tr>
<tr>
<td>DEDUCT in respect of:</td>
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<td></td>
</tr>
<tr>
<td>Housing Subsidies</td>
<td>16.19</td>
<td>5.45</td>
</tr>
<tr>
<td>Other Government Grants (excl. Rate Support Grant)</td>
<td>3.64</td>
<td>2.56</td>
</tr>
<tr>
<td>Appropriation from Balances</td>
<td>2.72</td>
<td>1.38</td>
</tr>
<tr>
<td>SUB-TOTALS –</td>
<td>114.43</td>
<td>16.10</td>
</tr>
<tr>
<td>ADD Lump Sum Precept:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Merton and Sutton Joint Cemetery Board</td>
<td>.07</td>
<td>19,200</td>
</tr>
<tr>
<td>N.E. Surrey Cremation Board</td>
<td>NIL</td>
<td></td>
</tr>
<tr>
<td></td>
<td>139.54</td>
<td>39,908,000</td>
</tr>
<tr>
<td>DEDUCT in respect of:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Greater London Rate Equalisation Scheme</td>
<td>.63</td>
<td>178,860</td>
</tr>
<tr>
<td>Rate Support Grant (Needs Element)</td>
<td>60.91</td>
<td>17,421,140</td>
</tr>
<tr>
<td>NET GENERAL RATE</td>
<td>78.00</td>
<td>22,308,000</td>
</tr>
<tr>
<td>Sewerage and Services Charge for the Thames Water Authority</td>
<td>4.90</td>
<td>1,303,000</td>
</tr>
<tr>
<td>TOTAL RATE IN THE POUND</td>
<td>82.90</td>
<td>23,611,000</td>
</tr>
</tbody>
</table>

NOTE ON RATE SUPPORT GRANT

There are three "elements" to this grant.

(1) Needs element — is shown above as a direct credit against the gross rate levy. This is the most important element in terms of cash received.

(2) Resources element — A Council is required to take this into account when computing its estimated product of a 1p rate. This element is payable only to those authorities whose rateable resources are less than a national average. In 1977/78 Merton will not benefit from this element of the grant.

(3) Domestic element — domestic ratepayers and occupiers of mixed (i.e. partially domestic) property benefit by deduction of a poundage from the standard rate in the £. For 1977/78 the deduction is 18½p for domestic and 9p for mixed properties. The Council are reimbursed the aggregate amount of such deductions directly by Her Majesty's Government.

THAMES WATER AUTHORITY - CHARGE FOR SEWERAGE AND OTHER SERVICES

From the 1st April 1974 the responsibility for sewerage, sewage disposal and pollution control was transferred to the Thames Water Authority and the cost of these services will no longer be met from the general rate income of the Council. However because of the difficulties of making other arrangements the Water Act 1973 provides that the Council will continue to collect the charge for these services with the general rate and pay it over to the Thames Water Authority. The charge to Merton of £1,303,000 is shown as a rate of 4.9p in the £ in the panel above.

23
'On the face of it the history of local government finance from 1918 to 1966 is a history of recurring themes and arguments which never seem quite to be finally settled. Although at each stage some people at least express confidence that the main problems have been resolved, always within a few years the same arguments as before seem to recur.'1

'The character of the problems reviewed in 1902, 1911, 1918, 1922, 1925 and 1929, to cite only a few occasions, bears a strong family likeness to the present.'2

Given statements of this kind, there would seem to be no need for any apology for devoting a chapter to recurrent themes. Some of these themes - in particular, that despite all the criticisms over the years rates are still there as the only source of local authority taxation and that despite the perpetual cries about domination of local authorities by central government the percentage of local expenditure which is grant-financed has continued to increase3 - will be explored in detail in subsequent chapters. We shall therefore devote this chapter to various other topics: conflicts of interest; Treasury control; the search for additional sources of local revenue; the influence of short-term considerations; the insularity of outlook.


2 Layfield Report, op. cit., p. 33.

3 As Rhodes put it, '... two paradoxes ... run through this whole period. The first is that, despite all the complaints about rates and the rating system, the system remained as firmly established at the end of the period as it had at the beginning as the only independent source of revenue for local authorities. The second paradox is that a constant theme of much argument has been that local government was becoming too dependent on government grants, and yet the underlying tendency throughout these years has been for the grant income of local authorities to increase more rapidly than their income from rates.' Op. cit., para. 132.
Conflicts of Interest

The conflict of interest on which most commentators have fastened is that between central government and local authorities. Thus there is a perennial cry that local authorities have been losing out to central government both through a reduction in the number of functions they perform and through a diminution in the degree of independence left to them in such functions as remain. Much the same representations were made at the time of the Poor Law reform of the 1920s, the nationalisation of public utilities in the 1940s, and the further loss of functions in later years (such as water in the 1970s). And it was a common complaint from local authorities in the early 1920s that they needed more help to meet the national or 'onerous' obligations placed on them which the Royal Commission at the turn of the century had so clearly distinguished.

The Layfield Committee got to grips with these matters very early in the Report - in Chapter 1, to be precise. The local authorities complained that they had only one effective source of revenue and one, moreover, in which the elasticity of tax yield with respect to money income changes ('buoyancy') was relatively low. They also felt that the central government tried to have it both ways: encourage them in one minute to spend more on the development of particular services and censure them in the next for increasing expenditure. The central government in turn was insistent that local authority spending in recent years had increased much faster than warranted by GNP increases and much faster than forecast in public expenditure plans - that in a nutshell it had been out of control.

But the general nature of this confrontation is so well known that we need not document it further. It may be more enlightening to turn our attention to other sources of conflict which are not quite so well known but are nonetheless very real ones. First, there is the running battle between government departments with their very divergent interests. Thus in the 1920s it is recorded that the Treasury was at one time pressing hard for a general block grant but that Home Office arguments were so powerful that police expenditure could not be included in it.

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5 G. Rhodes, op. cit., para. 16.
6 Ibid., para. 39.
(It is worth noting that to this day police expenditure is outside the rate support grant system.) It is also recorded\(^7\) that there was long-continued opposition right up to the 1940s to the idea of a uniform nationally administered Inland Revenue System of valuation for rating purposes, even though the deficiencies of local valuation had been pointed out as far back as the 1901 Royal Commission.\(^8\) (The Inland Revenue still does not cover rating assessments in Scotland.)

As Rhodes\(^9\) put it:

'As was evident in the lengthy discussions of the 1920s any proposals for reform of the system of local government finance which were devised within government had to try to meet the requirements of three different kinds of departmental views: (i) the view of the department concerned with the development of local government generally; (ii) the view of departments concerned with particular services; (iii) the view of the department concerned with public finance generally.'

Given such an array of conflicting interests the marvel is that any decisions of any kind are ever taken, rather than that lengthy periods are necessary before they can be reached.

But it should not be thought that it is only within central government that major conflicts of interest arise. A similar, if not worse, situation arises with conflicts between different local authorities - rural v. urban, England v. Wales (or Scotland), London v. other big cities and so on. As a result, it has been a central feature of grants settlements that, whatever fine sentiments and fundamental principles might be enshrined in the relevant Act of Parliament, no one group of local authorities should ever lose too much (or gain too much) from grants revisions. Thus in 1929 it was felt important to compensate authorities for losses of previous revenue due to industrial de-rating, disappearance of assigned revenues and agricultural de-rating.\(^10\) It is openly admitted,

\(^7\) Ibid., para. 44.

\(^8\) Cd 638, op. cit.; Report of Sir E. Hamilton and Sir G. Murray, p. 145. The reform of valuation was described as 'imperatively necessary'. Valuation was one of the subjects (rating incidence being the other) to which the then Chancellor of the Exchequer, David Lloyd George, directed the attention of the 1914 Kempe Committee, Cd 7315, op. cit., 1914.


as we have seen,\(^{11}\) that the regression formula introduced in 1974 for the purpose of allocating the needs element is doctored to make the results 'look right'. And a fundamental disagreement about the relative amounts of needs element paid to the more urban and the more rural areas was obvious when the Association of Metropolitan Authorities and the Association of County Councils met together in July 1977.\(^{12}\)

Finally, the enduring conflict between local ratepayers and their authorities is hardly surprising. If one compares the list of complaints recorded by the Royal Commission of 1901\(^{13}\) with that noted by the Layfield Committee\(^{14}\) - that local authorities are extravagant, that rates are an unfair tax and so on - one might be forgiven a slight feeling of déjà vu.

So although the enduring nature of the conflict between central and local government is understandably the best known and best documented, it is but, to quote the famous phrase of Alfred Marshall, 'the leading species of a large genus'.

Treasury Control

'The Treasury view' in the context of local authorities has been stated on a number of occasions.

Thus in Treasury evidence to the Royal Commission on Local Government in the late 1960s it was stated:\(^{15}\)

'The need to exercise closer control over the expenditure of local authorities as a whole is not easily reconciled with the need to give them greater individual freedom to determine both their total expenditure and its distribution between services.'

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\(^{11}\) See p. 13 above.

\(^{12}\) The Economist, 30 July 1977.

\(^{13}\) Cd 638, op. cit., p. 11.

\(^{14}\) Op. cit., Ch. 1.

And the Layfield Committee quotes the opening statement of the Treasury evidence to it:  

"From a Treasury standpoint the most important current problem in the field of local government finance is that of reconciling freedom for individual local authorities with the responsibilities of central government for economic management and for determining priorities in public expenditure."

There would appear to be two different strands in the Treasury insistence on the need to control local expenditure. The first goes back formally to the famous White Paper of 1944, with its emphasis on the need for government intervention to smooth out the business cycle (informally, some of the roots of the argument, e.g. for public capital expenditure variations, go back a good deal earlier). To put it briefly, the view has been that local authority taxing and spending preferences - especially on capital expenditure - must be subservient to the needs of overall demand management in the economy as a whole.

Contrasting with this aim of avoiding excess demand or excess supply, there is another side to the Treasury view; that there is an appropriate division between public expenditure and private expenditure out of any given total of national output - carrying with it the corollary that there is also an appropriate size for local authority expenditure. This stand rests on two legs: first, that in some general sense there is a principle or set of principles determining the appropriate size of the public sector and that in some general way all sorts of nasty things can happen if these principles are not observed. Secondly and more specifically, undue compression of real wages after tax and personal consumption because of public sector expansion is liable to trigger off wage demands or industrial troubles, add to cost inflation and so on.

Given the premises certain conclusions followed. First, central control over local authority capital expenditure has throughout the post-war period been much tighter than that over current expenditure. Second, the Treasury has consistently opposed the handing over of revenue sources from central to local government, on the argument that it was easier to exercise a restraining influence on local authorities when they were heavily dependent on central

16 Layfield Report, op. cit., p. 244.

17 Employment Policy, Cmd 6527.
government grants than if they had their own revenue sources. This is a theme which can be found running through many discussions over many years. It is particularly clearly set out in the 1971 Green Paper, as a basis for objections to alternative means of local authority financing. But it also goes much further back. As Rhodes put it:

'No Chancellor of the Exchequer has been willing to surrender to local authorities at least on a permanent basis the control of any tax which might be of value for national purposes. This was what killed the system of assigned revenues. And in the 1950s and 1960s when there began to be pressure for more serious consideration of possible alternatives to the rating system, such as local income or entertainments tax, this attitude combined with the practical difficulties of introducing a new local tax continued to ensure that no progress was made in this direction.'

In fact, Treasury opposition before the Layfield Committee to local taxation went even further in that the possibility of local authorities increasing expenditure and financing it from additional rates was frowned on, on the grounds that the overall result might be a net addition to total demand.

In recent years, there has been a number of other Treasury desiderata in the name of macro-economic control, notably the alleged necessity to fit local authority expenditure into the general system of forecasting and controlling public expenditure as a whole (the Public Expenditure Survey Committee process, or PESC for short). And the Layfield Committee itself was sufficiently impressed with the Treasury arguments to propose a new system of regulating local authority current expenditure by what amounted to the imposition of a progressive 'tax' on local authorities, the rate of tax increasing the more expenditure exceeded a predetermined norm.

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18 Cmd 4741, op. cit.
20 Report, p. 239.
21 Put briefly, the argument was that the additional rates levied would only be partially met by cut-backs in consumption, the rest being met by curtailing saving; so the reduction in private expenditure would be less than the increase in public expenditure.
One can see some justification for the Treasury viewpoint. If one accepts such propositions as the necessity for the use of Treasury fiscal instruments for anti-cyclical measures, it is very hard to deny that local authorities should be exempted from them. Nor can one maintain with conviction that local authorities would act voluntarily to curtail expenditure at times of boom if there were no Treasury intervention. In fact, the reverse could very easily be the case insofar as they try to follow local demands for, say, more roads and sewers to service privately built additions to the stock of housing. And even if they do not go as far as to act in a pro-cyclical fashion, it is asking a lot to expect the average local politician or bureaucrat to have sufficient sophistication in these matters to act in a counter-cyclical fashion.\(^{23}\) Nor is it the case that Treasury measures to cut local expenditure are unsuccessful because any shortfall in grant revenue is compensated by rate increases. This may be a short-run reaction, but all the evidence is that, with a lag, the Treasury's local finance measures do produce the results which are intended.

But having made a case for some support of the Treasury view, one is nevertheless left with the strong impression that it has consistently overplayed its hand in this particular game. First of all, there are several points of logic. The scope for fiscal policy generally in anti-cyclical policy is a topic far beyond our scope here; but it must be noted that it very much depends on whether one adopts a monetarist or a Keynesian line. But even if one takes an essentially Keynesian stance, the weight put on some arguments, e.g. the balanced budget multiplier theorem, by the Treasury (and seemingly endorsed by the Layfield Committee) is surely too great. It has been acknowledged for many years now that this argument is much less convincing than it seemed when it first appeared.\(^{24}\) Nor is the logic of the proposition that local authority expenditure must be cut back to make room for private expenditure entirely unassailable. The optimum combination of private and public expenditure is hardly a settled subject; and

\(^{23}\) A small anecdote may be permitted here. On one occasion, whilst explaining some economic problems to a group of local authority councillors, the writer was stopped in his tracks with the injunction: 'Give us facts, not statistics'.

in any event all that flows from any such proposition relates to the total of all public expenditure, not the total of local authority expenditure.

More generally, the Treasury's arguments might be more easily swallowed if they had only been made in the years since its wedding with the full employment doctrine was consummated. In fact, they had been made many years earlier. Thus Rhodes records that the Treasury came out clearly and unambiguously in the 1920s against any percentage system of grants because it 'takes away from the State the power very largely of reducing expenditure'. No doubt the full employment principle was a very good rallying cry for the post-war period, but one cannot resist the suspicion that Treasury attitude to local authority freedom and independence would have been very much the same if it had never been thought of.

It also has to be remembered that other countries manage their economies without nearly such detailed constraints on local authority and without a noticeably worse record, to put it mildly, in fluctuations in their economies. The Layfield Committee conducted an investigation into the extent and complexity of control of local expenditure by central administrations in various European countries and found that they were on balance less tight than in the United Kingdom. It is also the case that Canadian Provinces have the right to levy separate, though co-ordinated personal income taxes; and the right of Australian States to levy surcharges on Commonwealth income tax is under discussion. It may be that some of these developments will lead to worse records than in the past in the control of the business cycle. But so far Britain has not had a particularly glorious record in this respect compared to other countries. So the argument that one must have tighter control of local authority spending than other countries for the purpose of sustaining an inferior anti-cyclical record begins to look a little thin, to say the least.

26 Appendix 5, Reports on Foreign Visits.
The Search for Additional Sources of Local Revenue

Hope springs eternal in the breasts of local councillors on the subject. In the latter part of the nineteenth century, it was thought that the system of assigned revenues introduced in 1888 was a satisfactory answer. Broadly, this system was endorsed in the majority report of the 1901 Royal Commission. But insistent voices soon began to be heard about the need for a local income tax. We shall explore this subject in detail in a later chapter, but it may be noted now that it is a constantly recurring theme over the last 60 to 70 years.28 Another evergreen is the idea of a local sales tax, no doubt by analogy with, for example, the sales taxes in the States of the U.S.A. and the Provinces of Canada. Others which recur from time to time are local employment taxes, entertainments tax, vehicle duties,29 motor fuel taxes, taxes on increments in land values, tourist and hotel taxes and, going further down the line, lotteries and charges for services rendered by local authorities.

But as has been pointed out on many occasions, there are serious obstacles to all these suggestions. The 1971 Green Paper examined most of the alternatives at some length under the three headings of administrative complexity, suitability as a local tax and economic effects and found all of them wanting. So did the Layfield Committee five years later. One need not be as influenced as some have been by the Treasury view of these matters to accept the main conclusions. Local sales taxes pose difficult problems in a small country and especially one with a national value-added tax; much the same holds for motor fuel taxes; motor vehicle duties have recently been re-organised on a national basis and so are no longer a candidate. And even if administrative obstacles and the like could be overcome one would have to compensate in some way for the very unequal yields of such taxes in different areas if one places much store on geographical equalisation. The quest may not be entirely hopeless (e.g. recent legislation on increments in land values and on lotteries). However, it is quite clearly unrealistic to expect

28 For example, the 1901 Royal Commission, the 1914 Departmental Committee Report, the Royal Institute of Public Administration book of the 1950s (New Sources of Local Revenue, Allen and Unwin, London, 1956), the 1971 Green Paper (op. cit.) and last (though hardly finally) the Layfield Report.

29 This suggestion was put forward as far back as 1914. See Cd 7315, op. cit.
any major changes here, leaving aside the question of local income taxation for the time being. Even if the Treasury's opposition on macro-economic grounds is put on one side, the likelihood of relief to local authorities coming about by such means must be rated extremely small. Nevertheless, if the history of the last 75 years or so has anything to tell us, it is that people will not cease to advocate such measures.

The Influence of Short-Term Considerations

Rhodes concludes his review of some 50 years of U.K. local finances with these words:

'How far and within what limits local authorities could be allowed to go their own way, decide their own priorities, and spend their money as they thought fit were questions which tended to be submerged in practice under the immediate and practical necessities of finding the money to carry on and in many cases expand services. The history of local government finance is largely the record of successive attempts to meet these immediate necessities.'

'Meeting immediate necessities' is indeed a theme-song in a number of aspects of U.K. economic history and not least the one concerning us here. An outstanding example is the events surrounding the Layfield Committee. It was set up in the aftermath of a sharp rise in local authority rating demands in the spring of 1974 and the operations of the Committee were clearly dominated by this single central fact - and the desire of the Government to be seen to be doing something about it. Part I of the Report has the dramatic title 'The Nature of the Crisis'; Chapter II has equally dramatic sub-headings - 'Causes of the Crisis' and 'The Character of the Crisis'; a whole Annex (p. 354) is devoted to the immediately preceding increase in domestic rate bills; and the Committee states (p. xxviii) that it was asked to report within less than eighteen months of being set up. So the whole of the inquiry was being conducted against a short-term background and under the constraints of a very short-term timetable, despite the fact that it was the first official committee to survey the whole field of local finance for half a century. It is not entirely surprising that the Report bears obvious marks of haste in the general (dis)arrangement of its contents, the breathless pace of some of the discussion and so on.

Matters were not always so. The Royal Commission of 1901 took some five years over its deliberations and the Kempe Committee of 1914 some three years. Nevertheless, whether or not commissions of inquiry were appointed in the light of political outbursts and whether or not they took a short time over their labours, it has for many years been true without exception that governments acted and reacted to very short-term considerations in this field. Thus it is recorded\textsuperscript{31} that, in settling the nature and pattern of government grants:

>'The search has largely been on empirical lines, trying out various factors and combinations of factors in various relations to one another to see which was likely to produce the desired results.'

Although this specific comment was primarily directed at the General Exchequer Contribution introduced in 1929, it could equally well be applied in the subsequent years. In particular, as we have seen, the post-1974 usage of regression analysis as a basis for distributing the needs element of the Rate Support Grant has in fact been only a first step, the regression results being doctored to produce what were thought to be less embarrassing results.

Nor is the adjustment of grants formulae to fit 'political facts' the only example of short-term expediency. To take one other case only, a Committee\textsuperscript{32} was set up in 1963 to consider the working of and hardships imposed by the rating system, but long before the Committee reported\textsuperscript{33} the Minister concerned had felt it expedient to introduce a limited measure of relief.

It would not be difficult to give many more examples of the propensity to react and over-react to short-term furores whilst ignoring the longer-term issues which continued to be present decade after decade.

\textsuperscript{31} G. Rhodes, \textit{op. cit.}, para. 147.


\textsuperscript{33} G. Rhodes, \textit{op. cit.}, para. 122.
The Insularity of Outlook

A very marked feature of official discussions (though not necessarily of unofficial ones\textsuperscript{34}) has been the tendency to discuss U.K. problems of property taxation, grants from upper to lower tiers of government and so on as if it was the only country in the world which had ever had to face such problems.

In some - but only some - respects the Layfield Committee took more cognisance of overseas developments than did many of its predecessors. One volume (Appendix 5) is in fact devoted entirely to reports on foreign visits but even so the countries visited and the range of topics covered were much narrower than desirable. Thus little or no attention seems to have been paid to the sophisticated grants system and grants machinery developed over many years in Australia; or to the Canadian experience of revenue sharing between central and Provincial governments and the evolution of separate income taxes in recent years. One particular North American device is worth mentioning in a little detail. Approximately one-half of the U.S. States and one-third of the Canadian Provinces have in recent years introduced systems of credits (not deductions) in respect of property tax payments against State/Provincial income tax (allowing cash refunds if the eligible credit exceeds income tax liabilities). This system receives no mention or discussion in the Report of the Committee. A suggestion was made, in evidence by the Association of District Councils,\textsuperscript{35} that the general tax-credit scheme discussed at some length in the U.K. in 1972 and 1973 should be revived and that the credits should include a component for rate payments. The Inland Revenue, predictably, demolished the proposition in its evidence,\textsuperscript{36} but without a single reference to North American experience with this type of relief. Nor in the subsequent 100 pages or so of oral interchange between the Inland Revenue and the Committee is there a single mention of this overseas experience. It is perfectly true that the U.K. has evolved its own schemes of relief for domestic rate-payers over the years but it is regrettable, to say the least, that none of those involved was able to raise his eyes sufficiently to look at alternative methods used in other countries and compare their merits with those of the schemes currently found in the United Kingdom.

\textsuperscript{34}See, for example, New Sources of Local Revenue, op. cit.

\textsuperscript{35}Appendix 2, Evidence by Local Authority Associations, pp. 97 ff. See also Layfield Report, op. cit., p. 163; and Appendix 2, pp. 482 ff.

\textsuperscript{36}Appendix 8, Local Income Tax: Evidence and Commissioned Work, pp. 90 ff.
IV LOCAL PROPERTY TAXATION

We shall start by reviewing briefly the general theory of local property taxation; then interpret it in the light of the characteristics of the U.K. rating system; discuss the advantages of the rating system and also its disadvantages, including a number of propositions which are fallacious; then we shall turn to prospective future changes; examine some major remaining deficiencies; and conclude with some reflections on lessons which can be learned in this area.

General Theory of Property Taxation

It is convenient to start by assuming that an annual property tax is levied at a single rate by a single local authority on the capital value of all the immovable property - housing, business buildings and plant, land - and all the movable property - personal possessions, etc. - in its area. It is assumed initially that no other local authority raises a property tax and that competitive market conditions prevail.

Strictly, we should ask about the particular local authority's fiscal alternative - does it reduce the revenue it collects from another source or does it increase its expenditure - and if so, what are the effects of either of the two alternatives? But let us for the moment assume that the effects of these alternative courses of action are so diffused as not to have any marked impact on the distribution of income, the allocation of resources and so on. We shall return to this point later.

Traditional economic analysis would then proceed as follows: A distinction must be drawn between short-run and long-run effects. In the short run (perhaps a very short run for movable property), the owner of property would bear the whole burden of the tax. This can be seen by imagining that a landlord wishes to sell a house which he owns; as a result of the tax the net income yielded by the asset will have fallen, hence the house will only be salable at a lower price than that which could have been obtained before the tax was imposed. In other words, we say that the tax is capitalised on the existing owner.

In the longer run, a distinction must be drawn between the ownership of land and of other assets. Land cannot move and its supply is fixed to this locality; and so the long-term position remains the same as the short-term position in respect of this asset. On the other hand, other capital assets are not there for ever. The stock of houses and business premises, etc., will tend to fall in the particular area as more and more capital funds are attracted to other areas where they do not face an annual property tax. Hence pre-tax house and business rentals tend to rise in the taxed jurisdiction - at least on the assumption that property demand does not diminish pari passu with supply.

Looked at from the viewpoint of the taxed area only, this might be thought of as being a sufficient account of the effects of introducing a property tax. Given time, one can say that the non-site component of the tax will be passed forward. Insofar as housing expenditures are a higher proportion of low incomes (as conventionally measured) than high ones, this seems to lead to the clear conclusion that an annual tax on the capital value of housing is regressive, in the usual sense of that term. Insofar as business rentals rise, the result would be accepted as being more complicated in that resultant rises in prices of final goods and services might affect poorer and richer people in that area differentially. More important, however, the effects would spread outside the taxed area by virtue of business sales to (or purchases from) people in other jurisdictions.

One particular point should be noted about this analysis. These conclusions about the regressiveness of domestic rates depend on particularised assumptions. One is the general point that only current taxation payments, as distinct from present values, are being considered. For example, a rich man may currently pay less tax, as a percentage of income, than a poor man because his consumption is a smaller percentage of income, but one must also ask how the rich man will spend his (by definition) proportionately greater savings when he comes to dissave, how much additional tax will then
be payable, what is its present value, etc.  

Another set of assumptions relates to the measure of income used in arriving at the regressivity conclusion. Even if one takes short-period income, there are likely to be omissions such as the imputed rental value of owner-occupied housing – a very peculiar omission in this particular context. And if one takes a long-period measure of income much of the regressivity which is conventionally deduced disappears.

So, even if we play the conventional game the traditional conclusions about regressivity of housing taxation are by no means self-evident. In fact, the conventional game is not the only one and we must look at alternative possibilities.

The key point is the assumption on p. 37 that one confines oneself to the effects inside one jurisdiction only. Once we take on board the consequential effects of the tax change in one area on other areas, we have a very different set of conclusions. Concentrating on housing again, although it may well be true that the pre-tax rate of return on capital will increase in the taxed area, the re-allocation of capital funds to other areas will result in an addition to the stock of housing and a fall in rents there (if it is assumed that there is no concurrent increase in demand). In other words, the extra tax on capital in one jurisdiction is diffused throughout the generality of capital owners, with some reduction in the net return on capital in the country as a whole corresponding to the property tax paid in the taxed jurisdiction. So combining the various reactions, we have rent increases in one area and rent decreases in others, which might or might not be to the disadvantage of the poorer members of the population when grouped together; and we have

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3 Assume that annual imputed rental value is 50 for a (conventionally measured) income of 100 and 200 for an income of 1,000; and that the tax is 10 per cent of annual value. Tax would then be 5 per cent of conventional income for the poorer man and 2 per cent for the richer man. But if incomes are now re-defined to include imputed rental value, the ratios become 3.3 per cent and 1.67 per cent respectively - a rather different picture.

4 Cf. H.J. Aaron, *op. cit.*, pp. 27-32. If one takes housing expenditure as a fraction of consumption (which may be taken as a rough proxy for permanent income), the variation at different levels is far less than if one takes the ratio of housing expenditure to measured income.
some reduction in the rate of return on capital which is likely to be relatively disadvantageous to the rich insofar as property income is an increasing function of total income, i.e. a conclusion which is the exact opposite of the traditional one.

Insofar as property taxes on business assets are concerned, the same general results follow - some reduction in the net rate of return on capital in the country as a whole and some tendency for gross rents to rise in the taxed area and to fall outside it. Any migration of workers from the former to the latter to take advantage of the additional supply of capital equipment would have still further repercussions on income distribution.

We started with the simple case of a uniform tax on all property but in one area only. One can see what sorts of conclusions are likely to follow when more complications are introduced. If the tax only applies in one area, but at differential rates (e.g. exempting movable assets or taxing housing at a lower rate than business assets), then there would be a shift of capital between assets (as with a differential commodity excise tax) as well as between areas. If the tax applies at a uniform rate inside any one area, but the rate differs from area to area, the same general consequences apply as earlier, but capital movements are clearly likely to be less if there are only small inter-area differentials than if one area has imposed a high tax rate and the rest are untaxed. Finally, one can have a combination of intra-area and inter-area differentials, with still further compounding of the above results.

At the other extreme, one could have a property tax imposed nationally at a uniform rate on all capital assets. In that case, the essential result is a fall in the net return to owners of capital without any of the side effects we have had to take into account in the partial (area or asset) tax case. With a uniform national tax one cannot escape the effects of the tax by shifting funds from one jurisdiction to another inside the country, thereby generating the series of changes in pre-tax rates of return on domestic and business property sketched out above. There may be further long-run effects if the supply of saving available in a country diminishes as a consequence of the fall in the net rate of return to capital, but these effects must inevitably be of a speculative character.

Two major qualifications need to be made to the theory as presented so far. We said earlier that we would ignore for the time being the effects of the expenditure out of the property tax. Under some circumstances, where expenditure is in some general sense 'wasteful', this procedure is perfectly reasonable. But suppose that the expenditure leads to tangible and palpable benefits
which are of obvious value to the taxpayer concerned? The benefit from, say, better roads and municipal services generally may attract house-purchasers and business firms to the taxed area, thus offsetting completely the repelling effect distinguished earlier. In other words, benefit capitalisation as well as tax capitalisation must be taken into account. If benefits weigh as heavily as taxes, the net effect on capital flows of taxation and expenditure taken together would then be zero. Whether this is so in practice is an empirical question which cannot be answered without detailed investigations.

The second major qualification is that an initial assumption was made that competitive conditions prevailed. If that is not the case, the general conclusion that a property tax will be essentially at the expense of capital owners may need to be qualified - in much the same way as the usual arguments about the effects of corporation taxes are qualified under conditions where sales maximisation motives predominate over those of profit maximisation or where market power is restrained for one reason or another.

An obvious example is rent control on housing. Whether the property tax is locally differentiated or national in scope, the enforcement of below equilibrium rents combined with the power to raise such rents when property taxes increase will mean that any such increases will be transmitted to tenants even in the short run. There is no presumption in such cases that the tax will reduce the rate of return on capital. A similar sort of result would come about in respect of property taxes on business firms when there is a system of rent control with the power to pass on property taxes.

Interpretation of the Theory in the Context of the United Kingdom Rating System

The first question is whether the U.K. system of levying a tax on occupiers of property on annual values raises any major modifications to the arguments above. The short answer is a slightly

5 This argument was first developed at length by A. Marshall, *Principles of Economics*, Macmillan, London, 1920, Appendix G: 'The Incidence of Local Rates with some Suggestions as to Policy'.

6 For a rather similar problem - the proposition that the extent to which incentives to work are affected by taxation will depend on the composition of the corresponding government expenditures - see C.S. Shoup, 'The Limits on the Taxation Capacity of a Country', (unpublished paper).
qualified 'No'. Obviously, a tax on annual rental values could in principle correspond precisely to a tax on capital values of property but there are reasons why this may not be so in practice.

First of all, capital values take account of the whole stream of future land rents including any increases which may come about due to re-development. If, as in the U.K., a tax on annual values only takes account of current, as distinct from future, land rents we shall have a different distribution of the tax burden among landowners; those owning sites with imminent development prospects will be hit less hard under such an annual tax than under a capital tax. Nothing has happened to change the general proposition that the burden of the tax on site values will rest on landowners; but the distribution of the burden will be different with an annual tax on current rental values.

Second, the ratable values assessed may only bear a very rough and ready relationship to rental values for a number of reasons which we shall be looking at later. This may well mean in turn that there may be differences in the taxes imposed on two houses in one area that are equal to one another in terms of market rental values; but this does not upset the general reasoning above. Nor does the imposition of tax on the occupier rather than the owner of premises introduce any major new element; it is as true in this context as in others that a tax can equally well be imposed on the supply or the demand side of the market.7

It is implicit in what has already been said that the tax structure in the U.K. is differentiated by local authority areas - in that valuations for tax are likely to differ pretty arbitrarily between areas if they do so within them.8 In addition, there is now a system whereby domestic ratepayers pay at a lower poundage than business ratepayers in any one area,9 And within the domestic sector the system of rate rebates10 and ancillary welfare provisions means that in effect a different tax rate may be applied to identical properties because of differences in the occupier's

7 It should be noted, however, that there is a difference in that, unlike ownership taxes, occupancy taxes carry with them an implication of not taxing empty properties. It may also be that occupiers correspond more closely than owners to the list of local voter-beneficiaries.
8 For evidence on this subject, see Layfield Report, op. cit., p. 258 and Annex 19.
9 See above, p. 11.
10 See below, p. 49.
income, needs, etc. Rating of business property by no means corresponds to a uniform rate of tax on value added; the Layfield Committee estimated that it ranged from 1 per cent in light industries to 5 per cent in heavy industries in 1958.\textsuperscript{11} And agriculture, as we have seen, is totally de-rated. Therefore the picture for the U.K. corresponds neither to that of a uniform national tax nor to that of a single area going it alone, but to a variegated pattern of rates throughout the country.

Another important feature of the U.K. scene is rent control. Rent control of domestic property has existed in one form or another since 1915. In 1973, some 44 per cent of all dwellings was rented but a distinction must be drawn between the private component (13 per cent of all dwellings) and the public component (31 per cent).\textsuperscript{12} Whereas one can reasonably expect that the earlier argument about immediate passing forward of rate increases would apply in the former case,\textsuperscript{13} the same condition does not follow so clearly when the local authority is the landlord. When housing provision is regarded as a social service, there is no particular reason why higher rate demands should necessarily and automatically be reflected in higher charges to tenants. So the argument that rent control is likely to lead to a simple and straightforward passing forward of rates needs qualification on this account. At the same time, it should be noted that there have from time to time been controls on business rents which have created passing-forward opportunities in that area.

Given that owner-occupied housing is now some 52 per cent of the total,\textsuperscript{14} it is worth pausing for a second to ask how the theory set out earlier applies in that area. At a very simple level one can say that one need not worry whether the tax impinges on tenant or landlord in that they are one and the same person. At a rather more sophisticated level, one would have to ask whether inter-area rating differentials would lead to capital movements between areas - and then remember that this would also imply


\textsuperscript{12} Layfield Report, op. cit., p. 436.

\textsuperscript{13} In fact the rate demand would often be sent direct to the tenant and not to the landlord.

\textsuperscript{14} Approximately 4 per cent is in residual categories such as tenancies of people with a residence associated with their employment.
owner movements as well. Nor do the rent control type arguments apply here; as Musgrave points out,\textsuperscript{15} there is little chance that owner-occupiers could buy houses more cheaply and thus avoid the burden of the tax if rates increase.

Another relevant consideration is the extent to which rate increases are accompanied, and are seen to be accompanied, by benefits to those who pay taxes. In general terms, one would think that taxes for financing schools and environmental improvements would be regarded as less burdensome than those needed for meeting general administrative expenses. But, given the complexities of local financial arrangements, with their mixture of demands by different authorities and the confusing nature of the rate demand note\textsuperscript{16} (an aspect of the 'lack of accountability' identified by the Layfield Committee), one must have very serious doubts whether the benefits are sufficiently perceptible to count for much against the tax payments. This must be especially true in respect of rate payments on business property - more than half the total in the U.K.

One last but very important point remains. Much of what has been said in this section is of a speculative character in that the basic investigations which have characterised recent U.S. literature on this subject have simply not been made in the U.K. It may even be that they cannot be done at present. Whether this be so, or not, one is bound to echo the warning which the Layfield Committee felt compelled to make\textsuperscript{17} when discussing the subject: the arguments must be extremely tentative at this stage.

\textbf{The Advantages of the Rating System}

Historically, rates were justified on the grounds that they approximated to a tax according to ability to pay; this was particularly true before the exemption of movable property from the tax base in 1840.\textsuperscript{18} Alternatively, various types of rating demands could be justified on benefit principle grounds.\textsuperscript{19} So there were arguments of both kinds to be found in the literature.

\textsuperscript{16} See Chapter II, Appendix A.
\textsuperscript{17} Op. cit., Annex 12.
\textsuperscript{18} Cd 638, \textit{op. cit.}, p. 33.
\textsuperscript{19} Cf. E. Cannan, \textit{op. cit.}
The emphasis has changed in modern times, and few people would now be willing to place such emphasis on either of these traditional contentions. The Layfield Committee summarised the arguments in favour of rates as follows:20

'(i) a tax on property is particularly suitable as a local tax. There is no difficulty in attributing the yield to even the smallest units of local government, since the yield depends on the physical location of property;

(ii) the form of tax is relatively simple and understandable, however much less easy it may be to comprehend the underlying details;

(iii) over many years there has been considerable stability in the operation of rating, with relatively small changes from year to year;

(iv) property is visible and easily identifiable. It cannot be shifted geographically in response to change in rates of tax;

(v) the yield of the tax is readily predictable and certain;

(vi) evasion is extremely difficult;

(vii) the cost of maintaining rating is not high in proportion to the yield;

(viii) rates are a perceptible tax. The demand, expressed as a lump sum at yearly or half-yearly intervals, brings the tax prominently to the notice of ratepayers;

(ix) because rates are perceptible and because deliberate decisions have to be taken to raise rate poundages to meet increased costs, the tax promotes accountability;

(x) there are no problems of confidentiality of the taxpayer's personal income or circumstances (save now, when rebates are claimed).'

Unambiguous, predictable, not easily avoided or evaded, relatively cheap to collect ... such adjectives would figure in any appraisal of the tax.

However, there are some further points to be made. One is that too much can easily be made of the accountability argument. There are plenty of voters in local elections who are not ratepayers and so their views on taxation and expenditure are only indirectly

linked to taxes paid; on the other hand, there are plenty of business firm ratepayers without votes. So it is easy to exaggerate the extent to which tunes are called by pipers. And although existing property cannot be shifted geographically in response to tax rate changes, additions to property may well be made with an eye to relative rate burdens in different localities.

In contrast, something more can be made of the perceptibility argument. Whereas the yield of progressive income taxes can increase under inflationary conditions without any action of any sort on the part of the government, rating yields can only increase if either the ratable value or the poundage is changed, both of which courses require express action on the part of the authorities. This is not to say that rates necessarily lack buoyancy of any kind but simply that the yield does not increase while local government is asleep, as it were. For those who feel that tax revenue increases should only be possible on the basis of specific and known action by the authorities, this is a very real advantage.

A related but separate point concerns the fluctuations in rating yield over the course of the business cycle. It is often argued that a desirable property of a national tax for countercyclical purposes is a high degree of built-in flexibility of yield. But for a local tax, where budget deficits are undesirable or unacceptable or both, the reverse is the case. Once again, rates score reasonably well, there being no strong tendency for ratable values or revenues to fall in the recession phase.

Another proposition is that there is no conceptual difficulty in defining all the property in a given area, in the way that one encounters difficulties with other taxes, for example, in the definition of income. On the other hand, the notion of any annual value for some types of property (e.g., historic monuments) is clearly artificial in the extreme - even worse than trying to evaluate imputed elements of income, for instance.

It might also be added that there is a very long case history relating to rating principles and practices. Some of the 'principles' which have emerged may be arbitrary, but at least they are consistent - one manifestation of the old tag about old taxes being good ones.

21 See below, p. 53.

22 Except to the extent that more property becomes unoccupied and more occupiers become bankrupt and are unable to pay their rates.
Finally, it is worth driving home the facts about collection costs. With public collection costs around 2 per cent of yield, the figures are comparable with those involved in collecting personal income tax in the U.K. and are considerably less than for other taxes, such as the suggested wealth tax. Moreover, these are figures of public costs only. It is usually accepted that private costs of collecting income tax are about the same as public costs. This is most unlikely to be the case with rating demands and so the total cost of collection is likely to be a smaller percentage of yield than personal income tax.

The Disadvantages of the Rating System

We shall now survey the various criticisms commonly leveled against the U.K. rating system, commenting as we go along on their validity.

One area of criticism centres on resource allocation aspects. As far as domestic rating goes - and we must remember that this only accounts for some 40 per cent of all rates collected - the argument is simply that a special tax on the annual value of housing is likely to reduce demand for housing, discouraging housing investment relatively to other outlets for capital and so on. Similarly, commercial and industrial rates are also held to be a discouragement to building activities, with some obvious differentiation between those industries where they impinge more heavily and the rest. Indeed, some observers have felt that these and other effects of non-domestic rating were so pernicious as to demand their abolition.

23 Cmd 4741, p. 30. It is not clear whether this figure also includes the costs of Inland Revenue valuations and those of appeals before various tribunals.

24 Layfield Report, op. cit., p. 149.

25 Ibid., pp. 152-3. It should be clearly understood that the same discouraging forces will be at work whether one thinks of non-domestic rating as primarily working its way through into higher prices of end-products or as impinging primarily on returns to owners of buildings and plant.

One strand in this sort of argument is a very old one, relating as it does to the relative merits of levying property taxes on unimproved (or site) values rather than improved values. There are really two basic differences between these two systems. The first is that the unimproved value system exempts the value of any structures placed on sites; the second is that the site value is taken as that which would prevail if the land were used for its most profitable possible development (which may or may not be a great deal higher than existing use value depending on, inter alia, planning legislation). In principle, one can argue that for both these reasons a tax on improved values is likely to be more of a disincentive to development and building than a tax on unimproved values.

Whether the argument is an important one in a densely populated and long settled country like the United Kingdom is another matter. The situation is very different from that prevailing in the nineteenth century in Australia and New Zealand when unimproved value rating took a firm foothold there. One must also remember that there are many other taxes and subsidies to take into account in the U.K. Thus house-building is a zero-rated item under value-added tax and there is a whole range of other concessions to housing (e.g. no taxation of imputed rents but deduction of mortgage interest against other income for income tax purposes in the case of owner-occupiers; and complex far-reaching subsidy arrangements for local authority tenants). New industrial and commercial building costs are a deductible item in computing value-added tax liabilities; and new industrial building receives substantial assistance in the form of accelerated depreciation. Industrial properties in Scotland are also partially de-rated. If all these factors are taken into account it would seem highly unlikely that substantial disincentives to investment in building arise generally on this account — though this is not to deny that there are some differential effects with, for example, rates paid representing a higher than average fraction of value added in the case of retail distribution, but without the benefit of accelerated depreciation for income taxation.

28 Evidence by the Department of Environment to the Layfield Committee ('New Sources of Local Revenue' in op. cit., Appendix 1, Evidence by Government Departments) was less than adequate in not considering all these other taxation and subsidy aspects.
One further aspect of this subject requires a little more discussion as it is a source of common confusion. Proposals for the taxation of 'development value' fall under two different heads: an annual tax on unimproved value, as defined above, or a once-for-all tax on increments in land value. These two concepts are entirely distinct and utter confusion is the only result if this is not clearly recognised. In this respect, the U.K. seems to have slipped backwards over the years. If one turns to the 1901 Royal Commission Report, the distinction is very clearly recognised.30

On the other hand, the Layfield Committee31 dismissed site value taxation as having lost all relevance since the Community Land Act 1975 which (together with associated legislation) provided, initially at any rate, for a special development land tax of $66 \frac{2}{3} - 80$ per cent on increments in land value associated with development. Even if one disregards the uncertainties about the permanence of this legislation it is hard to justify the Layfield conclusion - unless one is to say that an annual wealth tax has no place in a tax system if there is a capital gains tax. And in any event there is the other aspect of site value rating - the exemption of buildings from tax - which is not affected by the Community Land Act or Development Land Tax - even in the more distant future when development rights are due to be reserved for local authorities only. We are not concerned here to promote the cause of site value rating; there are many objections to it on grounds of equity, practicability of administration32 and so on. But it should not be rejected for unconvincing reasons.

We shall now look at equity objections to the rating system. For the moment we shall assume that valuation procedures work smoothly and that there are no inconsistencies between the assessments of similar properties; this is an aspect to which we shall return later.

30 For example, see Cd 638, op. cit., p. 44: 'In any case it is obvious that, if a special burden is to be imposed on land, on the ground of any increase in its value, the object could not be equitably met by the imposition of a new rate on site value from year to year.'


The 'intrinsic inequities' of rates form a subject which has received a great deal of attention over a long period of time, as the Rhodes survey\textsuperscript{33} clearly shows. As far as domestic rates go, the major argument is that rates paid are regressive against incomes and so do not correspond to ability to pay principles. To examine this argument more closely let us look first of all at the comparison between rates paid by households, assuming only one income earner per household.

The first question to ask is whether we assume that rates paid fall wholly on occupiers or not. As we saw, this is not an argument susceptible of an easy answer, the general theory of incidence admitting of all manner of results. Nevertheless, it is the case that there is a high proportion of owner-occupiers in the U.K. and that rent control applies to tenants. If, \textit{faute de mieux}, we assume that all domestic rates are paid by occupiers we still need to take account of a number of other factors. As the Layfield Committee showed, if calculations are made of actual rates paid (i.e. after reduction of rebates to poorer people and allowing for supplementary means-tested benefit payments) we have a situation where rates take a bigger share of higher than of lower incomes at the bottom end of the spectrum, there is proportionality over the middle ranges of income and only higher up does the traditional picture of regressivity emerge.\textsuperscript{34} This is not to say that there are not wide variations between rate payments by people at the same level of income; these arise for a variety of reasons associated with inconsistencies of valuation and the working of the grant system, as well as on account of 'genuine' variations in the rental values of housing enjoyed by people at the same income level. But the average relationship between the ratio of rates paid to income and the level of income is clear. Moreover, this relationship is between rates paid and annual incomes, not life-time incomes. There is U.S. evidence\textsuperscript{35} to show that if the latter were taken into account we should expect to find a relationship between property tax payments and income which is even nearer to one of proportionality.

\textsuperscript{33} Op. cit.

\textsuperscript{34} Op. cit., p. 159 and Annex 19. It should be noted that the domestic element in the rate support grant (see p. 11) does not materially alter the picture in that the amount of relief given is proportionate to ratable value, so that within any one local authority area each ratepayer receives the same proportionate abatement of rates payable.

But even if it could be demonstrated in an unimpeachable way that domestic rate payments were regressive against income, one would still have good reason to ask why this should matter. As the Layfield Committee is at great pains to stress,\textsuperscript{36} rates are one of many taxes paid by households (for example, they are less than one-seventh of national indirect taxes). What matters in any evaluation of the redistributive effects of taxation is the totality of effects - hard as they may be to calculate - rather than the particular way in which one particular tax operates. So one must understand that the regressivity or otherwise of rates is a relatively unimportant feature of the overall tax position.

We come now to the situation where households contain more than one income earner. There are several different propositions to consider. One is that any comparison of rates paid with income of the head of the household is bound to give a distorted picture of the progressiveness or regressiveness of rates with income. Obviously, this criticism fails as a general proposition; the determining factor must be whether the percentage to be added to the income of the head of the household is greater at lower than higher income levels, or vice versa. Another is the 'unequal treatment of unequals' principle, i.e. that if two households live in houses with the same ratable value in any one area, total incomes of the households may differ because of more earners in one than the other, but rates paid will not. Once again, this is a defective argument - even assuming, for simplicity, that a larger number of incomes means a larger total income. For a start, the principle is an exceedingly slippery one and no one is entitled to speak as if he knew a unique answer to the question: how much more tax should be paid by family A which has a higher total income than family B?\textsuperscript{37} And even if this obstacle were surmounted, one would still have to take account of differences in other types of tax payments as well as rates.

Finally, it is often argued that non-ratepayers should not be entitled to vote, or more generally that there should be no representation without taxation. This is a highly


\textsuperscript{37} Partly because of the difficulty of designating the approximate unit for tax purposes and partly because of the intractable problem of how much tax payments should differ between different income levels.
questionable proposition and the Layfield Committee dealt far too leniently with it. The fact that someone does not pay rates himself is no indication whatever that the burden of rates does not fall on him. For example, a lodger in any given house may well find his weekly bill increased if the occupier's local rate bill goes up. The principles of tax incidence apply here no less than in other contexts. Moreover, if this principle about voting were admitted at local level, it could soon spread much further, for example, in denying anyone the right to vote at local or national level if benefits received outweighed taxes paid by him.

Most attention in the equity field is usually given to the domestic side. But serious questions also arise with non-domestic rates in that they may have unwarranted distributional effects. But the most blatant inequity in this area is the complete de-rating of agricultural land and buildings. We shall return to this later.

The complaint that rates are an arbitrary tax is a very old one. It is put forward in a trenchantly argued part of the 1901 Royal Commission Report, and Rhodes states:

>'For the greater part of the period 1918 to 1966 valuation in England and Wales could not be said to fulfil the conditions of "uniformity, equality, simplicity and economy"...'

More particularly, there were obvious signs in the 1930s that all was not well on the valuation front, despite the attempts in the previous decade to improve the rules and practices.

Essentially, the problem here is that rating valuation may differ very considerably for houses which are very similar.

39 R.A. Jackman, op. cit.
40 See below, p. 55.
41 Cd 638, op. cit. The Report of Sir E. Hamilton and Sir G. Murray argued for more uniformity in the rating system.
43 Ibid., para. 42.
44 Still further variations may arise in rates paid because of the grant system. See Layfield Report, op. cit., p. 258. We shall discuss this in Chapter VI.
This is partly a matter of differences between regions. The Layfield Committee\(^\text{45}\) found that in 1974 a standard house in Greater London would have had a ratable value more than twice that in Wales. But even in other regions there were considerable variations for a standard house (e.g. £146-£201 in the East Midlands and £160-£236 in the North-West). No doubt some of these variations represent 'true' differences in rental values but it is most unlikely that this is a complete explanation.

There can be little doubt that although the problem is an old one it has become considerably worse in the post-war period. The main reason is not far to seek: the long-term effects of rent control. In 1973, it is reported that only 2 per cent of all rented houses (themselves less than half the total of all houses) were rented out in anything like market conditions. In a special survey, usable rental evidence was only found for 13,000 houses and flats out of a total of more than 800,000.\(^\text{46}\) Despite the whole series of attempts to improve valuation procedures and consistency during the last half-century - notably the concentration of valuation responsibilities for England and Wales on the Inland Revenue since 1949 - matters have become progressively worse over the years.

It is not surprising in these circumstances that rating has become an extremely unpopular tax.\(^\text{47}\) This is partly due to valuation inconsistency. It is also that the notion of a letting value for rating purposes is simply incomprehensible to most people living in owner-occupied houses or facing controlled and/or subsidised rents. Unpopularity and arbitrariness have in turn fed on one another. On many occasions, pre-war and post-war, the Government has not been able to organise a rating valuation at the time it should have taken place or has not been able to face the consequences of it taking place even if it could be organised. This has in turn meant that when revaluations did occur the jumps in ratable value were that much greater, with still further cause for criticism and unpopularity. Another

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\(^{47}\) G. Rhodes (op. cit., para. 115) quotes The Times of 1 March 1963 to the effect that 'rates are a uniquely unpopular form of tax'; and The Economist of 26 November 1960 proclaimed 'if taxes are odious, rates are anathema'.

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point of some importance is that for the vast majority of taxpayers large payments of tax are unusual. The system of withholding for income tax ensures that most people pay that tax without noticing it. Such is not the case with rates which, until very recently, had to be paid in two substantial instalments per annum.

The last of the major complaints about the rating system is that revenues from this source are not buoyant, i.e. there is a low elasticity of tax yield with respect to changes in nominal income levels. In general principle, it is not easy to understand why this should be so. One would expect the level of site rents to rise over time as population and capital grow, even if there is no general price inflation. And there is no compelling economic reason why the real rate of return on housing or commercial/industrial building should fall so much as to offset the rise in site values. And if there is general price inflation, there is no obvious reason why it should not apply in these as in other areas.

The reasons why this complaint has been made are two-fold. The first is that revaluation only takes place at considerable intervals - and, for that matter, intervals which have been consistently longer than they should have been. When the nominal growth in ratable values is measured between revaluation dates there is a substantial annual rate of increase.\(^{48}\) Therefore much of the alleged lack of buoyancy arises out of the infrequency of revaluation. The slowness of the change in the total of ratable values in the intervening periods is, of course, more obvious in a period of rapid inflation than in one of relative price stability.

The second reason for lack of buoyancy may well be the pervasive influence of rent control. We say 'may well be' in that there is no hard evidence to this effect. But when the rate of increase of rents is held below that of the prices of other goods and services it would seem very probable that this policy is reflected in movements of ratable values, and hence that such values show a lower elasticity with respect to increases

\(^{48}\) The Layfield Committee (op. cit., p. 148) found that in England and Wales the nominal annual growth rate between 1963 and 1973 inclusive was about 12\(\frac{1}{2}\) per cent (including additions to the stock of property) and about 10 per cent (excluding such additions).
in nominal incomes than would otherwise be the case. This conclusion is a speculative one but nevertheless seems highly likely.

So the truth in the lack of buoyancy argument is not that this is an inherent feature of a property tax, but that it is manifested as a result of rent control and long intervals between revaluations.

Proposals for Change

Our next subject is how far the criticisms of the rating system outlined above are likely to be muted by any changes in prospect. This is essentially a matter of looking at the proposals made by the Government in response to the Layfield Committee recommendations.

The most important proposal is that domestic property in England and Wales should be valued on a capital basis rather than an annual basis, on the ground that the latter is now totally unreliable. Many problems will result from such a change. For example, problems will arise in ignoring purely ephemeral changes in market values, adopting a system of 'banding' so that all properties falling within a given range of values are treated alike for rating purposes, making sure that revaluations do not become even more irregular because of the change of system, and applying an appropriate divisor so as to obtain a notional annual value to which the rate in the £ can be applied, in the same way as for non-domestic property. (In parenthesis, this is a peculiar way of proceeding; one would have thought it more logical and more comprehensive to convert annual values on other types of property to a capital basis by means of a multiplier.) Inevitably, a major change of this kind will alter the relative

49 Except in the pedantic sense that revaluations of ratable value have to take place to link such totals with nominal income changes; there is no automatic linkage as with the personal income tax. See Chapter V, p. 61, for further discussion.


51 It is judged that such a change is unnecessary in Scotland where there is more evidence of rental values, the proportion of owner-occupied property being considerably lower than in England and Wales.
burdens falling on house occupants and no doubt this will cause all sorts of outcries when the time comes. But the overall conclusion must be that capital valuation will narrow the variations in the ratable values of similar properties in different parts of the country which, as we have seen, has been a major criticism of the present system.

Other changes may be mentioned more briefly. One is the intention to stick to re-rating timetables; but any experienced observer may perhaps be excused the remark that he will believe that when it happens and not before. The system of payments by instalments is to be improved and various proposals are made for the treatment of non-domestic and mixed properties, public utilities and charities. But perhaps the most important of these additional intentions is that rate demand notes should be made much clearer so that ratepayers can know who is demanding how much and for what purposes.

Major Outstanding Deficiencies

One major remaining deficiency is that agricultural land and buildings (though not dwelling houses on such land) are fully de-rated. It is estimated that the rates lost in England and Wales in 1974-75 on this account were £120 million, which would have meant an addition of some 3 per cent to the total actually collected but with large variations between different local authorities.

The Layfield Committee was quite emphatic in its view that there were no arguments of principle in favour of agricultural de-rating, whether considered from the angle of land being an inappropriate basis for rates or from that of the allegedly disastrous effects for the industry. The Government has decided against these recommendations for re-rating, however, partially on

52 Cmd 6813, para. 6.22.

53 It is fairly clear, however, that the changeover to capital values will not mean the incorporation of site values at their maximum development value which, as we saw earlier, is a theoretical difference between property taxation on capital and annual value bases.

grounds of costs involved and partially on alleged grounds of principle. The former seems more than a little thin in that the Layfield estimate of recurrent costs of valuation was in effect about 1 per cent of annual revenue - markedly less than annual public sector costs of raising income tax or V.A.T. But if that reason is thin, the main reason of principle which is given is simply preposterous. It is worth quoting in full as it is such a gem of evasive nonsense:

'... the total income of local authorities would probably be unchanged because the increase in rateable value would be balanced by a reduction in grant from government'.

On this basis, there is no difference between local revenue resources and grant income. Why not go a bit further and advocate the abolition of local property taxation altogether? After all, the income of local authorities would be unchanged, if grants increased sufficiently. If arguments of that deplorable quality have to be used one can only conclude that the economic case for de-rating was non-existent but considerations of low politics dictated its retention.

One other aspect of de-rating might be mentioned in passing. Industry in Scotland, unlike that in England and Wales, continues to be relieved of half its rating burden. The Layfield Committee was somewhat indecisive on this matter, perhaps reasonably so, given the present political situation with Scotland, but it did seem to accept without questioning the proposition that Scottish industry needed this boost to make it competitive with its rivals from south of the border. Whether or not this is true is doubtful, but in any event this is an argument derived from regional economic considerations and one which must be considered along with other policies differentiating between regions. In a report devoted to the problems of local authorities, which steers completely clear of regional economic issues in virtually all other respects, it is somewhat curious to find this one proposition standing on its own.

55 Cmnd 6813, op. cit., para. 6.23.

56 Op. cit., p. 166. Initial valuation cost was put at £10m-£15m and annual costs at between 5 per cent and 10 per cent of initial costs. With an annual revenue of over £100m, this leads to an annual cost/yield ratio of about 1 per cent.

One topic which is conspicuous by its absence in recent discussion is any intensive consideration of the reform of valuation procedures. Little or no attention seems to have been given to recent developments in the U.S.A. where since the State of California pioneered the use of computer-based re-assessment there has been a major shift of valuation practice towards estimating changes in property values on the basis of statistical analysis of 'trends in market prices and such characteristics of properties as location, type, previous value and nearby municipal improvements and private construction'. It would appear that daybreak has not yet arrived in the U.K. where this subject is concerned.

Concluding Reflections

The first is the enduring characteristics of the rating system. Politicians, administrators, commentators generally have poured abuse on it and prayed for its demise for years, but it continues to survive. The latest illustration at the time of writing is the May 1977 Green Paper, where the Government very reluctantly accepted that it could not propose the abolition of rates. But this is only one of a long list of possible illustrations of this viewpoint. The implication of continuing survival must surely be that the rating system does have a lot to recommend it, at any rate when we compare it with any alternative forms of raising revenue. We need not rehearse again the reasons why the rating system does commend itself despite its faults, but simply offer the prediction that this situation of reluctant acceptance is likely to persist for many years to come.

The second reflection is the difficulty of eradicating tax concessions. Although, after a great effort, the early 1960s saw the re-introduction of rating on current values for housing, shops and offices and (in England and Wales) industry, agriculture has continued to stay outside rating completely. Scottish industry is partly outside and the introduction of the domestic element of the rate support grant in the late 1960s was equivalent to a partial de-rating of domestic property again. As we have seen, the Government has recently shied away from any proposals for changing the rating status of agriculture. It seems a fair bet that domestic partial de-rating is also there for a long time.

58 H.J. Aaron, op. cit., p. 69, and cited references.

59 Cmd 6813, op. cit.
to come. It must be doubted whether those who advocated agricul-
tural de-rating in the depressed conditions of the 1890s ever dreamt
that de-rating would still be in evidence so much later and under
such changed conditions for the agricultural industry. But this
does seem to be a particularly good example of the aphorism that
an old tax is a good one but an old subsidy is a bad one.

Finally, one has to recognise that there is no shortage of
long-lasting fallacies and half-truths in the area of property
taxation - whether in respect of the incidence of property
taxation, the distinction between taxing annual (maximum
permissible) values of sites and taxing increments in site values
and so on. Fallacious reasoning has persisted for many past
years in the literature and it would be a bold man who would
bet that this situation will not continue for many future years.
The arguments about local income taxation in the U.K. have a jack-in-the-box flavour in popping up time and time again despite all the force with which they are struck down whenever they do appear. Thus they were considered and rejected by both the Royal Commission of 1901 and the Departmental Committee of 1914. Discussion rumbled on during the inter-war period and came to life again in the Royal Institute of Public Administration study of 1956, where this proposal was the centrepiece of its recommendations. This was followed by a study by the Institute of Municipal Treasurers and Accountants in 1968 and the investigations of the Royal Commission on the Constitution. The Layfield Committee's investigations in the 1970s, however, have provided the most thorough study so far and we shall largely concentrate on its discussion of the subject.

We shall look first at the arguments for a local income tax; then at the counter-arguments, distinguishing between those of general principle and those pertaining particularly to the U.K.; then describe the scheme proposed by the Layfield Committee and the Government's reactions thereto. Some final reflections will then be offered.

The Arguments for a Local Income Tax

The most general argument for a local income tax is that a number of other countries raise revenue by this means and this creates a prima facie assumption that this may be a practice to

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3 Op. cit., Chapter VII.
6 Report, op. cit., and Appendix 8, op. cit.
follow. The Layfield Committee in fact commissioned a special survey of local income taxation in Sweden, U.S.A. and Canada.\textsuperscript{7} This showed how practices varied enormously in the three countries with, for example: close integration between local and central taxes in Sweden, but virtually none in the U.S.A. (at least in the case of New York, which was selected for detailed study); three possible levels of income taxation in the U.S.A. but only two in Canada; collection of upper and lower tier income taxes at national level in Sweden and Canada but not in the U.S.A.; satisfaction of Provincial income tax demands in Canada by percentage surcharges on Federal revenue collections, but not so in the other two countries. If the survey were being made in 1977, it could profitably take account of recent Australian developments. By an Act of 1976, the Australian States became entitled to a share of Commonwealth personal income tax revenue (subject to certain exclusions) as from 1976-77. The overall share for all States was fixed at an agreed percentage (33.6, initially) of the total of such revenue, the percentage being based on the relationship of financial assistance (i.e. general revenue) grants to personal income taxes in 1975-76. The distribution between the States was also based initially on the previous relativities established for financial assistance grants distribution purposes.

A separate 1976 Act provides for 1.52 per cent of Commonwealth personal income tax collections to be paid to the States for distribution to local governments in accordance with recommendations of State Grants Commissions to be established for the purpose; at least 30 per cent of the local government tax sharing entitlements must be distributed on a population basis (possibly adjusted for differences in population sizes and densities), while the remainder will be distributed on an equalisation or needs basis. The local government tax sharing entitlements replace general revenue equalisation grants previously paid (since 1973) by the Commonwealth on the recommendation of the Commonwealth Grants Commission, the role of which under the new arrangements is restricted to advising on the distribution of the 1.52 per cent among the six States.

It is further proposed that from 1977-78 each State will have the power to ask the Commonwealth to collect a surcharge or (at the State’s expense) allow a rebate in respect of personal income tax collected in its area, with some rather complex provisions for inter-State equalisation. At the time this monograph was written, this proposal was not yet law; but it shows, none the less, the direction in which the wind is blowing.

\textsuperscript{7} Appendix 8, \textit{op. cit.}, pp. 269 ff.
What are the ways in which these examples of practices elsewhere can be made relevant to the U.K. situation? We now have to distinguish between two broad alternatives (intermediate ones will be omitted for the sake of simplicity). The first alternative is that income tax should be a substitute for rates, i.e. the more is raised by the former, the less needs to be raised from the latter. The second alternative is that personal income tax revenue should be used to supplement that from rates, thereby reducing the need for grants from central government.

Taking the first alternative (income tax accompanied by reductions in rates), one argument in favour is that income tax is more closely related to ability to pay - a more or less tautological statement if ability to pay is deemed to be highly correlated with income. The persuasiveness of this argument depends critically on how far that element of rating receipts which is displaced by a local income tax is not related to income. This in turn depends on exactly how the reduction in rating revenues takes place (e.g. is it all in respect of domestic rate payments or not?) and on how the displaced element is itself related to income. As we saw in Chapter IV, the latter subject is itself very far from clear and so one simply cannot be sure of the degree to which the net result is a closer correspondence between local tax payments and income. And, if reference is made again to our discussion in Chapter IV, any proposition that a closer correspondence between local tax payments and income is 'fairer' requires still further assumptions and qualifications.

Another argument applicable in the income tax-rates substitution context is that income tax is more buoyant. This phrase has many uses and misuses but we shall, as before, take it to mean the elasticity of revenue receipts with respect to nominal income changes. The responsiveness of income tax yield to income changes depends on the rate structure, concurrent changes in income distribution, any element of indexation in respect of purely nominal income changes and so on. The responsiveness of rating yields depends on the growth rate of property values relatively to income changes, the frequency of re-assessment and the like. So the extent to which income tax is more buoyant in the sense used here will depend on the precise period considered, e.g. whether it falls

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8 The Layfield Committee (op. cit., p. 184) did not help in this regard by allowing the phrase to mean increases in revenue due to changes in tax rates, etc., as well as to increases in income.

9 See Chapter IV, p. 53.
completely between rating revaluations or not. It is easy to see why in the various representations to the Layfield Committee, the standard assumption was that income tax yield would be much more buoyant the rapid inflation of 1973-75 and rapid rise in income tax revenues explain that. But on a longer perspective, this is less clearly true and, in any case, even if it were the case that income taxation were more buoyant in any one set of circumstances, there is the further difficulty that this would be a matter of removing the cork from the spending bottle.  

Another supporting argument for local income taxation comes from the proposition that it is more perceptible than rates to any one taxpayer and is also likely to be paid by more people in any one local authority area. The latter proposition is clear enough but the former is less so, given that income tax is collected from most people by that stealthy process known as pay-as-you-earn (PAYE) while rates are frequently paid in large lump sums. However, this particular argument leads to the other alternative - that income tax is not a substitute for but an addition to revenue from rates. In other words, its role would be to replace an element of grant income. (Given that the rate support grant income of local authorities in Great Britain was some £6.7 billion in 1975-76, it would be impracticable to think of replacing it entirely by local income tax. For example, a 4 per cent tax rate on all taxable personal income would not yield more than £1.5 billion.) The Layfield Committee was prepared to advocate this additive role for a local income tax in the context of what it thought of as a 'localist' solution to local financial problems, i.e. effectively giving local authorities more power and independence, thus necessitating, in their view, a larger local tax base. Accountability, it was argued, could only be expected to play its full and proper part if those who were responsible for local spending decisions also had to provide a larger part of the finance than at present. So the notion of perceptibility and the importance of making as many local voters as possible taxpayers comes back again in this context.  

10 See Chapter IV, p. 45.

11 We shall have something to say about the validity of the accountability and local sources of revenue argument when discussing the grant system in Chapter VI.
Do notions of fairness, buoyancy, etc., play any role in this context? The answer is clearly 'No'. Unless one knew which national tax would be reduced (or national expenditure increased) as a result of the grant reduction accompanying the local income tax and unless one could ascertain the consequences of such reductions for individual local authorities, the discussion would have no meaning - there is an infinity of answers as to how local income taxes plus unspecified national changes would affect income distribution. Obviously, any one local authority might know the effects of its own tax addition; but that, from a national viewpoint, is only part of the story.

So we can see that there are a number of arguments for local income taxation but there are question marks which must be put against most of them. Perhaps the strongest is that most heavily emphasised by the Layfield Committee - that one needs a substantial addition to local revenue if one is going for a localist solution and personal income tax may well be the only runner in such a race.

The Arguments Against a Local Income Tax

These arguments divide into two parts: the general ones which would apply in any country and the particular ones arising from the peculiar nature of the U.K. income tax system.

Taking the general arguments first, there are several which would apply whether the context were that of substitution for or addition to rates. The first is that variations in taxable income from one year to another are greater than variations in ratable values (revaluations apart), partly because the level of local income can change rapidly and partly because national income tax allowances, etc., can also change rapidly, so that if the local tax is meshed into the national one its yield may well be affected thereby. The Layfield Committee recognised the problem clearly. It suggested that, as a reasonable constancy of yield is highly desirable for a local authority, there should be some method of smoothing out the income tax base from year to year to prevent

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12 And, for that matter, revenue buoyancy.

13 As long as people can move readily between local authorities it is, needless to say, impossible for any one authority to pursue an income redistribution policy markedly different from that adopted by others.
violent yield fluctuations.\textsuperscript{14} Such a procedure can best be seen as part of the process of breaking the link between taxes actually collected from a given local authority and the amount of tax credited to it.\textsuperscript{15}

Another question to be resolved is the number of local authorities with power to levy local income taxes. There is a dilemma here. If one attaches great weight to local responsibility and accountability one must plump for a large number; if one thinks of the administrative costs of collection and allocation the more authorities there are the more hideous the task becomes. The Committee decided, as one might have forecast, to compromise in recommending that the tax might be levied by the 130 or so metropolitan districts, London boroughs, non-metropolitan counties and the like rather than the 450 authorities (if all participated) or 70 authorities (if the upper tier only was concerned).

A hoary old question which has exercised all who have thought about this topic,\textsuperscript{16} and even some of those who have not, is whether a local income tax should be levied at the place of employment or the place of residence. As the Treasury was quick to emphasise in its evidence to the Layfield Committee, the place of employment would leave awkward gaps in respect of self-employed people, pensioners and investment income recipients;\textsuperscript{17} it was also apprehensive that if everyone employed at a particular factory faced the same local income tax rate rather than different ones depending on the area of residence the tax would be more likely to enter into wage demands - though without spelling out the logic of the argument in any detail.

On the other hand, there are also objections to the residence principle, much as this conforms to that which tends to govern the overall rate of tax paid when income crosses international frontiers. One taxpayer may have more than one residence, thus not being uniquely associated with any one local authority area; another may have no permanent home at all. Nevertheless, it seems

\textsuperscript{14} Op. cit., pp. 194-5. This discussion was, of course, entirely in the context of a proportional income tax; fluctuations in yield would be even greater with a progressive rate structure, but no such idea was in question.

\textsuperscript{15} See below, p. 72, for further discussion.

\textsuperscript{16} See, for example, Cd 638, op. cit., p. 13; Cd 7315, op. cit., Chapter XI.

\textsuperscript{17} Layfield Report, Appendix 1, p. 282. Another category would be income earned from employment abroad.
best to settle for the residence base; the obstacles to that can be overcome more readily than can those to the employment base (e.g. a taxpayer can be asked to declare which is his principal residence, as for capital gains tax purposes in the U.K.). It is also worth noting that this was the conclusion arrived at on the basis of the international survey organised by the Committee.18

The distribution of investment income between local authorities also raises plenty of difficulties - should it be by area of residence of the recipient, the area of the head office of a company paying a dividend or the area where the company's factory is situated? This is indeed a hard nut to crack and, as we shall see later, only approximate solutions are possible.

We now come to the arguments against local income taxation which arise mainly in the context of local authorities raising revenue in this form as well as by rates. This is the point at which national Treasuries are liable to get extremely excited both because of the general feeling that taxation powers should not be surrendered to the lower orders19 and because of the ingrained belief that demand management will then become totally impossible. The latter point was hammered home relentlessly to the Layfield Committee - the awful consequences which might follow, for instance, if the Treasury wanted to reduce income tax rates overall in the country but local authorities insisted on increasing their own rates.20 The pages of evidence on this topic can in fact be summarised by a splendid quotation from a Treasury witness:21

'We need income tax as a fiscal instrument; we need to have it unimpaired; and we need to maintain its flexibility in the hands of central government.'

A nice, amenable attitude, if ever there was one!

18 Appendix 8, op. cit., pp. 269 ff.
19 Cf. G. Rhodes, op. cit., para. 97, in relation to the 1950s in the U.K.: '... the Treasury's unwillingness to release control over sources of national taxation remained as strong as ever'.
20 See, for instance, Appendix 1, op. cit., pp. 277 ff. and subsequent oral evidence; and Appendix 8, op. cit., pp. 211 ff.
21 Appendix 1, op. cit., p. 366.
As we argued earlier, this line needs to be taken with several very large pinches of salt. For instance, the U.S.A. manages demand pretty effectively despite the very great independence of State and local taxing authorities. The most that one need concede to this everlasting theme-song is that there is a case for limiting local authorities' freedom to please themselves completely in the level of local income taxation they choose to levy, over and above any restrictions which may operate through the grant system.

Another matter which comes to the fore when suggestions are made for augmenting local revenue sources is that local authorities may then have too much power to influence the vertical distribution of income and that such matters are a national rather than a local public good. Once again, this argument has some force but can also be easily overdone. The power of a local authority to make a big impact on the pattern of income distribution in its area is, as we have seen, limited by migration possibilities even if it has income tax as well as rates as a source of income. And if the ability to vary income taxes is restricted by integrating the local income tax system with the national one so that the definition of income for tax purposes, allowances given and so on is the same at both levels, there would be little reason to fear the distributional results.

Differences in taxable capacity of local authorities have long exercised central governments in many countries and grants systems are often designed to iron them out. If income tax raising powers are added to those of rate raising, the absolute (and, more arguably, proportional) differences in local revenue per head must be expected to increase if tax rates are at much the same level in richer and poorer areas. And if services provided were better or tax rates lower in richer than in poorer areas one could then expect to see some degree of migration into them. If the overall aim is to have a fair degree of equalisation of fiscal capacity, then a grant system differentiating between richer and poorer areas is likely to be operating. But this would be so even if local authorities only had rate-raising powers. The introduction of income tax powers makes no difference in principle, though obviously it might then become impossibly expensive to counteract differences in fiscal capacity by grants if tax

22 Chapter III, p. 27.

23 See p.63 above.

24 See Chapter VI, p.78 for further definition.

25 Assuming they could not or did not take a negative form.
revenue formed a very high proportion of total local revenue. But such is not the case with the sorts of proposals considered by the Layfield Committee.

If we turn to the possibility of substituting income tax for rates, there is very little to be said against that proposal (overlaps with the arguments above apart) except that one might hold that there is some appropriate balance between capital and income taxation which would be upset by such a change. But it is very hard to see much force in this contention at least in this particular context.

Such are the arguments of a general nature which have been raised against local personal income taxes. Before we turn to those of a more particular application in the U.K., it may be worth saying why there is general agreement that the obstacles to local taxation of companies are very much greater. It is not primarily a matter of demand management. 'Counter-national' movements in local corporation tax rates would be unimportant given the likelihood that the short-run impact might well be confined to the amounts of profits retained by corporations. The much more important difficulty is that of allocating corporation profits between areas. There is sufficient evidence of such difficulties from the example of the U.S.A. where the division of corporation profits between the fifty States is on a formula basis combining such factors as pay-rolls, sales and property values. There are many drawbacks to this system. They would be multiplied severalfold if one had a still larger number of local authorities involved in the pie-sharing process. So we shall not consider this topic further in our discussion.

We now come to the particular arguments against local income taxes arising from the peculiar properties of the U.K. income tax system. This is clearly not the place to give a full account of the U.K. system; and as the Layfield Committee provided a brief description, we shall not attempt even that but will simply try to show what rather special problems arise.

The Inland Revenue has set these out on many occasions in the last 80 years or so, whenever local income taxation has reared its ugly head. In its most recent expositions to the Royal Commission on the Constitution and to the Layfield Committee, it marshalled all the arguments with great force and clarity. The central point is that, totally unlike the systems in other advanced countries, the U.K. income tax system is for the vast majority of taxpayers one in which each source of income is taxed separately without any necessity to bring together the different sources of income into a single total each year. This seemingly deficient arrangement is possible because most people are taxed at a single rate ('the basic rate') and only a very small proportion become chargeable at higher rates. Furthermore, the system of PAYE is different from that of all other countries (apart from Ireland) in operating on a cumulative basis throughout the year in such a way as to make tax withheld equal to tax due for the vast majority of people, without the need for a positive or negative refund after the end of the year. For these two reasons - tax levied separately source by source and cumulative withholding - there is no need for most people to make an annual tax return totalling all income received. Indeed, the correct income tax deduction is arrived at for some 85 per cent of those in employment in the course of the year (an immense contrast to, say, the U.S.A. or Canada) without any need for subsequent adjustment. For very many people, in fact, there is no contact with the Inland Revenue in any one year; their employers operate the withholding system and account to the Revenue in such a way as to make any such contact unnecessary in each and every year.\footnote{As part of a checking process, everyone is asked to complete a return at intervals not greater than five years.}

This unique feature of the U.K. system has several important consequences for the implementation of any local income tax. The first is that at present there is no up-to-date knowledge of addresses of many taxpayers and so no basis for attaching the appropriate rate of local income tax to any particular person. A modification of existing procedures would be necessary to fill this gap. Second, the system of local income tax found in many countries whereby local tax is collected on the basis of data becoming available after the end of the year (either of income or of national tax paid) is simply inoperable in the U.K. The need to find substitute methods of assessing and collecting local income tax is therefore likely to mean a larger proportionate addition
to public and private manpower needs than in other countries, where end-year information of the right kind already exists. Third, there is no ready means by which the local tax collected from any one individual could be attributed and then returned to the local area in which he resides. This again means the use of some alternative mechanism for distribution of local income tax proceeds between the relevant authorities.

Unless and until some major change in U.K. income tax practices and procedures takes place (e.g. the introduction of a widespread self-assessment system) these core characteristics of the U.K. system will have to be taken into account very fully in the design and operation of any local income tax system. There are, in fact, several other matters to consider but these are of a less fundamental character. One objection to local income tax is that the marginal tax rate for very many people would become outrageously high, when existing national rates and national insurance contributions are taken into account. This objection is not overwhelming in that national income tax rates could perfectly easily be lowered as local income tax was introduced in that the latter would permit a reduction in the total of central-local grants.

Another minor point is that the system of collecting underpayments of national tax in any one year by adjustments to employee coding in the following year might need some modification in the case of local tax shortfalls. And, needless to say, the principle of unripe time can always be trotted out whether in the guise of the need to simplify national income tax allowances before any major change such as a local income tax, or the need to computerise further. Such points of this kind are not of the same weight or the same long-term character as those mentioned earlier.

The Layfield Proposals

It will be clear from the preceding discussion that some of the options theoretically open to the Layfield Committee were in

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32 Ibid., for further discussion.
fact closed. We shall try to avoid covering the same ground twice over but a small amount of overlap may be inevitable.

Various schemes for raising tax at the local level but outside the national income tax arrangements were considered by the Committee but rejected on grounds of impracticability in the U.K. context, or administrative cost, or both. So this narrowed the choice to a scheme tied into the national one. One possibility was to raise local income tax revenue by reducing the allowances (i.e. exemptions) given against national tax. But there were several difficulties with any such idea, e.g. the need for a local authority to inform an individual what he should tell his employer to do in the way of altering his tax-coding (and the obvious danger of breaks in such a chain of instructions), and the distributional implication of raising tax revenue in this way (e.g. the effect would be exactly the same as a poll tax for anyone within the long basic rate band). In the event, the Committee settled for a scheme closely integrated with the national system which, it was argued, would by giving local authorities a revenue source additional to rates be a vital ingredient of the 'localist' proposals to give local authorities more leeway and more independence of central government.

It was proposed to adopt the same definition of personal income, the same allowances and the same starting points for rate bands as in the national system. The Inland Revenue was also to be responsible for all aspects of tax collection and disbursement. Various possibilities about the roles of different local authorities were considered, e.g. how many authorities should have the right to levy income tax, whether rights to levy income tax and rates should be mutually exclusive (in the sense that one local tier might raise all its local revenue from income tax and the other from rates). In the end the proposal was that London boroughs, non-metropolitan counties and the like should have the right to levy local income tax (a compromise between considerations of administration and those of accountability) but that all authorities should have rates-levying rights.

33 See Layfield Report, op. cit., Annex 24, for details.
34 Appendix 8, op. cit., pp. 104 ff.
35 Another objection made by the Inland Revenue (ibid.) that total (central plus local) income tax paid would not be reduced does not seem so well-founded.
As might be expected from the earlier discussion, the principle of residence was preferred, on a whole variety of grounds, to that of source as a means of allocating the proceeds of the tax. But the lack of Inland Revenue data about home addresses of taxpayers meant that it was necessary to invent a means of collecting such information. The idea put forward was to collect the data on location of principal or only residence at the time of year that income tax returns are sent out to taxpayers, a special form being sent to those taxpayers not due to make a return that year. This address would then hold for the whole of the relevant tax year. It should be noted that such information about addresses would be nearly two years out of date by the end of that tax year, e.g. if a residence declaration form were sent out in April 1977, the information would be used for the whole of the tax year April 1978-March 1979. But despite the obvious drawbacks, this seemed to be the best solution.

For employees, the proposal was that the notice of coding sent by the Inland Revenue to employers would indicate the local taxing authority and details would be supplied of the local income tax rate corresponding to that authority, so that withholding would be a composite affair including both national and local tax. Employers would hand over all tax withheld in this way to the appropriate Collector of Taxes. Self-employed people would be assessed as at present and charged local tax (according to residence) as well as national tax.36

As to the structure of local income tax rates, the first point was that the possible rates which a local authority could choose must be kept within reasonable bounds both in the sense of the number of alternatives (for withholding procedure reasons) and their range (for management of the economy reasons). The main choice was between a system of absolute additions to national tax rates or proportionate additions with advantages and disadvantages attached to each. For example, the same absolute addition at all income levels would (by itself and neglecting changes at other points in the system) make the income tax system as a whole somewhat less progressive; the percentage addition system would mean that local income tax revenues would be less predictable than with the alternative,37 but on the other hand

36 As local income tax would not apply to corporations, one might expect the balance of advantage between corporate and non-corporate status to be changed.

37 In that the forecast yield would be dependent on the constancy of national tax allowances, rates and band starting points in one case but only on allowances in the other. See Layfield Report, op. cit., p. 203.
would fit more easily into employer payroll procedures. No final choice was made between these two alternatives.

Investment income posed a number of other problems, partly because of the difficulty of attribution of some income to a specific local authority and partly because at national level some income is taxed at source and some not. The suggested solution was not to try to attach any one local authority tax rate to any one receipt of such income but to levy a flat non-variable rate on all such income and then add the proceeds to the pool of other local tax revenues awaiting distribution. It would also be a desirable objective to extend the principle of deduction at source further.38

Having decided to collect local income tax in this way, the Committee next had to decide on the method of distribution to individual authorities. For reasons already explained (and augmented by the investment income treatment), there could be no question of identifying and labelling the taxes collected from each and every individual in any one local authority. Instead, it was proposed that an estimate be made each year of income received by the residents in a local authority area and the tax attributable to the authority be calculated by applying the relevant local income tax rate to that income total. In other words, the Collectors of Taxes would pool all the local income tax paid by or on behalf of individuals and the pool would be distributed on the principles set out above. The local income tax rate would determine the amount any one individual paid and it would determine the amount any one authority received but there would be no link between the two operations.

Then there were several other points such as the need to smooth out distributions of local income tax over time, to adjust the grant distribution arrangements so as to avoid 'too much' inequality between authorities, the impossibility of introducing a local income tax without giving the Inland Revenue time to make adequate preparations (said - no surprise! - to be several years) and so on. But we have already touched on all these points and need not elaborate on them further. What does need to be mentioned, however, are the costs, public and private, of administering a local income tax. It was estimated that another 12,000 Inland Revenue staff would be needed (an addition of some 14 per cent to the 1975 strength) and the annual cost involved would, at 1975 salary levels, be some £50 million - with possibly the same kind of additional costs being imposed on the private sector. The basis for these figures must be clearly

38 Ibid., p. 201, for further discussion.
understood: it is the necessary addition to costs given the present administration of the national income tax. If there were to be major changes such as those occasioned by the adoption of self-assessment, the additional costs incurred by a local income tax would be very much less.\(^{39}\)

The Government's reactions to the Layfield local income tax proposals were completely adverse.\(^{40}\) It rejected the idea of more local responsibility with as much vehemence as if it were a treasonable crime to suggest it. It was not prepared to accept that the cause of local accountability would be further advanced if more revenues were raised locally; and it was fearful, as always, that more local freedom would make central government management of the economy more difficult. It should be noted that the objections were not levelled against local income tax as such, but rather against the whole principle of giving local authorities more taxable resources, whatever the form. One suspects that the reaction would still have been hostile even if the Committee had discovered a local revenue source which would fulfil all conceivable economic and administrative criteria for perfection in taxation.

**Concluding Reflections**

Surveying the history of suggestions for local income taxation in the U.K. over the last eighty years or so, one is struck by a number of recurrent themes. Not surprisingly, local authorities and their representative organisations have often argued in its favour; and central governments have always argued against it, whether at political or official level. The Inland Revenue, in particular, has shown a tenacious consistency of view in admitting that it could operate such a system if it had to but would strive might and main to ensure that it did not have to;\(^{41}\) the longest not out innings in history, one might be tempted to say. But one major change has taken place. Whereas many non-official observers had advocated the tax at different times, no official commission or committee had done so until the Layfield Committee -


\(^{40}\) Cmnd 6813, *op. cit.*, para. 6.10.

and even there, as we have seen, its support was contingent on a localist solution. However, this does represent a significant change at that level of discussion. And it leads straight on to the question whether a local income tax may not enter the U.K. via the back door, in the sense that the demand for an independent revenue source for Scotland may become irresistible. Once the dam breaks at that point, the advocates of the tax may be riding on the crest of a pretty high wave. So even though the Government has firmly shut the front door in the face of the local income tax, we may see the back door slowly but steadily pushed open.

42 See Chapter VII below for further discussion. A Labour Party discussion document in August 1977 also envisaged the re-grouping of local authorities into larger units, with the possibility of regional income taxes (The Times, London, 19 August 1977).
VI GRANTS PRINCIPLES AND PRACTICES

The order of topics considered in this chapter will be a general discussion of grants principles, an account of the principal complaints levelled at the grants system in the U.K. and the suggested remedies, followed by some concluding reflections.

Grants Principles

It must be made clear from the beginning that the whole of this discussion will be conducted on the assumption that a particular structure of local authorities is already in existence and that it has a certain range of agreed functions and revenue sources of its own. So all questions such as whether the appropriate functions of local government and the appropriate size and format of central government grants would be completely different if there were a different set of constitutional arrangements will be set on one side. This is not to deny in the least the importance of such considerations; but simply that it seems reasonable to confine ourselves to the narrower range of questions arising if such matters are taken as settled. After all, constitutional arrangements do tend to remain unchanged for long periods of time; and the range of questions which can arise within such periods is still formidably large.

It will be convenient to discuss the objectives of a grants system first; and the instruments later.

Looking at objectives, it is customary to single out a number on which there is a great deal of agreement, at least at the level of general principle. Inter-authority grants (whether central-local or local-local) are not the only way of achieving such objectives but nevertheless they do have a role of some importance in each case. The cases to be distinguished are:

(a) Division of functions. This is simply that various general objectives of public finance may be best served by a greater concentration of revenue capacity at central level and a greater concentration of expenditure responsibility at local level. Standard examples are progressive personal income taxation and corporation taxes at national level; and detailed administration of certain types of services at local level.
(b) **Externalities.** Any one local authority's actions may confer benefits or impose costs on the citizens of other authorities as well as on its own. This may come about directly (e.g. a cost transfer in the form of smoke discharge) or indirectly (e.g. a benefit transfer in the form of the movement of people who have received training or education in one area to another). Grants, and for that matter charges, may well have an important part to play in this context.

(c) **Merit wants.** The central government may wish to encourage consumption of certain goods and services. This may again be a case for grants to local authorities, though two caveats should be noted: first, even if it is agreed that certain wants should be promoted (e.g. primary education) the further condition has to be satisfied that such promotion should be by grants from the central government to local government rather than to individuals; second, that de-merit wants exist as well as merit wants and they would point to negative rather than positive outpayments from the central authority.

(d) **Second-best arguments.** Obstacles to competitive forces whether in the form of pockets of monopolistic practices or impediments to labour migration and the like may easily interfere with efficient production. It may be simpler, from a number of viewpoints, to counteract such forces by a grant system rather than tackle them at the root.

So much for the 'easy' cases. We now come to the much more difficult subject of inter-authority fiscal equalisation, i.e. the proposition that there is a general case for levelling down 'rich' local authorities and levelling up 'poor' ones even if all the other objectives of grants identified above have already been satisfied.

One standard argument is that if one partitions a country into a number of different jurisdictions, there will be a differing spatial distribution of tax burdens (and/or expenditure benefits) from that which would arise if there were a single government only. With a number of jurisdictions one would expect some to be better

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off, or to have lower 'needs', than others and therefore able to provide a higher level of public services at a given tax rate (or the same level at a lower tax rate) than poorer authorities. A man with a given level of income located in authority A may therefore pay a lower total (i.e. central plus local) tax rate than a man with the same level of income in authority B, thus flouting the standard principle of 'equal treatment of equals'. With one administration covering the whole of the country, there is no reason why such a result should occur, it being perfectly possible to arrange the single set of taxes and public expenditures so as to avoid it.

The conclusion can then be drawn that this establishes a case for some sort of redistribution between richer and poorer areas; and this immediately opens up the possibility of a role for a grants system.

As many authors have pointed out,² this argument is not really so clear-cut as it might appear from the summary above. The first question is whether an extensive system of centrally organised redistribution of income between individuals would enable one to by-pass the need for inter-authority redistribution. At first, it might seem that this would not be so. Even after considerable income redistribution between individuals, one might well find that some authorities were richer than others and hence we should still have the same situation of two people at the same income level being taxed unequally (relatively to benefits received) because they happened to live in different parts of the country. But this counter-argument is not really convincing in that it would be within the compass of those concerned with inter-individual redistribution to take such matters into account directly, rather than through the medium of local governments, if they so wished. So all that one may be saying is that inter-individual redistribution has not gone sufficiently far to eliminate inter-area differences - or at least to reduce them to manageable proportions. Therefore, on this line of thought, inter-authority redistribution has to be thought of as an alternative to inter-individual redistribution.³

Given all the uncertainties which surround policies of the latter


³ 'Redistribution among communities is only a second-best alternative to inter-individual adjustments in distribution' (R.A. and P.B. Musgrave, op. cit., p. 636).
sort (e.g. whether we should look at vertical or horizontal redistribution, what measures of income differences are appropriate, how far one should go towards correcting them and so on) the role and functions of inter-authority grants of an equalising character become shadowy and elusive.

A different view can be reached about the case for interjurisdictional equalisation grants if the accepted political philosophy is one which centres on the relationship between higher-tier and lower-tier governments rather than on that between higher-tier governments and the individuals located in lower-tier areas. In this case it can be argued that the avoidance or minimisation of disparities of treatment at local government level is a goal in its own right. Whether or not over-all redistribution goals can be achieved by the centre concentrating solely on inter-individual redistribution is then beside the point. The crucial requirement, on this view, is to give different local authorities the capacity to provide something like comparable public services on the basis of something like comparable taxes and charges. Central government-local government relations and transactions are therefore of the essence.

Another question mark to be put against the general arguments for inter-area grants is whether they are not gravely weakened once the mobility of people is taken into account. Insofar as individuals flow out of fiscally disadvantaged areas to others, rents and property values tend to fall in the former and to rise in the latter in such wise as to offset and compensate for the fiscal differentials, thereby removing the need for equalising grants. It can, of course, be argued that such labour flows may have other, unwelcome, consequences (e.g. congestion costs in the receiving areas) if they do take place; or that impediments to movement are such that they would not take place on a sufficient scale. But if the latter is the case, for instance, this would seem to suggest that the earlier role distinguished for grants (i.e. to offset artificial impediments to movement) is not being adequately discharged.

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This leads us to another proposition: that inter-authority equalising grants are necessary to enable local authorities to provide public facilities on a scale warranted by central government merit wants considerations. Once again, the logic is far from impeccable. A separate role for grants to promote such purposes has already been sketched. So it would be double counting to use this argument again to justify equalisation grants. And, in any event, as we shall see in more detail later, merit wants purposes (or at least those stemming from central government considerations) are better served by specific purpose grants than by those of the general character usually associated with equalisation purposes.

Nor have we distinguished so far between the argument that some local authorities should receive equalisation grants and that the central government should be the vehicle of distribution. The case for compensating poorer authorities might be met by constitutional arrangements for imposing corresponding levies on richer authorities (as with the Länder in West Germany) rather than leaving it to the central government to pay out the grants and raise the necessary revenue in whatever manner it thinks fit.

Other questions also arise, though more commonly discussed in the context of financial relations between different countries than between local authorities in the same country. One is that apparent differences in local tax rates necessary to provide similar standards of public provision may be deceptive insofar as any one local authority is much more capable of exporting its tax burden to non-residents than another (e.g. with rates on commercial rather than domestic property). 6 Another is that fiscal equalisation between authorities is not identical with fiscal equalisation between individuals in the sense that the net result might be higher taxation on poor people in one area to finance higher benefits to rich people in another. The difficulty of gauging such results is made worse if one has a situation where grants are made to one authority for onward transmission to another, as is often the case when one has both State and local governments or more than one tier of local government.

For all these varying reasons, one must conclude that the equalisation argument for grants to local authorities is far from being firmly grounded in a universally accepted set of principles;

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6 The system of grants, positive and negative, designed to correct for externalities (see p. 76 above) could in principle take care of this problem.
some people (though not others) would regard it as a distinctly un-easy one, to echo the title of a well-known book. However, this is not the end of the story. There is in many countries a very good reason for making such grants: simply that grants have been paid from central government to local authorities for many years and that all sorts of institutions have been generated and arrangements made as a result. In the long run, this argument does not have any strength at all but in the short run it is politically and economically inconceivable that there could be radical changes in the general principles and practices that have grown up over many years. In other words, if one construes 'fairness' or 'equity' in the context of what has become customary in intergovernmental grant payments, one is likely to get nearer to the major forces of importance than by dwelling on what kinds of equalisation might be justified in a country where such grants did not exist. This may seem to be a retreat from high theory; and in a sense it clearly is so. Nevertheless, open recognition of such limitations on the freedom of action of governments seems to be a better basis for discussing the operational problems of giving content to inter-authority equalisation grants. When both politicians and officials are involved and when two or more levels of government are concerned, it is simply foolish to close one's eyes to the massive strength of the vested interests in continuing with long-established arrangements, even if their details are subject to changes over time.

When we examine the basis of such equalisation grants as exist in different countries we customarily find that they have both revenue and expenditure constituents. On the revenue side, one may wish to distinguish between taxable capacity and tax effort - for the reason that a given level of revenue could reflect either a low taxable capacity and a high tax effort or vice versa; and it may be desirable to distinguish between these two combinations. We say 'may be' as this conclusion is not universally accepted on such grounds as the additional incentive to add to local expenditure if the level of equalising grant is dependent on tax effort as represented by some measure involving the local tax rate. But if one does wish to make the distinction, there are several ways of doing so, whether by way of regressing tax/income ratios


8 Cf. W.E. Oates, *op. cit.*, p. 314. We shall have more to say about this in the context of the U.K.
on various indicators of differing local characteristics or by a representative tax system approach. The general aim is to distribute compensation between local authorities on the basis of taxable capacity and tax effort, more being available if taxable capacity is low or tax effort high.

Three further glosses can be placed on such allocations. The first is whether one measures local income on the source or the residence principle. The answer would seem to turn on which is the nearer approximation to taxable income. For example, in the U.K. it would clearly be the residence basis (at least as far as local, as distinct from regional, income tax goes) as we saw in the preceding chapter. The second is whether one introduces the principle of progressivity rather than that of proportionality. If income per head is greater in one authority than another but both levy the same tax rate, can one really say they are making the same tax effort? Or should one rather say that the poor area is making a greater tax effort? We link up here with the traditional but unsolved public finance riddles about the meaning and measurement of sacrifice. Finally, we have to remember our earlier warning that taxes passed on to inhabitants of other jurisdictions are by definition not borne by the inhabitants of the tax-levying jurisdictions.

The last question to decide on revenue-capacity equalisation is how far the process should go. As we shall see, a major bone of contention in the U.K. is whether richer authorities should be brought down to a common level as well as poorer authorities brought up to it. Economics can throw little light on this matter and it was no surprise to see the Layfield Committee conclusion: 'We believe the resolution of these questions is a matter of political judgment.'

On the expenditure side, the basis for equalisation grants may be even more obscure. For a start, we can say that there is one proposition in common to both revenue and expenditure sides:

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9 See R.J. Chelliah, H.J. Baas and M.R. Kelly, 'Tax Ratios and Tax Effort in Developing Countries', IMF Staff Papers, March 1975, for an account of these methods in the international context.


11 Op. cit., p. 215. It should be made clear that this conclusion embraced equalisation on the side of expenditure as well as of revenue.
that a simple comparison of recorded revenues or expenditures by authorities is unlikely to tell us much. In the same general way as revenue totals as such fail to tell us anything about tax effort, so expenditure totals tell us very little about 'needs'. Suppose, for instance, we look at U.K. expenditure on primary and secondary education. This could vary between authority A and authority B for any or all of the following reasons:

- Differing numbers of children of school age
- Differing age distributions of children (even if total numbers are the same)
- Differing levels of quality of service provided
- Economies of scale with respect to numbers taught (for any given area)
- Diseconomies associated with very small or very large size of area (even if total numbers taught are the same)
- Different costs of units of factor inputs (e.g. extra salary weighting for London)
- Different levels of 'efficiency' (in the sense of not minimising costs per unit of output).

So if one local authority has a different level of expenditure from another, it is very difficult to read anything into this unless all these separate possible reasons are disentangled. No doubt the difficulty of disentanglement differs from service to service and from country to country and indeed may even be less under Australian than British conditions; but the same general set of difficulties remains.

If one wishes to reward the deserving but not the undeserving, then in principle one needs to distinguish between these expenditures and potential expenditures which are outside local control and those which are not, endeavouring to compensate authorities where, in this sense, they are the victims of circumstances but not where they are wanton, profligate or wasteful. But there is no single unchallengable way of specifying what is a given level of output (or output per head) of any one service and precisely which costs of meeting it could be avoided, let alone of aggregating such results for all the services provided. In other words, the concept of needs is in the last resort subjective and elusive rather than objective and clear-cut. After all, even the proposition

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12 See J. Le Grand, 'Fiscal Equity and Central Grants to Local Authorities', *Economic Journal*, September 1975, for succinct discussion of these matters.
that one local authority should be paid more because its population is higher than another's does not hold if the view is taken that migration should take place from the former to the latter.

Nevertheless, there are certain customary ingredients which have been used in grant formulae for years and years and even if they have no absolute justification in logic they have come to earn their keep by venerable antiquity. Broadly, these ingredients are total numbers, numbers of weak or disadvantaged groups, size of geographical area and so on. Whether one can really do better than this is very doubtful. To illustrate, there has been much debate on whether local authorities should be grant-aided on the assumption that common standards of service provision are necessary throughout a country or whether attainment of minimum standards by all authorities will suffice. Any such decision would involve two separate components. First, there is the decision of principle (parallel to that on the revenue side) whether full equalisation of provision is a desirable objective or not. Second, one has to measure standards of service provision. This, to repeat, is not a matter of measuring costs of inputs at all. Nor is it just one of measuring levels of physical outputs - and this may be difficult enough when many local services are of a preventive character (e.g. police, fire\textsuperscript{13}) - but also one of measuring benefits derived from outputs. Unless and until these nuts can be cracked, the comparison of standards of service provision is about as rewarding as counting the numbers of angels on pinheads.

We now look at the grant instruments available for meeting these differing objectives. There are various ways of classifying grants, the most important being:

(a) whether the grants are related to rather general or very specific criteria;
(b) whether the criteria are related to revenue capacity or expenditure needs, or both;
(c) whether the grants are tied to levels of local authority spending; and
(d) whether the grants are limited in total amount or not.

Any one grant in any one country may embody more than one of these characteristics. Thus the Rate Support Grant in the U.K. and the general revenue sharing system in the U.S.A. are

\textsuperscript{13} Cf. C.S. Shoup, \textit{op. cit.}, Chapter 4.
related to general rather than very specific criteria (i.e. (a)); they also take expenditure as well as revenue needs into account (i.e. (b)). Supplementary transport grants in the U.K. are very specific (i.e. (a)); they are tied to local authority spending levels (i.e. they are a matching grant as under (c)); they are also in effect limited in total amount (i.e. (d)). U.K. police grants, on the other hand, are of a specific and matching nature but are not limited in total amount.

More generally, we can align instruments with objectives fairly readily. By and large, the 'easy' objectives of externality correction, merit wants promotion and second-best provision are met by grants which have very specific criteria and which are also tied to levels of local authority spending. Unless the latter condition is satisfied, the objectives of the donor government could easily be thwarted, in that the donee government would in effect simply have the equivalent of an increment in income which it could use in any way it wished, whether by way of increasing expenditure or reducing local tax rates. But if the grant is of a matching variety, there is a substitution effect as well as an income effect in that the marginal cost of expanding that service is reduced relatively to that of others. The position is then markedly different.

On the other hand, grants reflecting the division of functions between central and local government or grants designed for equalisation purposes need to have more general criteria and to be related to revenue capacity, need and the like.

Some final points of a general character need to be made before leaving the subject of grants principles. The first is to repeat an earlier warning that there is no presumption that a grant is the only or even the best way of achieving a particular set of objectives. The discussion of externality correction in recent years, the circumstances under which externalities can be 'internalised' and so on, is a good enough illustration of this proposition. The second is that one must take account of other fiscal arrangements as well as intergovernmental grants. An extremely sophisticated arrangement for compensating poorer authorities will not be of much avail if the tax levied to finance such expenditure falls on them in one way or another; or if other grants under entirely different programs (e.g. for regional purposes) work in the opposite direction to the inter-authority equalisation grants. Finally, the Layfield Committee was concerned to emphasise the relationship between grant structure and general policy on local responsibility, arguing that if the latter were favoured the case was strengthened for grants relating to general rather than specific criteria. It also stressed the need for individual local authorities to receive grants in their own right rather than
at second-hand. Finally, it laid great stress on a reasonable
degree of stability in the pattern and total of grants over time.

But remarks of this kind lead us to a detailed appraisal of
the U.K. grant structure, the complaints commonly raised against it
and the solutions suggested. We shall take first the general
question of the ratio of grants to local sources of revenue;
then we shall discuss various matters of grant administration which
have to be settled more or less irrespective of the size and pattern
of the grant structure; then we consider at considerable length
the details of the proposed reforms of the rate support grant; and
finally we look rather briefly at the remaining elements in the
grant structure.

The Overall Role of Grants in the United Kingdom

We alluded in our discussion of local revenue sources to the
Layfield Committee's discussion of a centralist or a localist
solution to what it thought to be the central problem of local
authority finance in the U.K. Therefore we can be fairly brief
on this occasion. Essentially, the argument was that at present
the U.K. falls between the two stools of a high degree of central
control accompanied by a high ratio of grant to total income, and
a fair amount of local independence associated with more local
financing (including other items such as fees and charges, as well
as local income tax and rates). The Committee's view was that the
general principles of accountability (i.e. appropriate linkages
between revenue-raising and spending decisions) required a move in
one direction or the other, but it did not itself come down decisively
on either side. Two major reservations have been expressed about
this need for greater accountability. One member of the Committee
(Professor Day) appended a note of reservation to the Report itself.\(^\text{14}\)
The principal contention was that the issues were not quite as
polarised as the other members of the Committee suggested and, in
particular, there was room for a middle-way solution on the lines
of national grants to secure national minimum standards of local
services together with local finance of improvements on minimum
standards. The principal issue at stake was whether, in fact,
minimum standards of service provision and costs could be defined
with sufficient objectivity to command general acceptance: the
dissentient thought it might be possible whereas the rest of the
Committee did not, at least given the present level of knowledge
in this field.\(^\text{15}\) We shall have more to say on this subject when
we return to the measurement of needs.

\(^{15}\) Ibid., p. 62.
The other major reservation is to be found in the work of Cripps and Godley. They denied the proposition that accountability principles demanded a general linkage between expenditure making and revenue raising decisions, as distinct from one at the margin of expenditure, on the grounds that with a general and non-specific grant local electors always have the right to turn out local politicians who do not spend such funds in a manner or on an object of which they approve. In other words, freedom to spend grants as they wish, and not as dictated by the constraints of a specific grant arrangement, automatically makes for accountability on the part of local authorities. The difficulty with this argument, as the Committee itself pointed out, is that it is only half the story. In fact, as we saw earlier, the growth in the ratio of general to specific grants over the years has been accompanied by a battery of administrative controls which have the prime effect of transforming an allegedly unhypothecated grant into one which is so beset with rules and regulations that it is in reality nothing of the sort.

The response of the Government to the centralist-localist choice was fairly predictable. It shied away like a frightened horse from any suggestion that there should be a clear division of functions between central and local government, whether of a centralist or localist form. And although in favour of a middle way, it was not prepared to take on board the determination and estimation of minimum standards. Nor did it acknowledge the constraints imposed by various central controls on the alleged freedom of local authorities to spend Rate Support Grant funds as they thought fit. It then soared off into the stratosphere with soothing remarks about preserving a sense of partnership, strengthening financial machinery for greater effectiveness, not forgetting (of course) to offer one or two trifling goodies to ratepayers and local electors on the way. If ever a mountain of effort brought forth a mouse of response, this was it.


18 In the limiting case, when the grant really is unhypothecated but is also the sole source of income, the recipient authority would have complete freedom to spend on whatever services it wished - but no freedom at all to determine its total level of spending, at least on the assumption that any spending shortfall in one year would lead to a corresponding cut in the grant total in the following year. So local electors would thus have no power to determine total spending as distinct from the constituents.

19 Cmnd 6813, *op. cit.*
Grants Administration

There are several matters connected with the administration of grants which are substantially the same whatever the precise level and precise composition may be. Foremost among them are various issues of central government-local authority relationships, notably the over-complexity of the grant system, the uncertainties associated with it and the difficulties of controlling spendthrift authorities. But there are also others affecting local authority-local inhabitant relationships, notably misunderstandings about the present system.

We outlined the system of determining the level and distribution of Rate Support Grant in an earlier chapter, and said that it is of Byzantine complexity. There are really two separate points here: the iterative process by which a complicated formula is made still more complicated to fit what are deemed to be the political facts of life and the further obscurities due to the payment of some grant components to some categories of authorities only and other components to other (different) categories. The Layfield Committee came out with clear-cut recommendations on the second matter and, although the precise implementation will depend on the final form of the Rate Support Grant, it would seem that these sentiments have found an echo in the Government response.

On the former matter, the situation is less clear. Once again, the precise form in which the Rate Support Grant may be recast will be highly important. But one proposition is worth noting. There has been one powerful plea for the introduction of explicit objectives, the derivation of grant formulae in the light of these objectives and the general opening up of the subject to public discussion. This is a somewhat incongruous echo, given the well-known views of these authors, of the rules versus discretion arguments familiar in some of the literature emanating

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20 See above, Chapter II.


22 Cmnd 6813, op. cit.

23 We shall come later to the proposal to integrate the present resources and needs components.

24 F. Cripps and W. Godley, op. cit., p. 57. See below p. 94 for further discussion.
from the University of Chicago over the years. The Government's response was predictably non-committal whilst paying lip-service to the general need for more transparency (to use a favourite E.E.C. expression), more perceptibility and the like. As always, there are many more governmental vested interests in discussions behind locked doors than in those in the open.

Another major complaint about grants is the uncertainty attaching to their determination. This uncertainty has several dimensions. One is that their size may often not be known until very late in the day; a second one is that there may be large fluctuations from year to year, in both the total and its distributional pattern; and a third is that such deficiencies are likely to be even more pronounced in times of rapid inflation. Some suggestions have been made about remedies, such as damping factors, based on previous expenditure patterns, to apply to the determination of needs element distribution — as indeed has been the practice very recently. But one cannot resist the suspicion that in some respects the vociferous exponents of these complaints were really crying for the moon in the sense that they sought to isolate the local authority area from readjustments necessitated by unforeseen economic developments. A general promise by the Government on the lines of 'I will be good' was the right response to these sorts of complaints.

Another matter of some importance, though more to central than to local government, is the need to control expenditure by spendthrift authorities - partly on grounds of managing the economy, but also partly for keeping the peace between some notoriously quarrelsome organisations. The crux of the problem is that until now central government has only been able to restrain individual authority expenditure by general grant cutbacks; it has not been able to make selective cutbacks, at least by the grant mechanism. This led to a Layfield Committee proposal, since echoed by the Government, that grants to individual authorities should be progressively reduced as expenditure rose above some predetermined level. One can see that there is a problem here which may from time to time call for action of this sort. But one is still left wondering whether such a weapon could or would be

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25 Cmd 6813, op. cit., paras. 3.24 ff.
26 Layfield Report, op. cit., p. 228.
27 Ibid., p. 224.
28 Cmd 6813, para. 3.13 and Appendix 1.
confined to spendthrift authorities only. However, this brings us very close to the subject of compensation for tax effort which we shall want to discuss shortly. So we leave it at that for the time being.

We can be more brief on local authority-local inhabitant issues. There are just two points to be made. The first is to echo the cry about the impossibility of comprehending the present grant system; if local authorities themselves have difficulty, this will hold a fortiori with their inhabitants. At the same time, many people are only too anxious to have it both ways in the sense of making loud demands for equity and fairness in the grant system whilst also wanting simplicity - in exactly the same way as with the system of personal income tax. The second is a matter raised earlier - the impossibility of understanding exactly what a local authority has been spending its money on or the reasons why expenditure may have changed from one year to another. Both the Layfield Report and the Government response thereto took this criticism seriously and so we may - possibly - see some improvements in this area.

The Rate Support Grant

As we have seen, the Rate Support Grant accounts for a very large proportion of all intergovernmental grants in the U.K. and so it is not surprising that it absorbs a large proportion of the discussion on the subject. The general aim of the grant has been stated on many occasions. Thus:

'A general aim in the distribution of grants is to enable authorities to levy similar rates of local tax for the provision of similar levels of local service.'

Similarly, the means by which this objective is to be achieved - compensation for differences in taxable capacity and in spending needs - have also frequently been described.

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29 See below, p. 92.

30 See above, p. 12.


32 See, for example, Department of Environment, Central Government Grants to Local Government, Layfield Report, Appendix 7, op. cit.
But many critics have argued that these objectives are currently achieved more in the imagination than in reality: that, for instance, there is a great variety of rate poundages as between authorities which bears no close relationship to the provision of different levels of service. We must therefore look at the various components of the Rate Support Grant one by one to see whether, and if so how, these criticisms can be made to stick. After examining the resources, needs and domestic components in succession, we shall then be in a position to discuss the most important proposal made in recent years: the combination of the separate components of resources and needs into a 'unitary' grant.

It will be recalled that the resources element, first introduced as a principle into the U.K. system in 1948, works on what we called the ghost ratepayer principle. If ratable value per head is below a centrally determined standard value per head, the government steps in as a substitute ratepayer, paying rates at whatever is the local poundage on exactly this shortfall in ratable value per head. So no eligible authority has a ratable value per head, including this notional component, which is below the national standard figure. On the other hand, those (few) authorities with ratable value per head above the standard are not penalised in any way. But not all authorities are in the eligible class in that the resources element is directly available to districts but not to counties.

There are four major criticisms directed at this arrangement. The first is that one cannot hope to achieve similar rates of local tax in any meaningful sense by concentrating on similar rate poundages (for similar services). This takes us back to our earlier discussion of arbitrary variations in ratable value between areas. Given the purely subjective character of many valuations for rating purposes, there is no reason for expecting similar rate poundages to correspond to similar tax rates on income. In other words, ratable values as assessed today are a poor measure of taxable capacity.

The Layfield Committee proposed to deal with this defect by using a measure of personal incomes as the basis for assessing

33 See D.N. King, 'Why Do Local Authority Rate Poundages Differ?', Public Administration, Summer 1973.

34 See p. 51 above.
relative taxable capacity of different areas.\textsuperscript{35} However, the proposal had its own snags, as the Government pointed out in its response.\textsuperscript{36} First, there was increased complexity. Second, one might find that rate imposts increased for people with below-average incomes living in areas where aggregate income per head was greater than average (and \textit{vice versa} for rich people living in poor areas); so closer correspondence of tax burdens with incomes might well not be achieved - in fact, the opposite could result. Instead, the Government preferred measures to improve the rating system so as to reduce the degree of arbitrariness and render it a better measure of taxable capacity.

One final comment needs to be made on this debate. A highly germane fact - though not one which received much attention - is the problem of tax exporting. Insofar as non-domestic rates are not borne by the inhabitants of the area in which the property is situated, this raises doubts about the meaningfulness of aiming at similar rate poundages for similar levels of service. It is also a matter for debate whether personal incomes received or personal incomes generated are a better basis for the measure of taxable capacity.\textsuperscript{37}

The second major criticism of the resources element relates to the non-penalisation of those authorities with ratable values per head above the standard level. Thus it can be argued that levying negative grants on such authorities will reduce the resources element outgoings from central government, possibly even to zero.\textsuperscript{38} In addition, such authorities are not penalised if the aggregate ratable value in their area increases, unlike those below the 'Plimsoll line', in that the latter will automatically lose government-provided ratable value if they succeed in attracting more industry and the like to their areas.

\textsuperscript{35} \textit{Op. cit.}, p. 222. The idea was that rate poundages could vary between areas providing similar services, if personal income per head differed between areas.

\textsuperscript{36} Cmnd 6813, \textit{op. cit.}, paras. 321 ff.


\textsuperscript{38} F. Cripps and W. Godley, \textit{op. cit.}, p. 37. Raising the level of the standard ratable value per head to that of the authority with the highest ratable value would also be a means of achieving equality of taxable capacity, but with a substantial increase in central government outpayments.
But debate of this issue could be interminable. We are back to controversy about full v. partial equalisation.39 This controversy is incapable of final resolution, though no doubt there will be protagonists on both sides until Doomsday, if not beyond.

The third major criticism is directed at the practice of government contributions to eligible authorities being based on the local poundage. In effect, this practice means that the resources element takes on the characteristics of a matching grant which not only adds to the resources of a recipient authority (an income effect) but also increases the advantages at the margin of local authority spending relatively to the disadvantages of levying rates (a substitution effect). So the result will be a greater inducement to a local authority to spend relatively to that which would arise if, say, the ghost payment were made on the basis of a national average poundage40 rather than at the local authority's own rate poundage. This situation can be criticised from various angles - that we have here an engine of extravagance, that it should not be a feature of a grant ostensibly designed to promote equalisation and so on.

At the same time there is an argument to be put on the other side: that if one authority decides to make a greater tax effort than another and as a result levies a higher rate in the pound, it should be rewarded for its enterprise, in the same way as one discusses such ideas in the international aid context.41 But one is no more likely to reach finality in this case than in that of, say, the question whether state pensions should be paid to retired people regardless of the effort they make to earn incomes of their own.

39 See above, p. 81.
40 The payment would then have an income effect only.
41 Another way of making this argument can be based on the paper by Le Grand (op. cit.). To simplify greatly, if one takes the objective to be the equalisation of benefits provided per head relatively to tax effort per head authority by authority, it is easy to see that one can justify paying out grants at the individual local poundage. Thus if two authorities are so situated that they could both provide the same level of benefits per head at the same local tax rate, but one chooses to levy a higher tax rate and provide a higher level of services, the distribution of the same absolute grant per head to each would be disequalising. But this is precisely the result which would follow from using a tax rate which takes no account of higher tax effort.

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The fourth and final criticism of the resources element is that the only way of cutting down total outpayments is by reducing the standard ratable value per head figure and this in turn means that all recipient authorities are affected - a blunt weapon for dealing with the spendthrifts. However, this takes us straight back to the development of marginal controls and so we need not spend more time on it.

Criticism of the needs element must now be considered. We have already described this system - a superficially imposing panoply of indicators, regression analysis and so on but tempered by judgmental corrections to make the results palatable to Government and local authorities. We have also argued that the whole concept of needs is so jelly-like that one is wasting one's time and everyone else's in thinking that there is some unique formula which, if only sufficient effort is put into its derivation, will solve all such problems for all time.

Criticism of the needs element in the present formula takes a number of standard forms: that it is extremely confusing even to those who have studied it at length, partly by virtue of its own intricacies and partly because of the interconnections with other elements in the grants system; that the continuing use of past expenditures is a grave weakness, in that this may bear little or no relation to needs; that the various indicators

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42 See above, p. 88.
43 See above, p. 13.
44 See above, p. 82.
46 Thus in the evidence by W. Godley, 'Reflections on the Control of Local Government Expenditure and its Financing', Layfield Committee, Appendix 7, op. cit., p. 65, it is argued that equalisation on a per capita basis is unfair to areas with a high proportion of children. If equalisation were on an adult basis, then two areas with the same number of people but with differing proportions of adults and children, would no longer be treated alike for needs element purposes. But by the same token the one with the smaller proportion of adults would obtain less resources grant than before, if the basis for that element then became ratable value per adult rather than ratable value per head.
such as population, numbers of children, population density and the like are unsatisfactory or inadequate; that the amount disbursed is more than sufficient for equalisation purposes;\textsuperscript{47} that the formula leads to over-large variations in needs assessments from year to year; and so on.

It is easy to be critical in this vein - until one comes to suggestions for improvement. To parody Winston Churchill's remarks on democracy as a form of government, the present formula is the worst of all possible ones, except in comparison with any other. Thus both the Layfield Committee and the Government in their response expressed pious hopes\textsuperscript{48} about the determination of national average costs of providing individual services. But it is agreed that such data do not exist as yet; and still less are the reasons known why particular local authorities might have average costs per unit of output which differ from the national average. Nor, one might repeat, does the determination of costs of providing a service shed much light on the level of service or the benefits derived from it.

However, the final word on this subject, like the resources element, has to be uttered in the context of the unitary grant. But in the meantime we can refer again to a conflict of principle which is particularly sharp in this area. On the one hand, we have the Cripps and Godley position:

'But we are emphatic that the matter should be resolved in a way that enables outsiders to understand what is going on, i.e. that the basis of calculation should be made public and explicit and it should also be ascertainable whether or how judgments have been made such that special characteristics of areas qualify for grant.

And we also think that the present way of calculating needs element is something of a scandal, since the regression results have an objectivity which is spurious.'\textsuperscript{49}

\textsuperscript{47} Layfield Report, \textit{op. cit.}, p. 461.

\textsuperscript{48} As did the 1971 Green Paper, Cmd 4741, \textit{op. cit.}, pp. 40-1. It is not clear that the determination of national average unit costs has made any progress since that date.

The Government concludes its discussion of assessment of spending need thus:\textsuperscript{50}

'It has to be recognised that there can never be a totally objective method of needs assessment. All the possible methods involve judgment at some stage. In the end the choice between methods must be a judgment, but the Government recognises that this choice should be made only after a thorough review of the alternatives in consultation with the local authority organisations.'

In the light of this statement, one's guess must be that subjective judgments will be the last thing which governments are likely to want to be fully open to the prying eyes and questioning minds of those outside the corridors of power.

The third ingredient in the Rate Support Grant is the domestic element, whereby a grant is paid to enable each local authority in England to reduce the poundage on domestic property by a given absolute amount.\textsuperscript{51} To analyse the effects, we can consider four different cases. First, two houses may have the same ratable value and the same poundage. The relief given would then be the same in money terms, but although the proportionate gain would be the same in relation to nominal ratable values, this would not necessarily be so in relation to true ratable values, given the inaccuracies of the system of determining nominal values. Nor is there any reason why relief should be the same percentage of household income in both cases. Second, two houses may have different ratable values but pay at the same poundage. The absolute amount of relief given would then differ but it would be the same fraction of nominal ratable value in both cases. Third, two houses may have the same nominal ratable value but different poundages if they are situated in different areas. The relief given would then be absolutely the same but proportionately smaller for the house with higher poundage. Finally, houses

\textsuperscript{50} Cmd 6813, \textit{op. cit.}, Appendix 2, para. 7.

\textsuperscript{51} The absolute amount differs in Wales and Scotland from that in England: an element of regional policy in the grant system. We shall confine our analysis to authorities in England, but comparisons can be made between England and Scottish (or Welsh) authorities without any difficulty.

\textsuperscript{52} Average domestic rating bills were cut by 27.5 per cent in England and Wales in 1975–76 as a result of this measure.
with different nominal ratable values and different poundages would combine together the features of the last two categories, with neither absolute nor proportionate relief being identical.

The origins of this system go back to the 1960s, when it was decided to cushion the effects of rising rate poundages on domestic property and the local authorities were compensated for the loss of taxable capacity by adding on another component to the general grant, as it was then called. This explains the system; but it does not excuse it. Clearly, domestic rate relief should be considered in the context of the relative rate burdens on domestic and non-domestic properties, as the Layfield Committee very rightly emphasised. The determination of the amounts to be raised by rates and the appropriate division of the burden between domestic and non-domestic is one subject; it should not be confused with the operation of an equalisation grant. Nevertheless, the whole episode is a small illustration of the general way in which grants come to be determined, that is in such a way as to make sure that no single authority ever loses more than a fractional amount as a result of a change of policy.

We now come to the major reform proposal for the Rate Support Grant: the combination of the resources and needs elements into a single unitary grant. Two drawbacks are laid at the door of the present combination of elements. The first is that it is complicated: that, for instance, the needs element consists not only of an equalising element but also of another which is solely related to population and has the effect of reducing rate poundages for all authorities; or that the complications of meshing the needs and resources elements together are sufficient to defeat all but those with I.Q.s over 200. The second is that full equalisation - in the sense of putting all in the same position as that of the authority with the lowest per capita needs and that of the authority with the highest per capita resources - would require either a very high grant total or the mounting of a sustained assault on the better off authorities by one means or another (e.g. by exacting a contribution from those with the largest resources); and neither of these alternatives is of great appeal.

A unitary grant could take a number of different forms but the essential principle would be to pay grants at such levels as


to enable any one authority to provide comparable services with others if it levied a nationally determined standard rate poundage. Any such system would require expenditure needs assessments for each and every authority, and the publication of such figures, as well as the national standard poundage rate. Such grants could be paid direct to each authority, if it were so desired.\(^\text{55}\)

The advantages claimed for such an arrangement would be threefold. The first is that full equalisation could be achieved at a lower total of grant outpayments than at present, essentially by taking advantage of such coincidence as exists between high needs and high resources (or low needs and low resources) rather than by operating on the resources side as if needs were identical and on the needs side as if resources were identical. No calculations have been published, however, of this potential saving. Secondly, there would be a ready mechanism for the control of spendthrift authorities. Instead of cutting grants to all, as under the existing system, there could be a system of progressive penalisation at the margin (involving progressively higher rate poundages) for those authorities deciding to raise spending levels above the norms set by needs assessments. Finally, it is argued, the whole system would be clearer to both authorities and ratepayers.

The disadvantages of a change of this sort are also fairly clear. As the Government itself admits,\(^\text{56}\) local authorities may not take kindly to central assessment of spending needs (even if it can be done without a lot of guesswork),\(^\text{57}\) regarding this as still one more step down the road to serfdom. Nor is it clear that one has to have a unitary grant system to ensure greater control of expenditure at the margin. The Layfield Committee suggested a method of margin control in the context of the present Rate Support

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\(^{56}\) Cmd 6813, op. cit., Chapter 3.

\(^{57}\) See ibid., Appendix 1, for the admission that the 'pure' needs assessment figures might have to be adjusted by actual past spending figures to avoid large initial changes.
Grant System.\textsuperscript{58} The claim that full equalisation can be achieved with a smaller grant total is more persuasive - provided that one accepts such an objective in the first place. As we saw earlier,\textsuperscript{59} this is by no means self-evident.

Other Grants

We need not spend much time on this section as specific and supplementary grants are only about 14 per cent of the grants total in the U.K., as officially compiled. But it is interesting to observe a marked difference of emphasis in recent discussion. The Layfield Committee\textsuperscript{60} had little time for them, recommending an immediate absorption of the Police Grant into the Rate Support Grant (despite the eloquent defence of the Home Office in favour of retaining it as a separate item\textsuperscript{61}) and similar treatment, though not immediate, for the Transport Supplementary Grant. It is fair to add, however, that the Committee did see a case for occasional temporary grants if additional needs or new policies justified them.\textsuperscript{62}

The Government's attitude in its response\textsuperscript{63} was rather different. There was no mention of absorbing the Police or Transport Grants. Rather it went out of its way to point to the circumstances under which specific grants were justified. There was nothing very new in principle here, with references to the need to encourage particular expenditures, aid to authorities generating spillover benefits and so on. But there was a particular hint about specific grants for some educational purposes, which might even mean something in practice - one never knows.

\textsuperscript{58} Op. cit., p. 224.

\textsuperscript{59} See p. 81 above.


\textsuperscript{61} Layfield Report, Appendix 1, pp. 271 ff.

\textsuperscript{62} Layfield Report, p. 223.

\textsuperscript{63} Cmnd 6813, op. cit., Chapter 4.
Concluding Reflections

A number of propositions stand out amidst the welter of argument and counter-argument about the principles and practices of intergovernmental grants in the U.K. The first is the antiquity of so many of the ideas which regularly appear as if they were brand-new. To return to the Royal Commission Report of 1901 again, we had there a whole Minority Report by Lord Balfour of Burleigh advocating the payment of block grants in accordance with population, ratable values and actual expenditure, whilst recognising the drawbacks of the third component. Nor was he alone in recognising these bases for grants, as the conclusions of the appended Report by Sir E. Hamilton and Sir G. Murray make clear:

'That the aggregate grant should be directly allocated among the various local authorities entrusted with the expenditure on a scheme such as we have propounded, paying due regard to the needs of each district and to its ability to meet them and uniformly applied to urban and rural districts alike.'

These examples could be multiplied by examples from the survey by G. Rhodes referred to earlier. He showed that the same arguments were being made in 1922 as in 1957 about the expenditure-promoting tendencies of percentage grants, and that the needs and ability to pay principles were both acknowledged and recognised in the 1929 Act. Despite the long historical lineage, nothing seems to be capable of stopping new commentators from producing such ideas as if they were freshly conceived. The tendency to re-invent the wheel every time the subject is discussed might perhaps be diminished if a little more attention were given to the historical literature.

It goes without saying - and here we come to our second observation - that attempts are made to cover up the staleness of many arguments by patter which would be more appropriate to a huckster in Oxford Street than to serious writers. The

65 Ibid., p. 134.
67 Ibid., para. 37.
general sentiments expressed in the Government's response\textsuperscript{68} to the Layfield Committee—references to 'middle way', 'partnership', 'local democracy' and so on—are sufficient evidence of that. The subject of local government finance seems fated to attract more than its fair share of anodyne platitudes.

A third feature is the insularity of much of the discussion on grants. This charge has two different bases: one is that there is usually very little discussion of grants principles and practices in other countries; the other is that the subject of taxable capacity is an historic one in the literature of public finance, stretching from such applications as those suggested in the Anglo-Irish context in the late nineteenth century\textsuperscript{69} to modern ones concerned with assessment of tax performance in developing countries,\textsuperscript{70} quite apart from the range of theoretical literature dealing with the subject. But one can read the Layfield Report from cover to cover without the slightest inkling that there are highly developed grants systems in Australia, Canada and the U.S.A. or that the literature on the subject of taxable capacity would fill countless volumes.

Another reflection is on the way that equalisation matters have come to dominate the scene. The stage was set for the post-war period some thirty years ago when Aneurin Bevan declared in the House of Commons:\textsuperscript{71}

"What really matters in valuation fundamentally is equity—whether two citizens occupying property of the same sort in different places pay the same kind of contribution for the same sort of social services."

Since that time, the tide has been flowing strongly in that direction, culminating in all the emphasis given in the most recent publications\textsuperscript{72} on the need for full equalisation and nothing less—in the same kind of sense as that sketched out by Bevan. Principles of efficiency in resource allocation—with questions about whether it is always sensible to encourage people to stay put—have taken a very decided back seat.

\textsuperscript{68} Cmnd 6813, op. cit.
\textsuperscript{70} R.J. Chelliah et al., op. cit.
\textsuperscript{71} Quoted by G. Rhodes, op. cit., p. 164.
\textsuperscript{72} Cmnd 6813, op. cit.
Although block grants with equalising properties have naturally been favoured in the light of such guiding principles, there is one rather curious feature to be noted. There has been a lot of comment (e.g. in the Layfield Report) about the need to secure minimum standards in the provision of major local authority services. In other words, the merit wants principle has been tied into the grand strategy about equity. One would have thought that, in these circumstances, rather more consideration would have been given to the advantages of specific grants directed to such ends. The explanation of this apparent paradox is really very simple. Virtually all the emphasis could be placed on the refinement and extension of block grants because the apparatus of direct controls has been strengthened over time. It is this very pronounced tendency which has enabled the protagonists of a joint program of equalisation grants and attainment of minimum standards to rest assured that there was no internal conflict in their policy.

73 J.A.G. Griffith, Central Departments and Local Authorities, Allen and Unwin, London, 1966, p. 100, when speaking of the Department of Education after the reforms of 1958, said:

'... The administrative controls of the Department over building programmes of local authorities remain and are, as they were between 1944 and 1958, the basis of the relationship.'
It would be pointless to go into the details of the devolution proposals actively under discussion in the U.K. in mid-1977 in that actual bills were still awaited incorporating the proposals in their revised form and even when such bills see the light of day (November 1977) there is a high degree of likelihood that they will be modified in the course of their passage through Parliament. Nevertheless, in a monograph covering intergovernmental fiscal relations in the U.K. it is highly desirable to say something about these proposals. One reason is that the financial issues arising when a unitary government is partially dismantled are important in their own right;¹ another is that the discussion of the financial issues arising has tended to be virtually independent of that relating to local authority financial matters, in terms of Parliamentary debates, departmental interests and official documentation.²

We shall confine ourselves in this chapter to the devolution proposals for Scotland. These go further than those for Wales and far beyond anything yet considered for the regions of England. They are also more likely to be enacted than the others. This does not necessarily imply that the Scottish proposals are likely to go through on their own without any other constitutional changes, but simply that we can grapple with most of the issues and yet simplify the exposition by concentrating on this one area.

We shall discuss first of all these constitutional proposals as they stood in the middle of 1977. Then we shall consider the financing issues which they raise, whether relating to Westminster-

¹ And not all that common - as distinct from, say, the break-up of a federation into its constituent parts (as in the British Caribbean or in Central Africa) or the division of a unitary government into separate States (as with the setting up of Southern Ireland in the 1920s).

Edinburgh matters, the financing of Scottish Assembly expenditure, the relations between the Assembly and Scottish local government or that between Westminster and Scottish local government. Finally, we shall glance briefly at a few longer-run possibilities.

Outline of Proposals

Growing regional dissatisfaction led to the appointment in the late 1960s of a Royal Commission on the Constitution with the idea, ironical as it might seem today, of exploring the possibility of building on what then seemed to be the successful constitutional experiment which had lasted in Northern Ireland for the best part of 50 years. The Commission itself reported in 1973[^3] but with many dissentient voices. After a great deal of further discussion, the Government's proposals appeared in their first form in September 1974, but there has been a number of important changes since; and there may well be more to come.

At the time of writing, it was proposed to have an elected 150-member Scottish Assembly in Edinburgh with an executive drawn from Assembly members, to which various subjects will be devolved from Westminster for legislative purposes, e.g. health, personal social services, education (except some higher education), housing, physical planning, environment, fire services, roads and (much) transport. Altogether, responsibility is to be transferred in respect of some three-fifths of identifiable Scottish expenditure. Whereas Scotland will continue to have the same number of M.P.s at Westminster as in the past (thus having a voice in all legislation affecting England), a large part of legislation relating to Scotland will be essentially a Scottish preserve[^4]. It is a matter of some importance for our later arguments that the devolved subjects will cover most (though not all, e.g. police) local authority spending responsibilities but will also cover other subjects falling outside their scope.

There have been various proposals on the financial side. The original idea was a block grant from Westminster to Edinburgh, with the right of Edinburgh to levy a precept (up to 10 per cent)


[^4]: Subject to some reserve powers at U.K. government or Privy Council level, the exact nature of which is still to be settled.
on the tax revenues collected by Scottish local authorities. Later, this idea was abandoned and reliance was to be placed on a block grant only. The most recent proposal at the time of writing is that there will be a block grant which will take into account not just public expenditure in Scotland and in the rest of the U.K. in the recent past but also some kind of needs formula. It is suggested that this grant should be fixed for a period of four years at a time, to avoid annual slanging matches, but that if the Assembly in due course makes a plea for its own revenue source, the U.K. government will listen sympathetically. But whatever changes might be made on this account in Scottish taxation arrangements, all U.K. taxpayers, Scottish as well as others, would continue to pay all taxes levied by the U.K. government.

Not even those who are most warmly disposed to the concept of 'regionalisation' could call these arrangements tidy. 'Constitutional monstrosity' and 'an unholy mix of federal and unitary principles' are two of the politer epithets which have been applied. However, it is not our task to pursue such comments further. Instead, we must turn to the financial implications.

Financial Aspects

The most important question is the extent, if any, of an independent revenue source for Edinburgh as a means of financing the expenditures which may be devolved to it. There are various other matters of financial relations between different levels of government, but these are subsidiary to the separate revenue issue. We shall come to some (though not all) of these subsidiary matters later.

Independence of revenue source is a phrase with many meanings and so we ought to clear our minds here and now on the various possibilities. One is that (the Scottish part of) a particular tax field should be evacuated by the central government.5

5 'A promising approach would be to relate the total of devolved expenditure in Scotland or Wales to comparable expenditure elsewhere in the country on the basis of relative need, and to express it as a percentage of comparable expenditure in the country as a whole.' Cmd 6890, op. cit., para. 76.

6 For example, the proposal to have a separate Public Accounts Committee in Edinburgh.

7 The same principle could apply to local government, but as it has only one tax field - rates - this is irrelevant under U.K. conditions.
and made available to Edinburgh. For example, the Royal Commission\(^8\) considered the possibility of driving licence revenues; betting revenues would be another example.

Another possibility is some system of parallel taxation. Thus Scotland could have a personal income tax which was separate from the national income tax to a greater or lesser extent, e.g. in the same way as the Quebec Provincial income tax is separate from the national tax. Or it could have an income tax which was a supplement to the national tax, i.e. following the same principles, and collected through national machinery but only applicable in Scotland. Or there might be a value added tax supplement. Another alternative is to share tax proceeds in pre-assigned proportions, as with the personal income tax arrangements in Australia in 1976-77.

Another possibility is for Edinburgh to levy a surcharge on tax revenues collected by Scottish local authorities. Finally, in principle (though hardly of practical relevance in the U.K. today) one might envisage some brand-new form of tax not already in being which could be allocated to the Scottish Assembly.

The arguments for an independent revenue source were very clearly expressed by Professor Peacock in the Royal Commission Memorandum of Dissent.\(^9\) An Assembly without some such source has little bargaining power in financial matters - in fact, less than the local authorities in Scotland, which have their own source of revenue. And the accountability or financial responsibility arguments apply at Assembly level in much the same way as the Layfield Committee emphasised in respect of local authority finances. It is also reasonable to conclude that if an Assembly were set up without such powers there would be insistent demands for them over the years, in much the same way as the demand for 'ressources propres' for the European Community in Brussels.

This is not to say that regions such as Scotland could expect to meet the whole of their expenditure from their own revenue sources. It is conceivable that variations in needs, as conventionally construed, are less between regions than between individual local authorities, in that, for instance,
there may well be pockets of city dwellers as well as rural dwellers in each and every region. It is also possible, for very special reasons which we shall come to shortly, that Scotland could finance the whole of its expenditure needs from sources of revenue which could readily be attached to it. But even if full weight is given to these qualifications, inter-regional differences in taxable capacity and needs are such in the U.K. that it is inconceivable that equalisation grants from the centre would not have a large role in regional finances.

But the U.K. Government has been extremely reluctant to concede even the most modest of roles for independent revenue sources - let alone a major role such as might be involved in the assignment of an appropriate share of North Sea oil revenues to Scotland. All the old arguments have been used, for example that revenue devolution would weaken Treasury demand management powers or that if one cannot finance all devolved expenditure from specified revenue sources then one should not finance any of it in this way. We have already argued that such contentions carry little weight for a whole variety of reasons and so we need not go into them again. It is also worth noting that in the 1975 version of the proposals, which would have given the Assembly powers to levy a surcharge on local rates, the maximum amount forthcoming from rates would have been of the order of £300 million per annum compared with a block grant from Westminster of £1,300

10 We say 'might be' as there are some complicated problems of domestic and international law at stake. The Scottish National Party claims that by virtue of the Continental Shelf Act of 1964 and the Continental Shelf (Jurisdiction) Order of 1968, all oil and gas found in the North Sea north of latitude 55° 50' North belongs to Scotland. The counter-arguments are that the 1968 Order referred to matters of criminal law and not to the division of national resources; and that the appropriate dividing line should be at right angles to the U.K. coast where the land boundary at 55° 50' N ends. Any such line would then be pointing north-eastwards rather than eastwards and so alter the division between Scotland and England. There are also unresolved issues about the possible exclusion of oil and gas found in Orkney and Shetland waters from the Scottish share.

11 See above, Chapter III. See also A.T. Peacock, op. cit., pp. 146 ff. One point made in Cmnd 6890 takes the breath away: we are told (para. 25) that any Scottish supplementary tax should not be capable of being passed on to English taxpayers. On this argument local rates should be abolished - or at any rate the non-domestic element.
million and borrowing of £500 million.\textsuperscript{12}

Many objections have been raised to specific regional sources of finance. The Inland Revenue took much the same line in its evidence to the Royal Commission on the Constitution as it did before the Layfield Committee and all its predecessors about local income taxation - problems of attribution of income to one region rather than another, the lack of annual income tax returns of total income for many U.K. taxpayers, the difficulty of levying a regional tax on investment income, and so on. And as for the suggestion of the regional surcharge on local tax yields, the Layfield Committee was apprehensive that this would blur responsibility and reduce accountability.\textsuperscript{13}

Given the force with which such arguments were presented, it is not surprising that the Royal Commission was somewhat lukewarm about regional tax sources and that the U.K. Government has since declared that there is no tax which meets the necessary tests of practicality and acceptability - though one cannot help feeling that the latter sentiment might well have been expressed, even if there had been no weight in the objections. It must, after all, be remembered that the difficulties with many taxes at regional level are quite considerably less than at local level. A personal income tax supplement which applies to Scotland only is a very different matter from a local income tax levied by 100 or so local authorities, or even from a regional supplement for all U.K. regions. And it so happens that all PAYE work in Scotland is concentrated on one computer centre at East Kilbride, which would make the task of levying a regional supplement much easier than elsewhere.\textsuperscript{14} Nor is it quite so difficult to envisage excise tax variations (e.g. petrol) between Scotland and England as it is between local authorities. So even though it can be argued that some taxes could not be serious candidates (e.g. corporation tax and value added tax for E.E.C. harmonisation reasons, among others) it is very hard to keep up this front in the case of personal income tax and all of the excise duties. But, of course, it is easy enough to play the old game of pouring cold water on any set of suggestions of this sort, whilst not considering or brushing aside the very real disadvantages of the relevant alternative.

\textsuperscript{12} Cmnd 6348, \textit{op. cit.} Although this proposal would effectively increase the ratio of revenue from rates to other taxes for the U.K. as a whole, the amounts involved are too small to be a matter of major concern. Later figures given in Cmnd 6890 show an even smaller ratio of revenue from rates to that from other sources.

\textsuperscript{13} \textit{Op. cit.}, p. 298.

\textsuperscript{14} There would still, however, be problems of English residents assessed for PAYE in Scotland or \textit{vice versa}. According to Cmnd 6890 the addition to Revenue staff necessitated by a Scottish supplementary income tax would be 2,500 compared with the Layfield local income tax figure of 12,000.
This in fact brings us to the first of our subsidiary financial issues - that of relations between Westminster and Edinburgh. Even if there were some separate revenue source for Edinburgh one might expect a good deal of acrimony to be generated in the settlement of a block grant. The history of settlements between the central government and local authorities in a much more subordinate relationship than the Assembly will be leaves one with no illusions on that score, especially when one allows for such possibilities as the Scottish Assembly being dominated by a political party not in power at Westminster or the ability of Scottish M.P.s to make trouble on issues which are entirely unrelated and perhaps even of no concern at all to Scotland. The Layfield Committee summarised the settlement process thus: 15

'Fair shares between England, Scotland, Wales and Northern Ireland will be a matter of political judgment based on objective information, taking account both of local needs and the desirability of some uniformity of standards and contributions in all parts of the United Kingdom.'

So, even if there were some separate revenue-raising powers for Edinburgh, a formula of this kind gives plenty of scope for squabbles. But if there is no separate revenue-raising power - and this is where we come back to the disadvantages of the relevant alternative - one can easily imagine that the situation will be very much worse. Assembly revenue sources undoubtedly would call for extra resources to be devoted to tax administration; but that might be a price well worth paying if the alternative is a substantial addition to bickering and dispute between Edinburgh and Westminster, even if the grant settlement can be made, as has been proposed, for a four-year period. 16

Another subsidiary matter is the likely relationships between the Assembly and Scottish local authorities. There are at least three matters of potential importance. The first is that the Assembly will have considerable powers in relation to local authorities: their precise organisation, the functions they discharge, the system of valuation for rating purposes and so on. Thus the relative treatment of domestic and non-domestic properties might be changed, irrespective of what was happening south of the


16 Whether local authorities in England will be content to see the Scottish Assembly being given its grant on a four-year basis, whilst they continue to be on a one-year basis may be doubted. And some people might even recollect that there was once a five-year settlement period for universities but this collapsed under the financial pressures of the 1970s - not a good augury for the new proposal.
border. It requires no imagination at all to see that there could be awkward problems of relations between the different levels of government, and not only of a settling-in kind; especially if opposing political parties, at loggerheads with one another, were involved.

A second matter is the 'pass-through' problem. At the moment, grants go direct from Westminster to local authorities. The only 'pass-through' problems are between tiers of local authorities, and these difficulties would disappear if the Layfield recommendations on this subject came to pass. But, under the proposed dispensation, the Assembly would be the recipient body, with, it would seem, the power to decide how much to hand on, and how to distribute that amount. It may well be that any system of this kind would have to be accompanied by a device such as that now used in Australia, whereby States have to hand over to local authorities certain specified proportions of sums received from the Federal Government. Otherwise, one might easily find all sorts of unwanted results such as sharp increases in local rate demands because of Assembly withholding of grants.

A third feature of Assembly and local relationships would be the arrangements for precepting on local authorities for revenue contributions, if such a scheme were resuscitated. This could easily be still another source of stress between the two levels of government. And it would certainly be necessary to distinguish very carefully between Assembly and local rate requirements when sending demand notes to ratepayers.

The last subsidiary subject is that of relationships between Westminster and Scottish local authorities. Some relationship would continue to exist after devolution had gone through in that certain local authority matters (primarily police) would not be devolved to the Assembly. It is not absolutely clear how such expenditure would be financed; but it would clearly be unsatisfactory for the Assembly to handle funds relating to a function entirely outside its control. It would seem that a system

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17 See 1977-78 Budget Paper No. 7, Australian Government Publishing Service, Canberra, 1977, for details. The basic stipulation is that in any one year local government is entitled to 1.52 per cent of net personal income tax collected by the Federal Government in the previous year.

18 This is another argument against the Layfield Committee proposal to bring the police grant into the orbit of the Rate Support Grant.
of specific grants would stay in being with the consequence that local authorities would then be serving two masters, one in Edinburgh and one in London - a perfect recipé for perfect co-ordination of policies.

Further Possibilities

Given that the whole subject of devolution is still so much up in the air, it may not seem worth while thinking about longer-term developments. But one or two speculations may perhaps be permitted. One is that devolution for Scotland must be expected to have some effects on constitutional demands by other regions - primarily Wales but also other regions of England. Indeed, this is precisely the reason why Westminster has been so reluctant to let itself be pulled or pushed down the Scottish road. But this in turn would have awkward consequential effects; it is one thing to have a Scottish supplement to U.K. income tax but quite another to have, say, ten regional supplements. And the sort of intergovernmental bickering which we judged likely in the Scottish case would then develop in other parts of the country.

Whether or not there were any substantial 'regionalisation' elsewhere than in Scotland, it is hard to think that local authorities would sit back placidly whilst independent revenue sources were granted to Scotland but not to them. To take the most obvious example, the Achilles heel of the Inland Revenue resistance to local income tax is that a Scottish income tax supplement may become irresistible. Once that happened, it could only be a matter of time before the idea spread further. No doubt this is exactly why the authorities have fought the idea with so many teeth and so many nails.

Whatever the outcome on that particular matter, it will surely become more and more evident as time passes that the separation of devolution finances and local authority finances into watertight compartments is wholly wrong-headed. It is uncertain whether this separation has been by design or by accident; but it is certain that it should not continue.
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A. R. Prest

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After holding academic posts in the Universities of Cambridge and Manchester, the author took up his present position as Professor of Economics (with special reference to the Public Sector) at the London School of Economics in 1970. He has written a variety of books and articles in the field of public finance and has been both a Visiting Professor and a Visiting Fellow of the Australian National University.