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CABINET

STEERING COMMITTEE ON LOCAL GOVERNMENT FINANCE STUDIES

LOCAL GOVERNMENT FINANCE: DRAFT GREEN PAPER

Note by the Secretaries

Enclosed is the draft of Chapters 1-5 of the Green Paper, Annexes C and G and the Chapters on Wales and Scotland prepared by the Welsh and Scottish Offices respectively. The drafts take account of some of the comments offered by E(LF)(O) members, but at this stage it has not been possible to incorporate all amendments. No attempt has been made to integrate the Scottish and Welsh chapters.

Chapter 6, on capital, is being circulated separately to interested officials in other Departments.

It is intended that this draft should be discussed at the meeting of E(LF)(O) on 10 December.

Signed J E ROBERTS
J RUTTER
D P WALKER

Cabinet Office
6 December 1985

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THE LOCAL GOVERNMENT FINANCE REVIEW

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* Available material shown in bold type

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CHAPTER 1: WHY CHANGE LOCAL GOVERNMENT FINANCE?

The background

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

1.2 Local government has become a business so big that it has nearly 2 million full-time, and one million part-time, employees. It accounts for over a quarter of all public expenditure, and 11% of GDP. In 1984/85, the services provided by local government in Great Britain cost £39 billion. There has been a shift in the nature of these services, with a particularly significant increase in welfare services - help for groups such as the elderly and children at risk. Local government has also become more politicised : in 1945 ■% of councillors were Independents; now the figure is only ■%. Against the background of the measures which were needed to tackle our economic problems and the pressures on public expenditure generally, the natural tension between central and local government has inevitably increased.

A historical perspective

1.3 In this country, all the powers of local authorities derive from Parliamentary legislation. The structure of local government, the services it provides, and the way in which it finances those services are - and always have been - subject to statutes passed by Parliament.

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

1.5 Parliament has also exercised control over the financing of local government, in terms both of the nature of local government's own sources of revenue, and of the extent of Government grants and the method of allocating them. Although there is some truth in the suggestion that rates go back to the reign of Elizabeth I or earlier, it is equally true that the rates as we know them - a unified local tax - did not exist until the end of the nineteenth century. Before that there were several different 'rates' for different purposes. These included highway rates, improvement rates, poor rates and school rates. Not all of them were assessed in the same way. Parliament has also experimented with other methods of funding local services - such as a system of assigned revenues, used for a time at the end of the nineteenth century.

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Central and local government services

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

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

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

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

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

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

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1.12 This growth in spending could not continue indefinitely. In 1975 Anthony Crosland, then Secretary of State for the Environment, made his famous declaration that "the party's over". Under pressure from the IMF the Labour Government asked for, and got, a substantial reduction in local authority current expenditure in 1977/78; and it also sought cuts in capital. Between 1974/75 and 1978/79, local authority capital expenditure almost halved in real terms. In addition, the Labour Government reduced the rate of Exchequer support in England to 61% by 1978-79. Current expenditure began to grow again in 1978/79, and the Labour Government's 1979 plans looking ahead to 1982/83 sought further growth averaging 1½% per annum in real terms (Cmnd 7439). In other words, local government was contributing significantly to the increasing burden which the public sector as a whole was imposing on the wealth-creating sector of the economy. This was the situation which confronted the incoming Conservative Government in 1979.

Local authority spending and economic policy

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

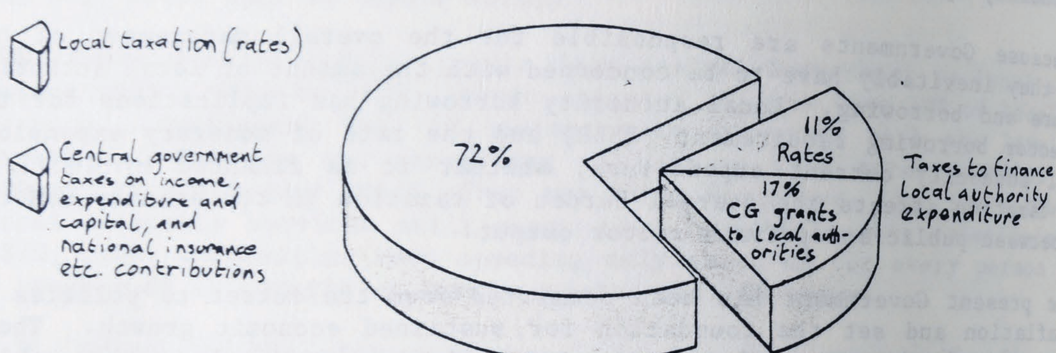
1.14 The present Government has been committed from the outset to policies to reduce inflation and set the foundation for sustained economic growth. These policies required the rate of monetary expansion to be curbed, and public borrowing to be reduced so that interest rates could be kept down. Higher local authority borrowing would have made it harder for the government to achieve these objectives.

1.15 At the same time, the Government sought to reduce the size of the public sector and free resources which could be used more productively in the private sector. This would, in turn allow reductions in levels of taxation and more freedom for individuals and firms to choose which goods and services they wish to consume. And excessive taxation - whether local or national - reduces incentives to work and invest as the rewards of enterprise are diminished and restricts economic choice.

1.16 Few would question central Government's right to control the level of local authority borrowing, which accounted for £2.4bn out of the PSBR total of £10.2bn in 1984/85, particularly when the overriding policy aim is the reduction in inflation. The mechanisms by which this is achieved - whether through direct borrowing controls or controls on capital spending - are, of course, a legitimate area of debate.

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

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



1.18 The thirty years since the war have seen sustained growth in local authority current expenditure to the point where in 1979/80, it constituted ■% of public expenditure. It was therefore inevitable that the success of policies to reduce public expenditure generally would depend to a significant extent on a reversal of post war trends in local authority expenditure.

Policy since 1979

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

i. A concern to contain local government expenditure at affordable levels. In England and Wales a new method of allocating the main unhypothecated grant towards local authority expenditure - block grant - was introduced in 1981/82. At the same time a new system of controlling capital spending, rather than just borrowing, came into effect. The Government also abolished supplementary rates, which had previously made it possible for authorities to begin a financial year with one rate, and then to increase it in the course of the same year.

ii. Encouragement to authorities to carry out services more efficiently, and to introduce private sector competition where possible. The Government established the Audit Commission, one of whose major tasks is to advise local authorities in England and Wales on value for money. It also established new rules governing local authority direct labour organisations, which include public tendering for most sizeable contracts.

iii. A reduction in detailed controls over local government. The Local Government Planning and Land Act 1980 abolished or simplified ■ detailed controls over local government in England and Wales, such as ■.

1.20 In each of these cases, the legislation covers England and Wales, though the block grant and capital controls systems are administered separately in the two countries. There is separate legislation in Scotland. Wales and Scotland are considered more fully in Chapter ■ and Chapter ■.

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

1.22 Since the Government had no direct means of controlling local authority current expenditure, it introduced a series of measures designed to achieve expenditure restraint through pressure from ratepayers. Under the block grant system the proportion of an authority's overall expenditure met by grant was less if it spent significantly more than was needed to provide a standard level of service (see Annex C). The Government also started progressively to reduce the percentage of local authority expenditure met by grant. In England this fell in stages from 61% in 1980/81 to 49% in 1985/86. Over the same period it fell from 74% to ■% in Wales, and from ■% to ■% in Scotland.

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

1.24 The government decided to supplement the expenditure pressures of the block grant system with a system of expenditure targets for every authority, based on its actual spending in earlier years. Any authority which exceeded its target had its block grant entitlement reduced so that it had to raise a much

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higher contribution from its local taxpayers. Expenditure targets were set from 1981/82 to 1985/86 and the penalties for exceeding them were increased year by year.

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

1.26 Throughout, the government has faced particular problems in dealing with a handful of the highest spending authorities in England and Scotland. In 1983/84 English local authorities' budgeted revenue expenditure exceeded the Government's targets by £770m. 75% of this was accounted for by the top 15 overspending authorities. A similar pattern occurred in 1984/85 when 75% of the overspend of £850m was attributable to just 12 authorities. Many of these were still increasing their expenditure. In 1984 Parliament passed the Rates Act, which gave the Government powers to set limits to the rates which English and Welsh high-spending authorities could levy. These powers were used for the first time in 1985/86 in England, when the budgetted overspend was reduced to under £300m. Similar powers have been in use in Scotland since 198[illegible].

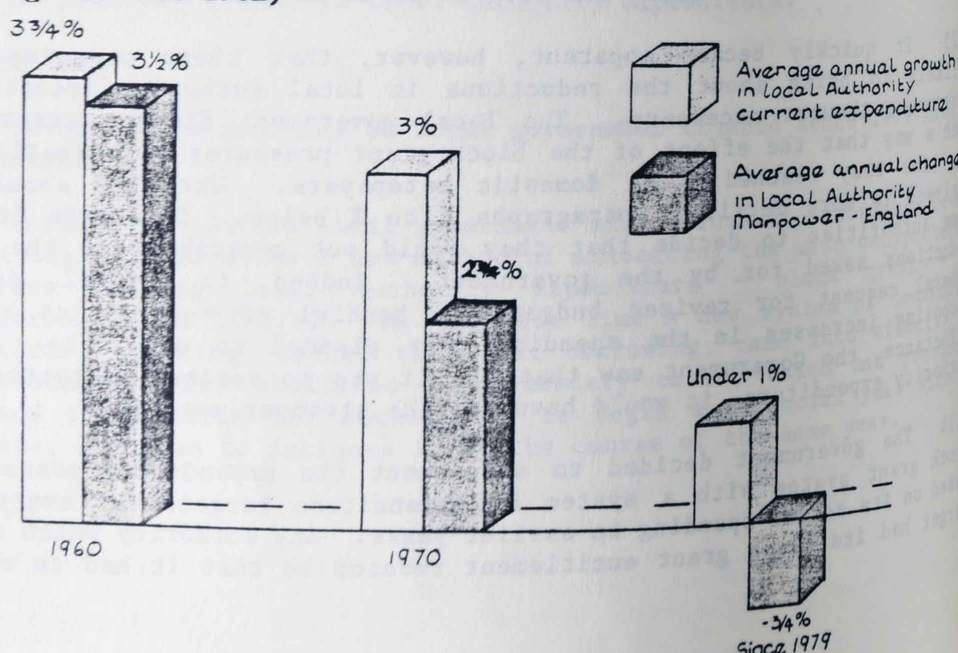
Success and failure

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

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

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

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



1.28 In Scotland and Wales, manpower has also fallen. While spending is still growing at about [illegible]% a year in Scotland, it has been held virtually constant in Wales.

1.29 Although growth in current expenditure and manpower had slowed down in the latter half of the 1970s in the wake of the IMF crisis, it was clear by 1979 that growth was to be resumed. In the light of this, and by comparison with the trends of the sixties and seventies these results represent a considerable achievement. Even so, they mean that in Great Britian as a whole, current expenditure is still growing and now represents a higher proportion of GDP than it did in 1979. Large elements of central government spending cannot be curtailed in the short term. For example, defence expenditure is affected by international commitments; unemployment benefit has inexorably risen at a time of world economic recession. So it is difficult to make room for extra local government spending within the public expenditure total. But every year since 1979 the Government has been forced to increase the amount allowed for local authority current expenditure in its public expenditure plans, because of the failure of local government to deliver planned reductions in expenditure. The reduction in local authority manpower, of 5% since 1979, is modest compared with achievements elsewhere in the public sector. And the manpower total has not fallen significantly since the end of 1983.

1.30 Such successes as have been achieved have also carried a heavy price. To secure any significant reduction in the total of local authority spending under the target system, the government needed to ask for expenditure savings based on previous years' spending levels from low-spending authorities. Councils which had a long tradition of careful husbandry and efficiently-provided services found it increasingly painful to make further savings from a low base.

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

1.32 All these measures rested on the assumption that local ratepayers would respond to the pressures applied by central Government and, in turn, bring pressure to bear on local councils for lower spending. But in fact only modest savings were achieved. For some authorities, the pressures failed to work at all, and the Government could restrain spending only through rate capping.

Why have these problems arisen?

1.33 The government's concern to restrain local authority expenditure and taxation has revealed serious shortcomings in the local government financial framework and in local accountability. These problems have not been caused by what has happened since 1979. The flaws have been inherent in successive systems over many years. But the inevitable tensions that have arisen - in a period when a government, for the first time since the war, has been seeking to exercise significant continuing restraint over local authority spending - have drawn attention to their importance in a way that has never happened before.

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

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

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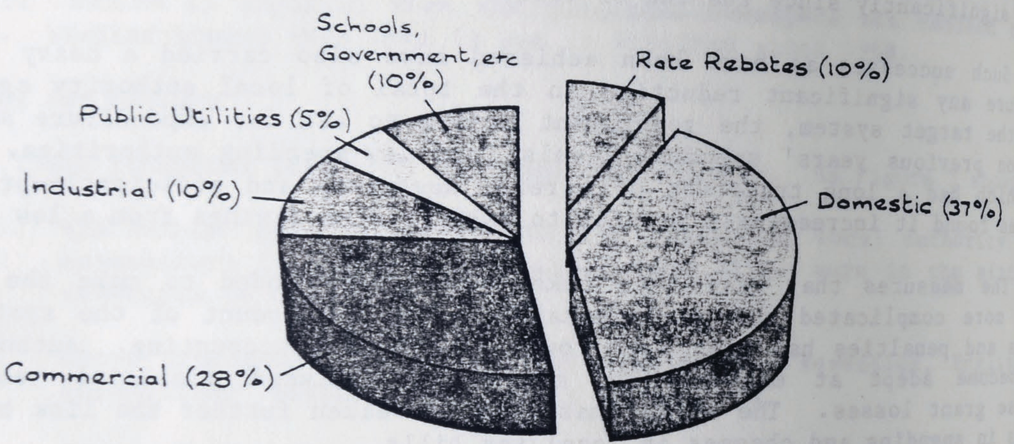
ii. the mismatch between those who are entitled to vote in local elections, those who benefit from local authority services, and those who pay domestic rates;

iii. the operation of the grant system.

(i) The contribution from non-domestic rates

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

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



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

(ii) Those who vote and those who pay

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

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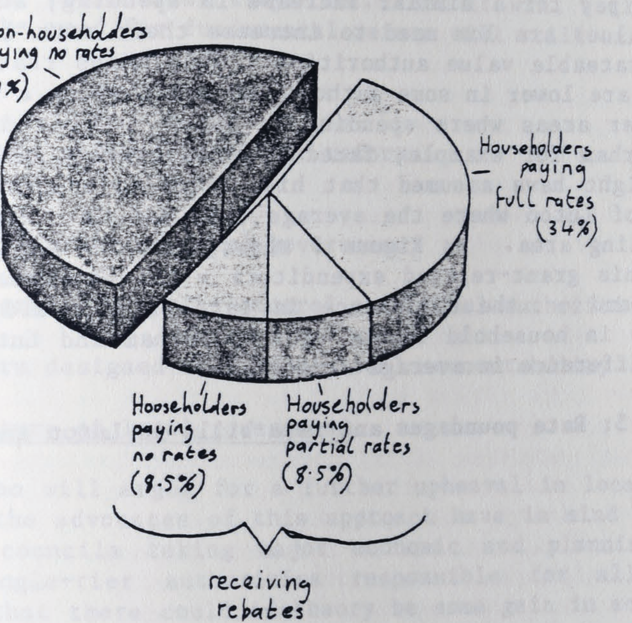
1.38 There are about 35m electors in England. Of these about 18m are liable to pay rates. Of course, many of the remaining 17m will be spouses of ratepayers; but they are not billed direct, nor do they personally make any payment to their local authority. Other members of ratepayers' families may have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

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



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

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

(iii) The grant system

1.41 Accountability is also impaired by the way in which grants are paid to local authorities. Authorities' grant entitlements are linked to actual spending - not only their own spending, but also that of every other authority. The result is that no authority can be certain how much grant it will receive until after the year for which the grant is paid is over. Grant entitlements also vary between years, partly for the same reason and partly because of changes to the various components of the grant system, such as the method of assessing the cost of providing a reasonable standard of service in different areas.

1.42 Successive governments have also paid grant to compensate authorities for variations in rateable value. In terms of what ratepayers are actually asked to pay, the use of grant to compensate for variations in rateable resources has a rather odd result. It ensures that different authorities can charge the same rate poundage for equivalent spending levels, but that gives very different rate bills. To pay for a similar increase in spending, authorities in areas where rateable values are low need to increase their rate bills by a smaller amount than high-rateable value authorities. This means that the rate bills faced by households are lower in some authorities which spend a lot on services than they are in other areas where spending is lower. The individual ratepayer in the City of Durham for example, faced with an average bill of under £[redacted] a year in 1984/85, might have assumed that his authority's spending was modest compared with that of Luton where the average bill was £[redacted]. But in fact Luton was the lower-spending area. As Figure 5 shows, if both authorities had spent at the level of this grant-related expenditure - the Government's assessment of their need to spend - the difference in rate bills would have been even greater. Differences in household income between Durham and Luton are much smaller than than the difference in average rate bills.

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

The direction of reform

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

1.44 Some improvements are possible within the context of the existing arrangements. The government is already proposing, as part of the Social Security review, to make one important change. It envisages that, in future, all domestic ratepayers should be required to pay at least 20% of the rate bill they face. This will re-establish a financial link between 3 million households and the local authorities in whose areas they live. But it will still leave many problems unresolved. The need for fundamental reform will still exist.

What kind of reform?

1.45 There are three main possibilities for reform:

- changing the structure of local government;
- imposing much greater central control over local authorities;
- financial reform designed to improve local accountability.

(i) Changing the structure of local government

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

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

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

(ii) Increasing central control

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

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

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

- Introducing central funding of the whole of education, personal social services, police, fire and highway maintenance expenditure would enable the government to control about three quarters of local authority spending. There would be a division of responsibility between these services and others, with purely local characteristics, financed from local sources. The Government would become responsible for setting each local authority's budget for the centralised services and for determining the policies necessary to implement them. Local authorities would act merely as agents for the main services with no incentive to manage them efficiently. A big increase in central government bureaucracy would be needed to enable the need for services to be accurately assessed through the country.

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

(iii) Improving local accountability

1.51 The Government has a responsibility to ensure that what the public sector spends is consistent with what the country can afford. It cannot abandon its concern with the level of local government expenditure. But neither structural

reform nor increased central control offers an attractive way of fulfilling that responsibility. The alternative is to increase local accountability within the present structure. This is more attractive on several counts. It guarantees the continued existence of a healthy system of local government. It should reduce the tension between central Government and local authorities. In the longer term it should help to ensure that services are provided more efficiently. And it strengthens the link between the local authority and those who live in its area. For the vast majority of people, this is the preferable way forward. But it can only work if we are able to deal with the shortcomings which this chapter has identified.

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

1.53 These problems are accentuated by the arrangements for paying government grants to local authorities. They make it impossible for ratepayers to see a clear relationship between the spending behaviour of the authorities in whose area they live, and changes in their rate bills.

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

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

- A more direct and fairer link between voting and paying, so that more local voters contribute towards the cost of providing local authority services.

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

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

1.56 Chapter 5 discusses the effects for households and local authorities of the improvements to local accountability discussed in the previous three chapters. Chapters 6 and 7 discuss other issues affecting the financial framework within which local authorities work, including the system of capital expenditure controls. To avoid over-complicating the presentation of the main issues, each of these chapters focusses primarily on experience in England.

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Chapters [redacted] and [redacted] set the review in the rather different circumstances of Scotland and Wales. The conclusions of the review are set out in summary form in Chapter 8.

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CHAPTER 2: LOCAL NON-DOMESTIC TAXES

The pattern of non-domestic rates

2.1 In Great Britain, non-domestic rates in 1985/86 contributed £[redacted]bn towards a total local authority revenue expenditure of £[redacted]bn - over [redacted]%.

2.2 The bulk of non-domestic rate payments come from industry and commerce, including shops. But there are also very large contributions from the nationalised industries, and from public sector bodies. Local authorities pay rates to themselves and to each other for the schools and other premises they occupy. Central Government, Regional Health Authorities, Universities, etc. are also large contributors. Figure [redacted] shows the breakdown of non-domestic rate revenue by sector.

Figure [redacted]: Non-domestic rates by sector (Great Britain 198[redacted]/8[redacted])

2.3 Non-domestic rateable values are heavily concentrated in areas of commercial and industrial activity. Typically, the urban centres will have a much higher concentration of non-domestic property than rural areas. But there are many exceptions - for example, the contribution from a single power station can make up a very large proportion of the total rate income of a non-metropolitan district council. London is an extreme example of the degree to which non-domestic rates are concentrated in particular areas. The London area alone accounts for over [redacted]% of the total non-domestic rateable value of England. And within London, over [redacted]% of the rateable resources are concentrated in the central boroughs of Westminster, Kensington and Chelsea, Camden, and the City of London. This extreme variability of non-domestic rateable values means that different local authorities' income from non-domestic rates also varies greatly. Complicated grant arrangements have to be used to compensate for this unevenness, and these obscure for local taxpayers the true cost of changes in expenditure.

2.4 The poundages charged by local authorities also vary greatly - from [redacted]p in the £ in [redacted] to [redacted]p in the £ in [redacted]. This means that similar businesses in similar premises can face rate bills that differ by as much as [redacted]% just because they are located in different authorities. Obviously this will have an impact on their competitiveness.

2.5 Non-domestic rates fall to be met as an additional overhead cost of the bodies which are liable for them. Unlike domestic rates, which are a direct charge on the "consumers" of housing, non-domestic rates are charged to producers of goods and services and passed on by them to the final consumers of their products. In the case of the industrial and commercial ratepayers, their prices are higher than they would otherwise have been. In the case of the public sector bodies, central and local taxpayers have to pay more.

2.6 There is no voting right attached to the payment of non-domestic rates. However much a business might contribute to the income of a local authority, it cannot exercise any direct electoral influence over taxation decisions by councillors that can have a profound effect on its competitiveness and on its scope for investment. Of course, there are other ways - through consultation, discussion, and argument - in which an influential employer can put his views across to a local authority, and the relationships between many local authorities and local businesssmen are excellent. But the fact remains that local authorities are not <u>answerable</u> to the business ratepayers who provide a large proportion of their income. Since non-domestic ratepayers on average contribute over [redacted]% of the total tax revenue raised locally (excluding rebates paid for by central Government), local authorities can find themselves under extreme pressure to spend more on services for their electors largely at the expense of the non-voting non-domestic ratepayer.

2.7 It is the combination of these various factors

- the very uneven incidence of non-domestic rateable values that makes complicated grant arrangements inevitable;

- the wide variation in the rate poundages paid in different areas that can distort and undermine the competitiveness of business;

- the fact that non-domestic rates are ultimately passed on to final consumers who may live far outside the authority concerned;

- the lack of any direct democratic accountability of local authorities to non-domestic ratepayers;

- the extent to which the large contribution of non-domestic ratepayers to expenditure at the margin can falsify the real costs or benefits of expenditure changes;

that has led the Government to conclude that non-domestic rates are not a satisfactory local tax.

2.8 This chapter considers what might replace them. It examines the options against two crucial tests. What will their effect on businesses be? And what effect will they have on local government?

Non-domestic rates and business

2.9 Non-domestic rates are now one of the largest taxes paid by business. Figure [redacted] compares the yield of non-domestic rates on industry and commerce in Great Britain since 1975 with the yield of corporation tax and the national insurance surcharge. The yields are not directly comparable, but they show a clear trend. Since corporation tax is directly linked to the profitability of businesses, its yield fluctuates. In [redacted], it fell to £[redacted]bn at a time when [redacted]. National insurance surcharge was reduced in line with Government policies until its final abolition in 1984. But the yield of non-domestic rates increased throughout the period. There is no correlation between this continuous growth in non-domestic rates and the level of profitability of business. This has been one of the main concerns of business representatives: that a major tax, which now produces a yield which is more than [redacted] times that of corporation tax, is completely unrelated to the competitiveness of those who pay it. It is the equivalent of a heavy overhead cost which businesses cannot control and which can vary erratically over time and in different locations.

Figure [redacted]: Taxes on business (Great Britain, 1975/85)

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2.10 The impact of changes in and levels of non-domestic rates for businesses is less straightforward than that of other business costs. Normally if the price of an input - such as the cost of a particular type of material - rises, the first reaction of a firm would be to reduce its consumption of that input by switching to a substitute material or looking for another supplier. But with a change in the cost of occupying property that entails very drastic measures indeed. There are considerable costs in relocation. Until 1984 even "mothballing" empty industrial property carried no guarantee of reducing the rates bill. The business is therefore normally forced to treat a rate increase as an unavoidable increase in fixed costs and to seek to pass it on - through charging higher prices to consumers or negotiating a lower rent with the landlord - or to reduce investment and hence job creation. For some marginal firms, an increase in rates may be a factor in determining their ultimate survival.

2.11 Hard evidence on the effects of rates on business is scarce. A recent study, commissioned by the Department of the Environment, concluded that during the period 1974-81 rates could not be shown to have had a significant overall influence on manufacturing employment, although high rate burdens in London were correlated with relocation of offices outside London. At the aggregated level at which the study was conducted, and over the particular period considered, these results are plausible. But they do not provide a good indication of detailed effects at a local level. Moreover, in the period studied (1974-81), non-domestic rate poundages fell in real terms in all regions studied, except London, and in London itself there was very little manufacturing employment to provide any evidential base. The 1974 starting point also excluded the significant rate increases associated with the 1974 local government reorganisation and the effects of the implementation of the 1973 revaluation, which would have overshadowed subsequent movements in non- domestic rates.

2.12 How far business rate increases do affect the location and viability of businesses in particular areas must therefore still to a large degree be a matter of conjecture. For most firms, rates are a small cost, and a change in their level would be unlikely to have a major impact on location decisions. But employers' organisations, both in the private and public sector, report that their members <u>have</u> been influenced by rates in making decisions on employment, where rate increases have been extreme. And common sense would suggest that where a firm is struggling to stay in business a sudden increase in its rates bill can seriously jeopardise its chances of survival.

2.13 A more general concern is the impact of rates on the overall competitiveness of industry. If rates are passed on in higher prices they will damage the ability of British industry to compete with foreign businesses. If rates are absorbed by reduced investment that will, in the longer term, reduce productivity and again undermine the competitiveness of industry. If rates are passed back to the landlord there will be less incentive to develop land for business expansion.

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

Figure ■: Spread of non-domestic rate poundages (England, 1984/85)

2.15 On grounds of economic efficiency, therefore, there is a case for setting non-domestic rates on a basis that does not distort the competitiveness of businesses simply as a result of the chance factor that they were set up in one local authority rather than another.

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

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

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

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

Neither argument is true of the non-domestic rate. Although non-domestic ratepayers actually write the cheques payable to the local authority, businesses do not ultimately bear the bill. As paragraph 2.5 above indicated, the final burden of the tax will rest with the consumers of the goods produced, the owners of the property occupied, the shareholders of the company, the workforce (either through lower wages or lower job creation), or the taxpayers who will pick up the bill for public sector bodies. These people will not perceive any link with the rating behaviour of the local authority. They are very likely to live outside the local authority's area altogether. So non-domestic rates fail the normal criteria for any local tax: that it should be perceptible to those who pay it as a tax imposed by the authority concerned, and that the taxpayers should be able to influence the behaviour of those who levy the tax.

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

2.19 On average for every £1 raised locally from domestic taxpayers £[redacted] is paid by the non-domestic sector. So the marginal cost of services to domestic taxpayers is reduced by the [redacted]% contributed by non-domestic ratepayers. Most authorities that receive block grant are near this average because of the way the "resource equalisation" arrangements work (see Chapter 1, paragraph [redacted]). In some authorities whose rateable resources are so high that they do not qualify for block grant, the marginal subsidy from non- domestic ratepayers is even greater. In Camden, for example, for every £1 contributed by the domestic ratepayer, the non-domestic ratepayer contributes £[redacted].

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

Options for reform

2.21 To summarise, non-domestic rates are not a satisfactory local tax because:

- they fall immediately on those who have no vote to influence local spending decisions;
- they are ultimately borne by people who are unaware of how these extra costs arise and may not live in the area of the authority imposing the rate;
- they reduce the apparent costs of local services to domestic ratepayers;
- they have an arbitrary and erractic effect over time and in different areas on the competitiveness of businesses.
- they make complicated and obscure grant arrangements inevitable.

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

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

2.24 One way of seeking to make local authorities answerable to their non-domestic ratepayers would be to re-introduce a business vote or establish a separate class of membership of local authorities for representatives of business. But this approach looks to be unworkable. The previous business vote fell into disuse and was eventually withdrawn in 1969 because it was available only to sole traders or partners in businesses operating in the area. Most businesses are now carried on by limited companies, many of which are trading in more than one local authority area. It would not be practicable to devise satisfactory arrangements for voting by limited companies. For example, who would exercise the vote of the large retail chains with branches in most shopping centres? Establishing a separate class of local authority membership for businesses would not resolve the conflicts in accountability which exist at the local level and would be regarded by many as an infringement of basic democratic principles.

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2.25 If these approaches - abolition of non-domestic rates, or making local authorities directly answerable to business ratepayers - have to be ruled out, the unsatisfactory characteristics of non-domestic rates as a local tax will have to be tackled by retaining non-domestic rates but directly restraining their variability. This means transferring to central government the power to determine the rate poundage applying to the non-domestic rate, while continuing to distribute the proceeds of the non-domestic rate to support local government spending.

Setting the non-domestic rate

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

2.27 Whichever approach is adopted both local government and business would require assurances about the way in which the arrangements would be operated.

2.28 Businesses will be concerned to ensure that the new arrangements do not lead to an increase in the proportion of local government spending financed by their rates. Local authorities will want to be sure that the contribution from businesses does not <u>fall</u>, leaving them to find more of the money to support their spending from local domestic taxpayers. The intention would be that the yield of the non-domestic rate should remain broadly unchanged as a result of the new arrangements. This is a two-part problem. How do we set the starting level? And how do we deal with subsequent upratings?

2.29 The Government would propose that in the first year non-domestic rate poundages should be set so as to maintain the real yield of non-domestic rates in the preceding year. If there is a national rate, it would be set at the average level (but see paragraphs ■ to ■ below). If existing relativities in rate poundages were to be maintained, a poundage for each authority would be set corresponding to the real value of the poundage in that area in the preceding year.

2.30 The best way of ensuring that business rates continue to meet a fair share of local spending, and that increases are predictable, so allowing businesses and local authorities to plan ahead with confidence, would be to index the initial poundages. The indexation should be provided for in primary legislation so that the arrangements could not be overturned without fresh consideration in Parliament.

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

2.32 Nationally the total of non-domestic rateable value continues to grow at an average rate of ■% per annum. Indexation of the poundage without an allowance for such growth would result in the aggregate yield rising faster than the rate of inflation. It would be for consideration whether, in specifying the arrangements for indexation, it would be appropriate to make an offset for such increases.

Distributing the proceeds

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

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

Local dialogue

2.35 In the 1984 Rates Act the Government for the first time required local authorities to consult with representatives of non-domestic ratepayers before setting their rate or precept. That legislation was a response to the dissatisfaction of business ratepayers with their lack of a say in the spending decisions of the local authorities and to the failure by certain local authorities to enter into any serious dialogue with businesses in their areas about the services which were needed and the level of rates which businesses could reasonably afford to pay. Early experience of the first round of statutory consultation has shown that in some areas these provisions have proved extremely helpful in bringing together councils and their local employers. In other areas businesses continue to complain that their authorities are merely going through the motions. We need to consider further ways of making a fruitful dialogue between local authorities and businesses the norm in all areas.

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

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2.37 A possible approach to meeting both objectives would be to allow local authorities to retain the discretion to levy a small rate on their non-domestic rate base, after consultation with their non-domestic ratepayers, and to retain in full the proceeds of such a rate. The poundage charged might be subject to an upper limit equivalent to, say, 5% of the national non-domestic rate (or 5% of the capped poundage if that were the method adopted).

Administrative arrangements

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

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

2.40 If, in the light of consultation, the Government decides to proceed with the proposal for a small discretionary local non-domestic rate with a maximum limit, upper and lower tier authorities would share the proceeds.

2.41 With separate arrangements for non-domestic and domestic local taxes it will be necessary to re-draw and clarify the borderline between domestic and non-domestic property. The dividing line will fall between residential property which is occupied as a main or only residence and residential property which is not occupied on that basis. Hotels and boarding houses, therefore, will continue to be regarded as non-domestic property, like other businesses, and liable to the non-domestic rate except where the predominant use of the property is as a main or only residence for those who live there. Detailed discussions will be required to establish the boundary line. It will be a matter for the Inland Revenue Valuation Office to decide, on the facts, whether a property should be subject to a non-domestic rate and it will be necessary to provide for an appeal procedure. Existing arrangements also provide for a category of "mixed hereditaments" with both domestic and non-domestic uses. Equivalent arrangements will be necessary for the new regime.

Rates on Government Property

2.42 Crown Property is not liable for rates. The Treasury, however, through the Rating of Government Property Department, makes contributions in lieu of rates on the basis of a rateable value equivalent negotiated between that Department, the Inland Revenue Valuation Office, and the local authority concerned. There may be more efficient ways of achieving this under the new non-domestic rate arrangements - for example by a direct payment into the national non-domestic rate pool. There would, however, be a case for contributions to continue to be made in respect of local domestic taxes where the

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English Crown Property concerned is residential in nature. The Government would wish to consult with the local authority associations about such arrangements and about which Crown Properties should be covered by them. Would it, for example, be appropriate for prisons to be treated in this way?

Non domestic revaluation

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

2.44 Introduction of new non-domestic rateable values would require the re-setting of the national non-domestic rate poundages so as to retain the yield of the non-domestic rate at the same level.

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

2.46 If such a system were to be adopted, it would be possible, instead of indexing the determined non-domestic rate poundage to the rate of inflation as discussed in paragraph H above, to freeze the poundage, but instead allow the buoyancy of rateable values to cause the yield to rise in line with the increase in non-domestic property values. The Government will issue a separate consultation paper on the practical issues arising from a system of rolling revaluations.

Transition

2.47 If a national non-domestic rate poundage is adopted, that should be done at the same time as introducing new non-domestic rateable values. Both sets of changes will affect rate bills for businesses, in some cases substantially. In many cases the two sets of changes will be offsetting and so clearly should be done at the same time. In other cases the effects of the two changes will combine to give substantial overall changes in rate liability. There would be a good case for phasing in the combined effects of both changes over a three to five year period.

2.48 If existing rate poundages were simply capped, the case for phasing in changes in rate liability arising from the revaluation would be less clear-cut, since the new rating liabilities would simply reflect real changes in the value of the properties occupied.

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Conclusion

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

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

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

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CHAPTER 3: LOCAL DOMESTIC TAXATION

The history of rates

3.1 It is often said that rates have been around for nearly [redacted] years and have therefore stood the test of time. As mentioned in Chapter 1, however, rates in their present form emerged only at the end of the last century. Between their inception and their final development into their present form, the rates underwent major changes in response to changes in social and economic conditions and in local government responsibilities.

3.2 The process of change saw the gradual unification of rates in the 18[redacted]s into a single tax. In earlier times rates were levied either generally, to pay for services - like Poor Relief, dating from Elizabethan times - which were redistributive in character, or on selected groups to share out the cost of providing an amenity from which they all benefited. Rates which were redistributive initially took as their base the value of land: in a largely agrarian economy the occupation of land was a reasonable measure of ability to pay and the ownership of land was linked to the right to vote. For services which provided a direct benefit the basis for dividing the cost varied according to the service provided. For example, the cost of sea defences might be shared between landowners according to the relative amounts of their land that would be protected by the works.

3.3 The transition to an industrial society, and the growth of the towns, brought with it the need for more communal services and new forms of local government. The existence of many separate rates for different purposes then became unwieldy. A process of consolidation started. In the absence of arrangements to reduce the cost of these new services to those with low incomes the courts led the way in securing the supremacy of the "redistributive principle" over the "beneficial principle" in levying rates. So by H there were in existence elected local authorities largely financed by a single property rate. Until after the first World War this local tax raised more than income tax and was the major source of tax revenue with any element of progressivity.

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

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

Criteria for a local tax

3.6 It is against this background that we need to consider how domestic rates measure up as a local tax. There are three main tests that rates, or any alternative local tax, ought to satisfy.

- Are they broadly fair?

- Are they compatible with healthy local democracy?

- Are they technically adequate?

9i0 Technical adequacy

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

(ii) Fairness

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

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

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

Figure ■: The relationship between rateable values and incomes (England 198■)

3.11 But nowadays the fairness of a local tax must be considered in the wider context of the national tax and benefit system. When the "redistributive principle" was gaining ground towards the end of the last century local spending included poor relief, and it was virtually all paid for by local taxation. In 1984/85 [redacted]% of net local government spending was met from exchequer grants financed from national taxes most of which are progressive or proportional. Of the remaining local spending met by local taxation [redacted]% is met from non domestic rates and is passed on to consumers of goods and services in proportion to their consumption. And [redacted]% is met from domestic taxes. The national rebate system, however, provides £[redacted]bn or [redacted]% to help those on the lowest incomes to pay their domestic rates. Rebates too are funded from central taxation. So regardless of the nature of the <u>local</u> tax much of local spending will in fact be supported by those with higher incomes. So long as a local tax is broadly neutral, the overall costs of local services will be funded on a redistributive basis.

(iii) <u>Local democratic accountability</u>

3.12 Consistently with the approach outlined in Chapter 1, the Government considers that the third test - whether a tax is conducive to proper local democratic accountability - is now of crucial importance. It is the key to an approach to local government finance that makes it possible to reconcile moderate and responsible local spending decisions with a reduction in central Government intervention.

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

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

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

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

Possible forms of local tax

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

3.15 All of these alternative forms of tax were extensively discussed in the 1981 Green Paper "Alternatives to Domestic Rates" and in the subsequent White Paper. The following sections re-examine the case for and against their use at local level in the light of the technical issues and criteria covered in that Green Paper, but also with particular regard to the crucial local accountability criteria set out in paragraph 3.13 above.

Domestic Rates

3.16 The 1983 Rates White Paper recognised the technical strengths of domestic rates, while acknowledging that rates were far from an ideal or popular tax. It put forward the following advantages for rates:

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

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

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

3.18 The 1981 Green Paper argued that rates did promote accountability since they were highly perceptible to ratepayers. But while that is true, it does not take adequate account of the relatively small numbers of electors who are ratepayers. While rates are highly perceptible to those who actually pay them they are much less so to those whose rates are hidden in their rent payments, of those who are not directly liable for rates such as spouses and adult children living at home, and those who benefit from the rebate system. The proposals in the Social Security White Paper (Cmnd ■) will mean that the 3m households in England who presently pay no rates at all because they receive full rate rebates will in future meet at least 20% of their rates bill. Even this reform will leave 17m adults who are not directly liable to local taxes yet who can vote in local elections. This is inevitable if the local tax is levied on a household, not an individual, basis. So domestic rates fail the first test of a suitable local tax. They fall on too few shoulders.

3.19 Rates also fail the test of giving clear signals to those who pay. They are levied on a notional tax base unlike an income or a sales tax which are levied on an actual transaction. The tax base is very unevenly distributed.

The tax base also has to be periodically revalued, and the variations in the distribution of rateable value require complex compensating grant arrangements. Both these factors lead to changes in local tax bills that have nothing to do with changes in local spending.

Local sales tax

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

3.21 That conclusions remains valid. A local sales tax would not be perceived directly by those able to vote in local elections. It thus fails the key tests set out for a new local tax. It would also entail considerable additional administrative complexity. The yield which would be lumpy would fall very unevenly indeed. Regional shopping centres would benefit at the expense of their hinterlands. The need for complex resource equalisation would remain and the small size of our local government units would encourage cross border shopping. There would be problems in apportioning the yield of local sales tax on services and there would undoubtedly be an additional burden on business.

Figure ■: Distribution of shopping floorspace per adult in West

(Version of: 5 December 1985)

3.22 Local excise duties - road fuel duty, alcohol duties and vehicle excise duty - have similarities with a local sales tax and were also considered in "Alternatives to Domestic Rates" as possible replacement taxes for rates.

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

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

Local Income Tax

3.25 A local income tax at an average rate of ▦p in the pound would be capable of replacing the present net yield of domestic rates. The introduction of a local income tax would represent the final shift away from the "beneficial principle" of local taxation towards the "redistributive principle". It would remove the need for a separately administered rebate scheme.

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

- the impact on work incentives and rewards;

- the failure of local income tax to underpin local accountability;

- the inappropriateness of relying too heavily on a redistributive tax to fund local authority services.

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3.27 The reduction of income tax is a major objective of government policy. The replacement of domestic rates by a local income tax would require an increase in the average basic rate of income tax from 30p to 3▦p. In some authorities the rate would be lower - but in other authorities it could be considerably higher. With present local spending patterns the combined national and local rate of income tax could be well in excess of 50p in the pound for basic rate taxpayers in some authorities. This would have severe effects on work incentives.

3.28 Local income tax does not adequately meet the criteria set out in paragraph 3.13 for a local tax which would underpin local accountability. There are ▦m income taxpayers in England, compared to 18m householders and 35m voters. So while the introduction of a local income tax would widen the tax base, there would still be only ▦% of the electorate who were paying local taxes.

3.29 A local income tax would make it necessary either for the Inland Revenue to know the residence of every income taxpayer (at the moment they do not need or use this information for the majority of income taxpayers) or for the local authority to know the taxable income of all its residents. It would be feasible for the Inland Revenue to administer local income tax alongside national PAYE. Employers would have to know the residence of their employees and apply the appropriate local tax rate on top of the national rate. The major objection to integration with PAYE is that local income tax would become imperceptible. For most employees it would be deducted at the same time as national income tax and national insurance contributions. There would be no direct link between the local taxpayer and the local authority levying the tax.

3.30 To overcome this the tax might be administered by the local authority. This would require either separate declarations of income to the local authorities or the passing of confidential information about individuals' taxable income from the Inland Revenue to authorities. "Alternatives to Domestic Rates" estimated that a locally administered local income tax could require around 55,000 local authority staff. The additional administrative cost entailed in local collection is likely to be very high.

3.31 The third objection to a local income tax is rather different - that local income tax is not an appropriate tax for local authorities. There is a broad distinction to be drawn between the roles of central Government and local authorities. Local authorities' essential role is to provide services - some "beneficial", some "redistributive". Local councillors are judged on their performance in delivering these services. Central government is only in part a service provider. Its main domestic responsibilities are for the management of the economy and the redistribution of income, through the tax and benefit systems.

3.33 This division of responsibilities should be reflected in the taxes that the different ties of government levy. Since central government is primarily concerned about the performance of the economy and the distribution of income it will inevitably need to control both the level and the structure of the major redistributive tax - personal income tax. It is not appropriate to give local authorities the power to tax incomes when they are responsible neither for the performance of the economy nor for the national distribution of income

3.34 An ideal local tax should fit in with local authorities' role as a service provider and promote the efficient provision of services to the levels desired by most members of the community. That argues in favour of a form of taxation which has at least some of the characteristics of a charge. Since local authorities are held accountable for services but are not held accountable for national economic performance, they would naturally be inclined to use a buoyant tax such as income tax which rises imperceptibly to finance an expansion of services without considering the economic benefits of reducing income tax rates or raising allowances.

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

The way forward: a community charge

3.36 Of the alternatives considered so far, only a local sales tax would meet the first condition specified in paragraph 3.13 - that a tax to promote

accountability should be paid by all those who are eligible to vote in local elections. But sales tax fails the second test - of bringing home to voters the cost of local authority spending. All the other options considered fail both tests.

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

3.38 The Government considers that the way forward on local taxation lies in introducing a new flat rate charge - a community charge - for local services, payable at the same rate by all the adult residents of a local authority. Such a charge would be more perceptible than rates. Each local authority would determine the level of its own community charge, and levy it. All adult residents would be liable to pay, not just householders. If each local authority is to be accountable to those who have to pay for its expenditure, clear and comprehensible price signals must be given to all local taxpayers. A community charge will achieve this, for all local residents will face similar bills.

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

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

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

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

3.41 It is for consideration whether a community charge of this sort might replace rates entirely. In many areas of the country that should be achievable without too much difficulty. But there are some local authorities where domestic rate bills contribute a relatively large share of local taxation, so that complete abolition of rates within a short timescale could present problems.

3.42 The move from rates to a community charge will inevitably affect the personal finances of households since single-adult households gain at the expense of multi-adult households. The Government therefore considers that the change should be made gradually by introducing the community charge

initially at a low level. In the first year of the new scheme rates would be reduced - by, say, an amount equivalent to the yield of a £50 per adult community charge. That would mean that the overall position of two-adult households would be broadly unaffected: their rates would go down by about £100, but they would have to pay an additional £100 - £50 per adult - in community charges. In some authorities where rate bills are low, a £100 reduction in rates would be a large proportionate reduction. In other authorities, mainly in London and South East England where some authorities have domestic rate bills in excess of £500 per adult - over £1000 a year for a two-adult household - it would be a much smaller proportionate cut and rates would continue to meet a large part of the local tax bill. All <u>new</u> local taxpayers would however face a similar bill, and there would be similar <u>cash</u> reductions in rate bills across the country. And in all areas single householders would pay less, and households with more than two adults would pay more, towards the cost of local services.

3.43 It will be for consideration how to proceed in later years after the initial cut in rates. One option for subsequent years would be simply to freeze rates at their lower level. Any increase in local expenditure not met by an increase in government grants would then fall to be met from the community charge. But, on reasonable assumptions about inflation and expenditure, this would mean that rates would still provide a major share of local authority revenue until well into the 21st century. It would take 20 years for rates to raise less than 10% of local revenue even in the authority with the lowest rate bill. In all other authorities it would take longer.

3.44 To reduce or eliminate rates within a shorter timescale, the proportion of local spending met by rates would have to be reduced in successive years. One way would be to reduce rates each year by an amount equivalent to the yield of a fixed increase in the the community charge. If rates in each authority were reduced annually after the first year by the equivalent of a £20 per adult increment in the community charge, rates would be eliminated in 60% of authorities within [illegible] years, in 80% of authorities within [illegible] years, and in 98% of authorities within 12 years. They would still remain for several years more in some authorities in London and South East England.

3.45 Another approach would be to freeze rates in all authorities for a period of years, during which their real value would be eroded, and then abolish them in one go. After a four year freeze rates could be eliminated in 62% of authorities if £100 were added to the community charge which, by then, would be well-established. A decision could then be made on whether, and how quickly, to phase out rates in other authorities where a longer transition was required.

3.46 A further option would be to leave a drastically reduced property element in all authorities - to meet say 30% or less of the local revenue requirement. This would reduce the length of transition in high rate bill authorities. The community charge would still bear the major burden of financing local authority services. If property were to be retained in the longer-term as a dynamic part of the tax base, the question of valuation would need further consideration.

3.47 The impact of various transitional schemes is further discussed in Chapter 5.

Operational issues

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

3.49 There will inevitably be less than 100 per cent compliance with the community charge. Local authorities have sufficient means at their disposal to check that most people are registered in the right place. Where someone deliberately avoids registration the final resort will be to the Criminal Courts, but this should be necessary only in a very few extreme cases.

3.50 Just as rates require rebates in order not to bear too harshly on those with low incomes, so will a community charge. The Government considers that it is better for there to be an explicit income support scheme of this sort operated through the social security system than to obscure the true cost of the local contribution to services by, for example, having a lower level of charges for those with low incomes. Either approach would require a test of income. A rebate scheme is the most efficient way of helping the poor without distorting the signals to the majority of taxpayers who will not require special assistance.

3.51 The new housing benefit scheme, as set out in the White Paper on Social Security, will be adapted to apply to the community charge. The key features of the scheme will remain - a minimum proportionate contribution by all those liable for rates or the new local tax, and a taper on the rebate related to net income. Details are contained in Annex G.

3.52 The new community charge will enhance the accountability of local authorities to their electors. In conjunction with the new treatment of non-domestic rates and the new grant arrangements discussed in Chapter 4 this will introduce new pressures for financial responsibility which are absent under existing domestic tax arrangements and lead to a healthier climate for local accountability which will make it possible for central Government to stand back from detailed control and confrontation.

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CHAPTER 4: GRANTS

Introduction

4.1 Chapters 2 and 3 set out proposals for major changes to the way in which non-domestic rates are paid; and for a new system of local domestic taxation, designed to increase local accountability. In 1984/85 about ■% of the cost of providing local authority services in England was met by non-domestic rate-payers. A further ■% came from domestic rates. But the largest contribution, ■%, was provided by national taxpayers as central government grants. Grants are administered separately in Wales and Scotland, where respectively ■% and ■% of expenditure was met by grant in 1984/85. This chapter looks at the place of grants within the present local government finance system and sets out the government's proposals for change.

Why do we have grant?

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

(i) Equalising needs

4.3 Some authorities inevitably face much greater calls on their services than others. The proportion of the population who are of school age, for example, varies widely across the country: children between 5 and 16 make up ■% of the population in ■ but only ■% in ■. At the other end of the age scale, the proportion of pensioners living alone ranges from ■% in ■ to ■% in ■.

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

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

(ii) Equalising resources

4.6 Under the present local government finance arrangements, the taxable capacity of local authorities is measured in terms of rateable value per head of population. This varies greatly from authority to authority, largely as a result of the concentrations of industrial and commercial property in particular areas. Block grant is used to compensate authorities with a small local tax base (on this definition of taxable capacity) relative to their populations. If they had to finance their services wholly from local taxation, such authorities would have to levy much higher tax rates than other authorities. Whether or not the tax bills they charged would be higher would depend on their average levels of rateable values.

(iii) National taxation

4.7 Successive Governments have also provided general grant support for local authority expenditure because they have taken the view that the burden of such expenditure should not be borne by local taxpayers alone. This view rests on two considerations: first, the wider "national dimension" of some of the main services which local authorities provide; and second the fact that domestic rates are not a tax which can bear the full weight of local authority expenditure, since they are poorly related to current ability to pay. The proposed new community charge is also unrelated to ability to pay. In these circumstances, if local services were met entirely out of local taxation, those on low incomes would pay a much larger share of the cost than was justified and this could inhibit the provision of satisfactory standards of service in some authorities. Providing Exchequer grants to local authorities avoids this problem.

Grants and local accountability

4.8 The fact that grants have to meet several different purposes means that the systems of calculation are inevitably complicated. No grant system that deals with several hundreds of local authorities carrying out a wide range of different services and costing billions of pounds can even be completely simple without an intolerable degree of rough justice. But it is important that grants should be paid in such a way as to enhance local accountability, not distort it. So far as possible, whatever the problems of calculation, the end result of the grant system should be transparent, so that local residents can see the extent of the help that is being offered from central taxation. And the way that grants are calculated should be accessible, so that people can understand how the size of the grant is determined.

4.9 The most important signal of all to local electors is the relationship between variations in a local authority's expenditure and the change in local domestic tax bills. If the grant system fairly takes account of local needs, it is right that, where an authority decides to spend more than its assessed need, the whole cost should fall on the local people who benefit from the extra spending. Under the local taxation proposals described in Chapter 3, all the adults living in the area will be helping to pay for the services that are being provided, as well as having the chance to vote for them. The proposals for grant, discussed below, will ensure that they understand how changes in expenditures on services affect the local tax bill.

The origin of grants

4.10 Sizeable grants began to be paid in the latter part of the nineteenth century, to encourage different areas to provide services of a consistent standard. At first this was achieved largely through specific grants. Some specific grants remain; these are considered separately in paragraphs 4.58 to 4.62 below. But gradually the main form of Exchequer support began to take the form of unhypothecated grants, paid towards local authority spending generally. This chapter is concerned mainly with those grants.

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

Before block grant

4.12 The grant system in force in England and Wales between 1974/75 and 1980/81 had a number of serious drawbacks. Two in particular warrant discussion. The first concerns the method used to "equalise resources" that is, to ensure that authorities could operate as though all were able to draw on the same rateable value per head in setting their local contribution to expenditure. This involved the Exchequer in effect standing in as an extra ratepayer in authorities with rateable resources below a given level, and paying whatever rate in the £ the authority levied on a fictional property with a rateable value equal to the shortfall. This meant that the amount of resources grant an authority received rose in line with the rate poundage it levied. The more an authority chose to spend, the more grant it received from its central government "ratepayer".

4.13 The calculation of needs grant to compensate authorities for unavoidable differences in their spending per head (see paragraphs 4.3-4.5 above) used the statistical technique of regression analysis to select and weight social and economic indicators which correlated with the broad pattern of actual local authority expenditure. It is true that under this arrangement individual authorities could not influence the amount of needs grant they received by their spending behaviour. But the calculation could be affected if a group of authorities with similar characteristics spent more. For example, if the majority of urban authorities chose to increase their spending, this would be interpreted by the regression system as greater need to spend in these authorities whether or not their real underlying spending needs were correctly reflected in their actual expenditure levels.

Block grant

4.15 Block grant, introduced in England and Wales in 1981/82, was an attempt to devise a system that would be fairer and more accessible in these respects than the arrangements it replaced. It succeeds in offering a system for supporting local authority spending which is conceptually much more logical and defensible than any previous arrangements. Annex C explains in more detail how it works in England, and also in Wales where there are some differences. The basic structure of block grant still reflects the earlier arrangements, however, so that it shares some of their defects.

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(i) Calculating block grant

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

4.17 Between years, entitlements can alter as a result of changes in an authority's needs assessment, its rateable resources, or its spending. However, expenditure changes are under the authority's control and movements in rateable value are generally predictable. The main source of volatility in practice has been GREs. Although it was hoped that GREs would be more stable than the previous system of needs assessment, this hope has not been realised in practice. Annual changes in methodology and data, as well as changes in the overall distribution between services, have resulted - as the Audit Commission noted in its Report on the Block Grant system in 1984 - in wide differences in rates of change of GRE for individual authorities. This has led to uncertainty over grant income for authorities and has tended to mask the impact of changes in actual expenditure to the ratepayers.

4.18 An authority's grant entitlement can also vary within a given year. This is an inevitable consequence of a system where grant is based on actual expenditure and where the overall grant provision is cash limited, so that individual authorities' grant claims - based upon their spending decisions - have to be 'close-ended' to the amount of grant available for distribution. Thus an authority's grant will change not only because of its own spending, but also because of the spending decisions of every other authorities. Moreover, final grant determinations cannot be made until audited outturn expenditure for the year is known - at least 18 months after the end of the financial year. Mid year GRE changes have been a further cause of grant volatility. GREs have been re-determined during the course of the year to correct data errors and to revise certain estimated items in the light of later information. All this means that an authority's grant entitlement, after taking account of the effect of grant penalties, could change 3 times between provisional notification in December and the final closing of the books 3 years later.

(ii) Resources equalisation

4.19 The way in which resources equalisation is undertaken within block grant also reflects earlier arrangements. Very substantial amounts of money are transferred between different parts of each country in a way which is entirely concealed within the operational complexities of the grant system. The map at Figure [redacted] shows, as an example, the scale of transfers involved between the various English regions: in total, some £[redacted]m is being transferred through the grant system from southern and eastern England to the rest of the country. Such transfers may or may not be justified. What cannot be justified is that such substantial transfers - which directly increase or decrease the cost to ratepayers of local authority services - are hidden from view in the complexities of the grant system.

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Figure [redacted]: Interregional transfers through resources equalisation (England 1984/85)

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

4.21 The differences in authorities' rateable resources for which resources equalisation compensates arise for two main reasons : the size and composition of their property base; and the general level of rateable values of properties in their area. An authority may have low rateable resources because it has relatively few properties pro rata to population (or relatively few commercial and industrial properties which generally have higher rateable values than domestic properties); or because the general level of rateable values in its area is lower than rateable values for comparable properties in other areas; or a combination of the two.

4.22 Resources equalisation is based on rate poundages - the rate in the £ that authorities levy. It aims to ensure that authorities providing the same level of service have to levy the same rate poundage. The effect of equalising rate poundages is that, in those authorities where average rateable values are low, tax bills on individual properties are lower than tax bills on comparable properties in authorities with high average rateable values. This would not be unreasonable if rateable values bore a reasonable relationship to the ability of householders to pay. Within a local authority area, rateable values probably do bear a reasonable relationship to ability to pay : the occupant of a modern detached four-bedroomed house in a pleasant suburban environment is likely to be better off than the occupant of an ageing two-bedroomed terrace house in a run-down area in the centre of the town. But between different local authorities, the rateable values of comparable properties vary much more than the ability of their occupants to pay. The rateable value of a good quality detached four-bedroomed house in a "good" area in the City of Durham is likely to be in the region of £[redacted], while in Luton it is likely to be £2[redacted]. Figure [redacted] shows the extent of this mismatch by comparing average rateable values and average incomes of each region in England.

Figure I: Average rateable values and average incomes in English

4.23 Resources equalisation is therefore subsidising the cost of local authority services to all ratepayers in authorities where rateable values are generally low. This is the logical consequence of rate poundage equalisation with a property tax. But in terms of what people pay and the services they get it makes little sense. For a comparable standard of service, the occupant of the four- bedroomed detached house in Durham pays £H a year, while his counterpart in Luton pays £H. If households in different areas use the same amount of gas or electricity, the range of bills is nothing like as great.

4.24 Not only is the justification for this situation weak in terms of ability to pay, but people whose bills for local authority services are being substantially subsidised (especially at the margin) have less incentive to be concerned about how much their local authority spends and every incentive to vote for higher levels of expenditure.

(iii) Grant Related Expenditure (GRE)

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

4.26 This approach makes it possible to see how GREs are made up. This was impossible with the purely statistical needs assessments used under the previous system. But the system does encourage complexity. There is a temptation to

make GREs over-complicated by introducing new factors and by continual refinement in order to shift the detailed pattern of grant distribution in one direction or another. This also leads to instability.

Objectives of a new grant system

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

4.28 The Government believes that the national taxpayer should continue to contribute via grants to the costs of providing local authority services. But in the light of the above analysis, it believes that the present system needs to be reformed. It has identified the following objectives for the design of a new grant system.

- It must compensate authorities for the cost of providing a reasonable standard of service, and local domestic taxpayers should be charged comparable amounts for similar services.

- It should ensure that the cost of spending which is high in relation to normal levels is met by local domestic taxpayers, and that, similarly, they benefit from expenditure savings.

- It should be as transparent as possible in its manner of operation - to residents as well as local authorities.

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

There is a further objective which is to avoid unnecessary turbulence in the changeover to new system. This requirement inevitably conflicts to some extent with some of the other objectives.

The government's proposals

4.29 To meet the objective of combining fairness with local accountability, the government proposes a lump sum grant system with just two main elements:

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

ii. standard grant, to provide an appropriate contribution from central taxes towards the cost of local services.

4.30 Compared with block grant, these arrangements would represent a considerable simplification and clarification. Block grant does three things at once : it equalises needs, equalises resources and pays an additional subsidy per head of population. For reasons set out in more detail in paragraphs 4.47 to 4.52 below, resources equalisation, in the form it has taken in recent years, would no longer be required with the local government finance system proposed in

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this Green Paper. And the separate treatment of needs grant and standard grant will make the basis of central government support much clearer to local taxpayers.

4.31 One part of the present grant system would no longer be needed at all. Under the existing arrangements, domestic ratepayers benefit from a discount on their rate poundages, as compared with non-domestic ratepayers, who do not. The size of the discount is determined by the government. Its cost is met by domestic rate relief grant. Domestic rate relief was introduced in 1966 as an interim measure to give some assistance to domestic ratepayers pending the possible overhaul of the rating system following the Royal Commission on Local Government which was set up that year. In the event, the rating system was not reformed and domestic rate relief has remained. However, since it is proposed that non-domestic and domestic taxpayers should now be taxed on quite separate and different bases there is no longer any need for a special discount for domestic ratepayers.

Needs grant

4.32 Whatever grant or local taxation arrangements may exist in the future, the Government remains committed to a grant system which compensates authorities for differences in the amount they need to spend to provide a typical standard of services. This applies equally to differences which arise because some areas have greater concentrations than others of people who need local authority services; and to inescapable differences in the cost of providing those services. Without some form of compensation, authorities affected by concentrations of need, or by higher costs, would have to either increase local tax bills, or reduce the standard of service provided. But it would be possible to compensate for these differences much more openly and directly than in the past, by paying a separate needs grant to each authority.

4.33 The calculation of this grant would be undertaken by assessing, for every local authority area, how much it might be expected to cost, per adult living in the area, to provide a normal level of local authority services. The result of the calculation would be a needs assessment for each area. The needs assessments would follow similar principles to those used for GREs under block grant, but should be considerably simplified. The way in which they might be derived is set out in more detail in paragraphs 4.40 to 4.44 below.

4.34 From the needs assessments, a ranking list of areas would be produced. At the bottom of the list would be the area which could provide an acceptable level of service for the smallest amount per adult. At the top would be the area where the same level of service cost most to provide. In order to pay needs grant to every authority, rather than just to one tier, it would be necessary to split the needs assessments between tiers of authority in the same area. There would be more than one way of doing this; similar issues already arise with block grant. Whichever method were used, the outcome would be a needs assessment for every authority. The Government would then pay a cash amount of grant to each authority to meet the full difference in cost implied by the gap between that authority's needs assessment and the cost of the authority with the lowest assessed need per adult in the country. For example, if the lowest cost authority was assumed to be able to provide its services for £350 per adult, then another authority with an adult population of 100,000 where the same standard of services would cost £400 per adult to provide would receive a grant of (£400 - £350) x 100,000 = £5m.

4.35 The total of needs grant to each authority would be fixed. It would not be affected by the actual level of an authority's spending. So an authority spending £25 per adult below its needs assessment would be able to reduce its local tax bill by a full £25 per adult in the area. In the same way, the needs grant would not increase if an authority chose to spend more. If it spent £25 per adult more than its needs assessment, local taxpayers in the area would have to meet the cost of that extra spending in full.

4.36 The total of needs grant would depend on the exact method of calculating the needs assessments and splitting them between tiers. The amount needed to equalise needs is however likely to be close to the figure contained within block grant. This was £[redacted] billion in England in 1984/85 - [redacted]% of the grant total. In Wales and Scotland it amounted to £[redacted]m and £[redacted]m respectively, [redacted]% and [redacted]% of the overall amounts of grant made available in those countries.

Needs assessments

4.37 Assessing the cost to local authorities of providing an acceptable standard of service has been a consistent thread running through discussions of government grants to local authorities throughout this century. It was Lord Balfour, in his Minority Report to the 1901 Royal Commission, who first suggested that relative need for expenditure should be assessed by finding the lowest expenditure per head of population for a particular service, and assessing grant for all other authorities on the basis of the unavoidably greater cost to them of providing the same standard of service.

4.38 Nothing came of the Balfour scheme until 1929, when a grant system was introduced which tried to assess the relative needs of different authorities. Its approach, however, was to take only a handful of general factors to assess variations in needs across all services. Immediately before the introduction of block grant these factors were selected automatically by the statistical process described in paragraph 4.13 above.

4.39 The introduction of GREs marked a big step forward. For the first time, an attempt was made to use a client group/unit cost approach to assess needs for the main services. By contrast with the previous statistical approach, which simply looked for correlations, this meant using factors that laymen and experts alike could see were the ones that actually <u>caused</u> variations in the cost of providing different services - factors like the number of schoolchildren the authority had to educate, and the number of miles of road it had to maintain. The needs grant system now proposed will continue to be based on the approach pioneered by GREs. After 5 years experience with GREs, however, certain shortcomings have become evident in England. The main problems, mentioned in paragraph 4.26 above, concern their complexity and volatility.

4.40 There are several services which feature separately in the GRE formula but on which the variation in spending - and in the GREs themselves - is small. These are services such as cemeteries and crematoria, and school crossing patrols. It is highly debatable whether any gain in fairness achieved by treating these small services individually is worth the complexity that results. It might well be preferable to deal with as many as possible of these minor services together, probably allocating the expenditure simply in proportion to the number of adults in the area.

4.41 For the major services, a client group/unit cost approach remains the most valid method of assessing the cost of providing services in different parts of the country. The problem here is that the detailed formulae for the major services have tended to become increasingly complex since block grant was introduced. This constant refinement is understandable. It reflects the fact that there are many factors which can be argued to have some relevance in assessing expenditure needs. But the result is a steady increase in complexity. And the introduction of new factors, or new ways of calculating such things as population density, inevitably increases the volatility of GREs. This can lead to substantial changes in the grant of some authorities from year to year that are in no way related to real charges in their need to spend.

4.42 The government therefore intends, in the run-up to the new system, to re-examine critically the GREs for the main services. The aim will be to see whether the existing pattern of GREs can be broadly reproduced using a simplified client group/unit cost approach which is more stable, and more understandable for councillors and their electors.

4.43 It may be possible to introduce some simplifications, both in the treatment of minor services and the number of factors used in the formulae for the main services, before the start of the new system. The government will have this possibility in mind in the normal annual cycle of discussions with the local authority associations. In other cases, it may be appropriate to wait until the new system is introduced before making changes.

4.44 After the new system has been set up, the government also considers that it would be appropriate to minimise changes in later years to the formulae used to calculate the needs assessments. Apart from taking account of new sources of data, changes should only be made where there will be a major gain in fairness that will clearly outweigh the disturbance that would be caused. This would mean placing greater emphasis on stability than has been the case in the past, either with block grant or with earlier systems.

Standard grant

4.45 Apart from the amount needed for specific grants (see paragraphs 4.58 to 4.62 below), the government feels that the most appropriate way of allocating the grant left over after needs grant has been paid would be as a constant amount per adult to every local authority area, so as to produce a matching reduction in the size of the community charge. This would be in keeping with past RSG arrangements, under which amounts of grant not needed for the purposes of equalisation have been allocated as a constant amount per head. The difference would be that, with the present and previous grant systems, the extent of this support is completely obscured within an overall total that also includes compensation for differences in needs and in rateable resources. With the approach we now suggest standard grant, representing the basic level of taxpayer support to local services, would be a freestanding and identifiable element in authorities' budgets.

4.46 If the total amount of Exchequer support were at the 1984/85 level, and the amount needed for specific grants remained broadly unchanged, the total available for use as standard grant in England would be about £[redacted] billion, or £[redacted] per adult across the country. In Wales it would be about £[redacted]m, or £[redacted] per adult; and in Scotland £[redacted]m (£[redacted] per adult).

Resources equalisation

4.47 Under block grant, and its predecessors, some compensation within the grant system for variations in authorities' rateable resources has been essential. Without it, rate bills in authorities with few commercial and industrial properties and low average rateable values would soar. Such authorities would not be able to afford to provide a reasonable standard of services. This would clearly not be acceptable. But the fundamental changes in the whole local government finance system now being proposed by the Government offer new ways of tackling the problem.

4.48 The main factor which causes variations in authorities' total rateable resources is non-domestic property. Even excluding London, where there is the greatest concentration of non-domestic resources, non-domestic rateable values in England range from £[redacted] per adult to £[redacted] per adult. Under any system where the entire yield of non-domestic rates lies locally, it is inevitable that the Government should intervene to compensate areas with only a small amount of commercial and industrial development; and to draw off some of the income from authorities with large concentrations of shops, offices and factories. Otherwise there would be very substantial variations in local services and local domestic tax bills, caused solely by the extent of industrial and commercial development in different areas.

4.49 However, the proposed reforms of the non-domestic rate described in Chapter 2 deal with this problem. Whether non-domestic rates are capped at their current levels or are fixed at a uniform level across the country, the proposal to pool and redistribute the burden as a common amount per adult among all authorities ensures that the benefit of all non-domestic rateable resources is shared equally among all authorities, thus removing a major source of variation. They would achieve automatic equalisation of non-domestic resources in a simple and transparent way without any of the cumbersome paraphernalia of a resource equalising grant that is tied in with the expenditure of local authorities.

4.50 If non-domestic resources are pooled and redistributed in this way, variations in authorities' resources arise only in the context of the domestic tax base. If, in future, the tax base were to be simply the adult population of the area - that is, if we were to move entirely to a community charge as proposed in Chapter 3 - each authority could be assumed to have the same taxable resources per adult. With a service grant such as is described above, two authorities spending at the level of their assessed needs would both have to raise exactly the same amount per adult from those living in the area. There would be no case for separate resources equalisation grant.

4.51 The domestic tax proposals described in Chapter 3 indicate the Government's intention to begin its reform of local taxation with a combination of a community charge and domestic rates, with the former increasing as a proportion of the tax base over a period of years, while the latter diminishes. As long as some element of domestic rates is retained, there will be variations in authorities' tax base. But their significance will be much smaller than at present, and under the proposals in this Green Paper, they will get even smaller over time.

4.52 The Government believes that in these circumstances, and bearing in mind that variations in the rateable values of domestic properties between different areas greatly exaggerate the ability of their occupants to pay, there is no case for a separate resources equalisation. It will be necessary, however, to ensure that in the initial years of the new system, while domestic rates remain a significant element in local finance, this does not lead to sudden increases in the burden of local taxation. The special arrangements discussed in paragraph 4.56 below and in Chapter 5 will be an important factor.

The operation of the new grant system

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

Figure ■: The grant system and local taxation

The effect on local tax bills - without special arrangements

4.54 The Government's proposals:

- that there should be a needs grant under which all marginal changes in spending are met by local domestic taxpayers;
- that the proceeds of non-domestic rates should be pooled and allocated as a constant amount per adult to all authorities;
- that there should be no other form of resources equalisation

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

4.55 The size of the changes would generally be small - for ■% of areas average local tax bills would change by less than [£2] a week. But, in a minority of cases, losses would be greater. And, of course, these effects would be superimposed on changes in the pattern of household bills <u>within</u> areas resulting from the gradual introduction of a community charge.

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

4.57 The government therefore envisages that special arrangements would be introduced to avoid any significant shifts in the burden of local taxation <u>between</u> local authorities in moving to a new system. Changes in the balance of local taxation <u>within</u> a local authority, arising from widening of the local tax base by the introduction of the community charge, would begin to feed through immediately. So would the effects of any <u>increases</u> in spending. But if a local authority maintained its previous level of spending, the average level of its local tax bills would be virtually unchanged. Once the new system is in operation and sufficient time has elapsed to permit a proper assessment of its impact and effects, the basis of the special arrangements would be reviewed at the same time as the review of the phasing out of rates envisaged in Chapter 3, paragraph ■.

4.58 A more detailed account of the impact of the new system and of the design of the special arrangements is given in the next Chapter, which also deals with the special position of London and the Scilly Isles. Chapters ■ and ■ discuss the position in Scotland and Wales.

Specific grants

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

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

4.61 There will remain a role for certain specific grants. But, equally, extensive use of such grants could run counter to the approach set out in this Green Paper of local accountability and choice. And it is several years since there was a thorough appraisal of the role of specific grants. It is not clear that the existing pattern of grants can easily be justified in terms of the policy objectives of the 1980s and 1990s.

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

a. to give special encouragement to expenditure or particular activities or services where there is a strong national interest;

b. to compensate local authorities for the cost of activities engaged in at the request of central government where the authority has little or no discretion over the amount of expenditure incurred;

c. to supplement Rate Support Grant in relation to types of expenditure, the need for which arises too unevenly, as between areas or years, to be reflected in a general assessment of expenditure needs;

d. to assist a local authority in the financing of expenditure undertaken for the benefit of a wider area than its own.

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

Calculating grant entitlements and obtaining Parliamentary approval

4.64 One of the problems inherent in block grant is that each authority's grant entitlement is subject to change during, and after, the year in question. The Government proposes to end this practice and to ensure that, under the new grant system, the cash total of grant approved before the start of the financial year will be the exact figure that each authority gets.

4.65 This will be possible because grant entitlements will no longer depend on authorities' actual spending; and there will be no grant abatement or holdback. Instead, each authority will know, even before it sets its budget for the year, the fixed amount of needs and standard grant it will get, and the exact total it will be paid from the non-domestic rate pool.

4.66 This will simplify local authority budgeting. Every authority will be able to see just what income will arise from these sources, and will know that the gap between that figure and the amount needed to finance its planned spending will have to be met entirely from local domestic taxpayers.

4.67 The total amount of grant which the Government plans to make available, and the basis of its allocation between authorities, will continue to be subject to approval by the House of Commons. The present Rate Support Grant Reports for both England and Wales are cumbersome documents. It is difficult, especially

for those who are not experts in the field, to pick out from the mass of material the elements that are crucial in determining how grant is apportioned. The content of these Reports has to meet requirements set down in primary legislation so there is little, if any, scope for simplifying them under the present arrangements. The proposed new grant system is in many ways simpler than block grant. This should automatically mean that the statutory documents can be simpler. But the Government also intends to look again at the way in which details of each year's grant settlement are presented to Parliament for approval, with the aim of adopting a form of presentation that will make it easier to identify the main principles which are to be decided and on which the grant allocation will be based.

4.68 The Government's intention to avoid changes in authorities' grant entitlements means that there will be only one Rate Support Grant Report for each year; the system of successive Supplementary Reports will cease. If changes need to be made to the calculations set out in the main Report - for example to correct a significant error in the data used, or to adjust any needs assessments that may be based on budgeted or actual spending - this will be done by making explicit compensating adjustments in the grant calculation for a future year.

Summary

4.69 Paragraph H above sets out the objectives that a new grant system should meet. The proposals outlined in this chapter would meet those objectives.

- They would be fair. Grant would fully compensate authorities for the fact that providing a standard level of service costs different amounts in different parts of the country.

- The cost of increases in spending above that level, or the benefit of reduced spending, would fall entirely on local domestic taxpayers.

- The grant system would be inherently simpler than block grant or previous systems. The government would also aim to simplify the formulae used to assess needs.

- The system would be stable. Authorities would know, before the year in question started, exactly how much grant they were going to receive. This figure would be fixed. And grant entitlements should not vary so much between years.

4.70 In the government's view, a special resources equalisation grant is unnecessary, given the proposals to pool the proceeds of the national non-domestic rate and to change local domestic taxation to a per-adult base. Ideally, the government's aim would be a system where tax bills were the same in different parts of the country for a standard level of service. Adopted without amendment, however, such a system would mean sudden and substantial shifts between areas in the burden of local domestic taxation. The government believes that such shifts are unacceptable, and envisages that special arrangements would be necessary to avoid excessive changes in average domestic tax bills for each local authority on introduction of the new system.

4.71 This would mean that average tax bills in different authorities would continue to vary for a standard level of service. But it would still enable the change to the fairer distribution of domestic taxation <u>within</u> authorities resulting from the move to the community charge to take place. And it would still ensure that every £1 increase in local authority spending would be met entirely from the domestic taxpayers of the authority and every £1 saved would reduce the local tax burden by the same amount. The aim of ensuring that the grant system contributes to local accountability would be met.

CHAPTER 5

THE COMBINED EFFECTS OF CHANGES TO LOCAL TAXATION AND GRANT

Introduction

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

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

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

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

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

iii. the grant system would be more stable and more comprehensible; the grant an authority receives would no longer depend upon how much it spends and there would be no grant support for marginal spending. At the same time the grant system - in combination with the new tax arrangements - would be designed to equalise tax bills for comparable levels of service rather than rate poundages, which at present cause significant disparities between tax bills between areas.

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

5.4 These reforms will also have important distributional consequences, affecting the finances both of local authorities and of households and individuals. This chapter explains in general terms what those effects are likely to be and describes how the reforms might be phased in over a transitional period so as to keep their distributional effects within reasonable and tolerable limits. Annex H describes the distributional effects in greater detail.

5.5 The effects described and illustrated both in this Chapter and in Annex H show what the impact of the proposed reforms would have been on local authorities and households in 1984/85 given actual local authority spending in that year. Detailed data for households and tax units has been derived from the Family Expenditure Survey for that year. To give an adequate sample size, four years' data (1980-1983) have been combined and repriced to a common 1984 level. The effects described assume that the proposals contained in the White Paper ["Reform of the Social Security System"; Cmnd 1234], will, as planned, already be in operation, and they assume no change in the overall size of the contributors of national taxpayers, non-domestic ratepayers, and local domestic taxpayers towards local authority spending.

The effects on local authorities

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

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

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

(ii) Authorities with high domestic rateable values. At present, the block grant system equalises differences in the rateable resources of authorities; grant is transferred from authorities with high rateable values to those with low rateable values. The discontinuation of this

process means that authorities with high rateable resources will retain a larger proportion of their grant than hitherto. Since non-domestic rates will now be dealt with separately, this effect will depend on the level of an authority's domestic rateable values.

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

i. High spending authorities. The limitation of non-domestic rate poundages and the pooling and redistribution of non-domestic rate income, combined with the loss of grant support on marginal spending, would mean a reduction in revenue from that source to authorities spending above the level of their GRE and currently levying an above-average non-domestic rate poundage.

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

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

5.10 The effects of the proposals in London need to be considered separately. Rateable values in many London authorities are substantially above rateable values elsewhere. This advantage would normally be offset by a reduction in grant under the "resource equalisation" principle. Successive grant regimes have however protected London from the consequences of full resource equalisation by allowing its authorities to retain a significant proportion of its resource advantage over other authorities, primarily to moderate the very high rate bills which would otherwise occur. In addition, a few inner London authorities who are out of grant, either because of exceptionally high rateable resources and/or high spending, have retained a further advantage under the present grant system. Because resource equalisation has always been limited for London, its high resource authorities stand to gain relatively little from the complete abolition of resource equalisation. Many London authorities, particularly in inner London, are spending very significantly above the level of their GREs. They therefore stand to lose revenue from the proposal to pool and redistribute non-domestic rate income. The combined effect would be significant reductions in the grant and non-domestic rate income for many London authorities.

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

Moderating the effects on local authority areas

5.12 Changes in the non-local income of local authorities will inevitably affect the burden falling on their local domestic taxpayers. If an authority's total income from grants and non-domestic rates goes down average domestic tax bills will have to be higher to finance any given level of expenditure, and vice versa. In a number of authorities these changes would be likely to be significant. Figure [redacted] shows the extent and magnitude of the changes by rating authority area (ie districts and London boroughs) arising from shifts in the grant and non-domestic rate income of all tiers of local government.

Figure [redacted]: Effect of grant and non-domestic rate proposals on average domestic tax bills with rating areas (England 198[redacted]/8[redacted])

Change in average domestic tax bills: £ per annum per adult	No of rating authorities	Nos of adults in these authorities
Increases		
more than £100		
£50 - £100		
£0 - £50		
Decreases		
£0 - £50		
£50 - £100		
more than £100		

5.13 The largest increases in average tax bills would occur in London authorities, mainly as a result of high spending in relation to GRE and the loss of their resource advantage. Average tax bills would also increase in northern England, reflecting high spending in relation to GRE, combined with low domestic rateable resources. Average tax bills in the South East and West Midlands, where spending tends to be low and rateable values tend to be high would generally decrease.

5.14 The Government believes that such changes are too large to impose upon domestic taxpayers and too disruptive in their likely effects on their personal finances. It therefore proposes that there should be a system of adjustments to the grant and non-domestic rate income of each authority, so as to preserve its overall level of such income after the introduction of the new system at the same level as it would have been under the present grant and taxation arrangements. This will amount to a self-financing pooling arrangement.

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

system is in operation and sufficient time has elapsed to allow a reasonable assessment of how it is working in practice, the future of the system of adjustments could be reviewed.

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

The City of London and the Isles of Scilly

5.17 Under block grant and its predecessors, special grant arrangements have been made to take account of the special circumstances of the City of London and the Isles of Scilly. Both are authorities with very small resident populations - about 5,000 in the City and about 1,500 in the Scillies. Comparable arrangements will need to be made under the new system proposed in this Green Paper.

5.18 In the case of the City, the bulk of services is provided for a very large non-resident population and for non-domestic ratepayers. Moreover, uniquely, some non-residents retain the right to vote in decisions for the City Corporation. It would therefore be unreasonable to adopt without modification proposals under which the full cost of marginal expenditure above the City's assessed expenditure needs fell solely on the resident population.

5.19 In the case of the Scillies, the principal problem is the significant diseconomies of scale incurred in providing the full range of local authority services to such a very small population. Because of this - and because in future the full cost of marginal increases in expenditure will be borne by domestic taxpayers - the needs assessment of the Isles of Scilly and the level of grant support has to be set with particular care. At present, under block grant, this is achieved by setting the GRE at the level of the authority's agreed budget, and by using a multiplier to adjust the authority's resource basis.

5.20 The Government's view is that some modification of the grant arrangements proposed in Chapter 4 will be needed in the case of the City and the Isles of Scilly. It intends to discuss with the authorities concerned how best to take account of their distinctive problems.

The effects on households and tax units

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

5.22 The effects of this redistribution of the domestic tax burden, arising from the complete replacement of domestic rates by a community charge, can be measured in two ways: on households and on tax units - that is couples or independent single people.

(i) Households

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

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

ii. According to the rateable value of the household property relative to that of other domestic properties in the authority's area. For a given household size (ie numbers of residents in a property) relatively high rateable value households will benefit more from the gradual move away from using property values as the basis of local taxation, while those in low rateable value properties will take a bigger share of the financing of local services. This effect will occur both across precepting authority areas and across rating authority areas.

5.24 The combined effect of these two factors means that [redacted]% of all households stand to gain from the new taxation proposals (including over 80% of all pensioner households) and [redacted]% stand to lose. There is a consistent pattern of gains and losses across all regions.

5.25 The size of gains and losses is generally small. In cash terms, [redacted]% of households in England are estimated to face changes of less than [£2] a week. Only [redacted]% of households lose more than £[redacted] a week, while [redacted]% gain more than £[redacted] a week; and virtually all such larger gains or losses are estimated to be less than £[redacted] a week. As a proportion of household income, [redacted]% of households in England face changes of less than [redacted]% of their net income; [redacted]% of two-person households face changes of less than [redacted]% of their net income; and all the [redacted]% of single pensioner households who stand to lose from the new taxation arrangements lose less than [redacted]% of their net income.

(ii) Tax Units

5.26 Of the 22.8 million tax units in England, [redacted]% are likely to gain from the proposals and [redacted]% to lose. But 70% of all gains and losses involve less than £2 a week, and 75% represent changes of less than 2% of net income.

5.27 About [3%] of tax units stand to lose more than 5% of their net income; about [90%] of these losses occur among single young adults who would be brought into the local taxation net for the first time by the universal community charge. About 1½% of tax units stand to gain more than 5% of their net income; about [80%] of these gains occur among single-person households, just under [40%] being single pensioner households. The pattern of gains and losses is broadly uniform in all regions.

The transition from rates to a community charge

5.28 The distributional effects summarised in paragraphs 5.17 to 5.21 above describe what would happen if rates were completely replaced by a community charge. But - as indicated in Chapter 3 - the Government believes it would be wrong to disrupt household finances by making the change in one year and proposes that the community charge should be phased in gradually over a number of years.

5.29 Paragraph 3.42 suggested that the community charge could be introduced initially at a low level - say £50 per adult per year - with the balance being raised by rates. This means that in the first year non-householders who do not qualify for housing benefit would have to pay less than £1 per week towards the cost of local services in the first year of the new system, while those on maximum rebates would probably pay only 20p per week extra. The burden could then be shifted over a period of years from the rates to the community charge element. The process would start in the first year of the new system by calculating the total local revenue - rates and community charge - required to finance the assumed level of expenditure. The rates component of local revenue would then be calculated by assuming that a £50 community charge was levied on all resident adults and the proceeds were deducted from the total local revenue to raise. The remaining sum would be the rates component. The rate poundage needed to raise that sum would then be set as an upper ceiling on rates. Under this arrangement, if an authority chose to spend in the first year of the new system at the assumed level of expenditure, its actual community charge would be £50. If it spent more, its community charge would be higher.

5.30 The transitional process in subsequent years could be handled in various ways. Domestic rate bills could simply be frozen in cash terms at the level specified in the first year of the new system, with the community charge bear all marginal changes in an authority's expenditure in subsequent years. Under this arrangement, rates would wither away over the years. In many parts of England, however, the initial level of rate bills would be such that progress towards a significant reduction in the domestic rate burden would be very slow.

5.31 The Government therefore proposes that in English local authorities there should be a phased transfer from domestic rates to the community charge, with the rates component of local taxation falling by a fixed amount per adult each year. If the rate of transfer were £10 per adult per annum, domestic rates would be eliminated in [redacted]% of authorities after 5 years and in [redacted] of authorities after 10 years. If the rate of transfer were £20 per adult per annum, rates would be eliminated in [redacted]% of authorities after 5 years and in [redacted]% of authorities after 10 years.

5.32 There are, however, a small number of authorities in inner London where rateable values are so high that even with an annual rate of transfer of £20 per adult from rates to the community charge it would take in the region of 20 or so years for rates to be eliminated. As indicated in paragraph 3.43, it would be necessary to take stock of the situation in such authorities after a suitable period of time had elapsed - perhaps 5 or 10 years - with a view to deciding whether the process of transfer should be speeded up, slowed down or even discontinued, leaving a permanent residual rates element in such authorities.

(Version of: 2 December 1985)

Interaction with the Social Security System

5.33 The proposals for replacing rates with a community charge interact with the Social Security System in two different ways:

(i) By substantially widening the local domestic tax base beyond householders, more people will become eligible for housing benefit; this will have cost implications, both in terms of additional benefit paid and increased workload for local authorities administering the benefit scheme

(ii) the effect on householders in receipt of housing benefit needs to be seen in the context of the proposal in the White Paper (Review of Social Security: cmnd 1234) that all benefit recipients should pay at least 20% of their local domestic tax bill.

5.34 We estimate that the full replacement of domestic rates by the community charge will lead to an increase in housing benefit caseload in Great Britain of between [ ] and [ ] and an increase in cost of £[ ] - [ ]. However, with the proposed transition over a number of years, these increases will build up gradually.

5.35 Otherwise, the interaction between the two sets of proposals is very limited. The proposals in cmnd 1234 redistribute income support among low income households, generally in favour of families with children. The local taxation proposals described in this Green Paper involve a switch in local tax burden from householders to non-householders and affect all income groups. In particular, single non-householders who start paying local tax for the first time are mostly unaffected by the Social Security changes.

Summary

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

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SCOTLAND

S.1 The main themes of earlier chapters apply equally to the quite separate system of local government in Scotland. Over the years since 1979 the Government have continued to press local authorities to restrain expenditure and the resulting burden on Scottish ratepayers. While many authorities have co-operated, overall in Scotland planned spending in 1985-86 was 3.2% above Government guidelines. Increasingly heavy grant penalties have been imposed to bring Councils' expenditure in line with guidelines. In cases where individual authorities have planned excessive and unreasonable expenditure the Secretary of State has taken selective action first by grant reduction and since 1983-84 by rate reduction, to reduce expenditure. Selective action has been initiated on 15 occasions.

S.2 The root of these problems, as described above, lies in the lack of accountability of local Councils. Over Scotland as a whole, with an electorate of 3.9 million adults, there are fewer than 1.2 million householders paying full rates. Of the money spent by local government 59% is provided by the national taxpayer through grants. Of the amount raised directly by local authorities in Scotland through rates 69% comes from non-domestic ratepayers with no direct voice in the election of local councillors.

Figure S.1 - Sources of funding of local government in Scotland (See Annex S for further detail)

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Ratepayers face widely different rate poundages. In 1985-86 the highest poundage in Glasgow was almost 80% above the lowest on the mainland in the Kincardine and Deeside District of Grampian(1).

S.3 The broad proposals for change outlined in chapters 2 to 4 offer a route to improving accountability. They would greatly increase the numbers of electors contributing towards the costs of spending decisions taken by local Councils on their behalf. In future the full consequences of marginal changes in spending would fall on local electors and the non-domestic ratepayer would no longer face demands varying widely from area to area and unpredictably from year to year. Application of these proposals in Scotland must take into account the differing structure of local government and perceptions of the existing system among Scottish ratepayers.

SCOTTISH DIFFERENCES

S.4 Compared with England there are differences in the range of services provided by local Councils in Scotland and the form of local government finance. These are fully described in Annex A. In financial terms the most important difference is that Scottish Regions and Island authorities are responsible for the full range of water and sewerage services. In England and Wales these are provided by separate water authorities which are nationalised industries rather than part of local government. This adds significantly to the scale of expenditure borne by local authority rates in Scotland. The average Scottish domestic rate bill including water for 1985-86 is £392. In England and Wales the average domestic bill for local authority rates is only around £340, but for a valid comparison based on similar services the average household bill for water and sewerage services must be added, yielding a total of some £430 - almost 10% higher than the Scottish figure. [When the high rates in London are excluded from the comparison, average rates for the remainder of England and Wales are about 3% higher than the Scottish figure.]

S.5 In recognition of the different circumstances facing local authorities in Scotland - including those of climate, topography and population density - Governments over the years have provided for higher levels both of expenditure by authorities and of assistance to them from the general taxpayer by means of grants from central Government.

S.6 Local government is subject to distinctive Scottish legislation and falls wholly within the responsibilities of the Secretary of State for Scotland. Scottish statute law requires regular revaluations, which have been carried out in 1971, 1978 and 1985, by local assessors who, though employed by local authorities, are independent in terms of their professional judgements on property values. (This contrasts with the English position where the task of assessment falls to valuation officers who are civil servants employed by the Board of Inland Revenue, and where there has been no revaluation since 1973.) While broad policies towards local government must take account of the overriding interests of

(1) Because of the changes in the distribution of the rates burden following Scotland's 1985 revaluation figures in this Chapter are given for 1985-86 wherever possible rather than 1984-85.

all United Kingdom taxpayers there remains scope for differences in the detail and in the timing of their application in Scotland.

REVALUATION AND THE PROBLEMS OF DOMESTIC RATES

S.7 The turbulence of the latest Scottish revaluation has led to enormous public loss of confidence in the rating system in Scotland. Revaluation not of itself affect the total to be raised from Scottish ratepayers and might be seen as fair in bringing assessments more closely in line with up-to-date evidence of rentals. However revaluation brought very considerable disruption to individual ratepayers. Overall the effect was to increase the share of the total rates burden falling upon householders while lessening that on industry. Even after Government intervention to increase the level of domestic rate relief, within regions the average domestic rates bill rose by 6% in Highland, 11% in Grampian, 15% in Borders and Dumfries and Galloway and 20% or over in Tayside, Fife, Lothian and Strathclyde.

S.8 Average movements in rate bills at regional level mask even more dramatic increases falling on individual ratepayers. The average domestic rateable value increased on revaluation by a factor of almost 2.7 but 130,000 properties (6▪%) faced increases of more than 3 times. To mitigate the impact of revaluation in these cases the Government introduced, by special legislation during the summer of 1985, an additional scheme of revaluation rate rebates. Despite this over 100,000 households in Scotland have faced increases of more than one-third in their rates bills between 1984-85 and 1985-86. It is hardly surprising that in many quarters the overwhelming desire is now for an end to a system which subjects the individual householder to what are seen as quite arbitrary and unpredictable fluctuations in rates demands following periodic revaluations.

S.9 The many defects of rates generally as a method of paying for local services, examined in some detail in Chapters 1 to 3 above, are found equally in Scotland. The amounts paid in rates on similar properties vary from place to place in ways that bear little relation to the relatively small differences in the standard of local services provided by Councils. Typically the rates bill for a standard modern estate-built house with [4/5 appartments] would be around ▪x in A, ▪y in B and as much as ▪z in C. Within local authority housing similar discrepancies exist. The average rates bill for a Council house varies from under ▪200 in Orkney to over ▪400 in Glasgow. Although there may be differences in standards of service, it is difficult to see justice in a system which assumes tenants in Glasgow should meet over twice the rates bill of those in Orkney.

S.10 While on average domestic rate bills in Scotland are below those in England, significant numbers of householders carry very heavy rates burdens indeed. In Edinburgh 21,500 householders, almost one in eight, now face a rates bill of over ▪700 a year. In Strathclyde [46,000] householders face bills of over ▪700 a year and some x of these pay more than ▪1000 in rates. Such heavy bills, many over twice the Scottish average, bear no relation to differences in the provision of local services. More importantly, they are determined solely by the location and type of house which the ratepayer occupies . Indeed, beyond the levels of income qualifying for rebates domestic rates in Scotland can impose quite significantly differing burdens of taxation for similar levels of local services.

THE GOVERNMENT'S PROPOSALS

S.11 Chapter 3 presents a series of reasons why the Government now favour the concept of a community charge payable by all adults as the main form of local taxation in the years ahead. Allied to changes in the treatment of non-domestic rates (Chapter 2 and S.X below) and a new approach to distributing grant (Chapter 4 and S.Y below) a community charge will promote accountability in local government. In future many more electors will be directly affected by local taxation and movements in each authority's spending decisions will be reflected directly in a charge paid equally by all adult residents with incomes above the level qualifying for rebates.

S.12 The proposals for England and Wales in Chapter 5(E) minimise the disruption that will arise from the change to a new system. In doing so they accept that with very high average domestic rate bills in some areas sensible transition arrangements will entail preservation of a property tax on domestic subjects for a considerable number of years. The Government believe that a different approach is needed in Scotland where such variations are less extreme. The evidence of the 1985 revaluation there is all too clear. The existing arrangements for valuation and rating of domestic property no longer provide a satisfactory basis for taxation. It is therefore urgently necessary to move rapidly towards the total abolition of domestic rates. The Government will not tolerate any delay longer than the minimum necessary to allow for those most affected by the change to come to terms with its effect on them. This transitional period must not exceed 3 years after the legislation is brought into effect.

S.13 A possible programme for transition in Scotland would be to oblige authorities to reduce poundage of domestic rates in year one of the new system to 60% of the poundage in the last year of the old system, making up the lost yield by a community charge. This proportion would fall in successive years to 40%, 20% and zero with final abolition of domestic rates in the fourth year of the new system. But the Government would especially welcome views on the appropriate form and speed of transitional arrangements in Scotland, consistent with the aim of total abolition of domestic rates within a reasonably short period. Further detail of the impact of a community charge in place of domestic rates is presented in Annex H. [Comment on any notable results.]

S.14 By way of general illustration if each individual local authority imposed a full community charge to raise the same amount as it levied from domestic ratepayers in 1985-86 the result would be charges varying

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from around ▪140 to around ▪240 per adult with lower figures for the islands where domestic rates have traditionally been very low. Current rates reflect authorities' overspending; if all acted responsibly and spent in line with Government guidelines the higher figures would be reduced [producing a range of charges from around ▪140 to around ▪230.

[Table S.1 - Figures for each authority]

These figures include payment for all water and sewerage services. Figures for the community charge in England in Chapter 5(E) should be increased by around 25% to bring them to a common basis. Both the <u>average</u> level and the <u>range</u> of the community charge are less in Scotland.

S.15 The Government are prepared to consider bringing forward the necessary Scottish legislation in the 1986-87 Parliamentary Session. Some 12 to 18 months from the passage of a Bill would be required for the task of establishing administrative machinery for registration and collection of a community charge; certain of the issues involved are discussed in Annex G. The first community charges under the new system would be payable from April 1989 and domestic rates would vanish entirely from April 1992.

S.16 Such a timetable is very tight and to leave adequate time for preparation of the necessary legislation, comment on these proposals as they affect Scotland should be submitted no later than the end of April 1986.

NON-DOMESTIC RATEPAYERS

S.17 Chapter 2 explained the Government's view that rates based on property values should remain as a form of taxation in the non-domestic field. Control over the scale of non-domestic rates would pass to central Government and in time a single rate poundage would be levied on non-domestic property throughout the country. Most or all income from non-domestic rates would accrue centrally. Throughout Britain the money would be redistributed to local authorities as a standard level of grant.

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S.18 The Government are however aware of the problems which the present system of valuation can cause for particular classes of non-domestic property. [Following the 1985 Scottish revaluation there is a clear need for adequate transitional arrangements in future, phasing in new values over a period]. Rental values alone can be a poor measure of the scale of commercial activity carried on in property and consequently often bear heavily on local shops and other small businesses. The Government are sympathetic to such problems and Scottish ratepayers with their recent experience of revaluation will wish to comment particular on the suggestions made in paragraph [2.xx].

S.19 In Scotland at present levels of valuation set in last year's general revaluation are far out of line with those ruling in England and Wales where the last revaluation took place in 1973. In [2.43] above it was proposed that all non-domestic property in England and Wales should be revalued with effect from 1990. Under statute a further Scottish revaluation is due in 1990 and it is proposed that this should go ahead but confined solely to non-domestic property. In 1990 and on subsequent occasions non-domestic revaluations would be brought into effect simultaneously throughout Great Britain. Although there remain certain technical differences in the law and practice of assessment in Scotland the result would be the same general level of valuation applying to non-domestic property throughout the country.

S.20 Where there are significant differences between Scottish and English valuation practice affecting certain types of property, it may be necessary to introduce changes by statute to ensure fairness among all non-domestic ratepayers throughout the country. Traditionally the major concern of both valuation systems and their related appeals procedures has been to ensure fairness among ratepayers in each local valuation area; in future comparison of values throughout Britain may have to be given equal weight. The Government will be consulting those directly involved with the workings of the valuation system on the necessary changes and would welcome comment from all with an interest.

S.21 Existing differences in the level of valuations, and in the range of services which local authority rates finance, make it very difficult to make meaningful comparisons of the general level of non-domestic rates in Scotland as against England. Evidence suggests that the burden of rates is higher in Scotland and consequently the move to a uniform poundage would on the whole benefit to Scottish non-domestic ratepayers. Industrial property in Scotland currently qualifies for 40% de-rating aimed at bringing the rates burden in relation to turnover for industry as a whole to a common level north and south of the Border. With the aim of a common level of valuation and rate poundage the Government see no case for continuing these special arrangements for industrial derating in the longer term.

S.22 Prior to the introduction of a common Great Britain system and the transition to a uniform national rate poundage on common values from 1990, the Government propose legislation to fix Scottish non-domestic rate poundages at current levels in each area with allowance for no more than a standard indexed increase (see paragraph [2.30]) during the interim period.

GRANT ARRANGEMENTS

S.23 The general objectives of a new grant system for Scotland would be the same as those set out for England in para [4.28]. It should enable local authorities to provide a similar level of service at a similar total cost to their local residents (the objective of the present needs element of RSG), but in future it should ensure that the whole cost of additional spending beyond what is assessed to be a reasonable level is met by domestic taxpayers. It would also provide a stable and clear system of fixing the grant entitlement for each authority.

S.24 The Government's proposals envisage two major elements of grant

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

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

The bulk of the proceeds of non-domestic rates would be redistributed to all local authorities as a fixed sum per adult supplementing the standard grant. In this system there would be no need for a grant to equalise differences in taxable resources. At present the resources element has as its justification the need to correct the variations in total rateable value between area. These variations arise very largely from non-domestic subjects which would no longer provide rating resources for the authority within which they are situated. With the separation of non-domestic and domestic local taxation and the move to abolition of domestic rates there would be no need for domestic rate relief and this would also end.

S.25 The service grant would be based on the client group assessments of relative expenditure need used at present in distributing grant in Scotland. These have been developed in consultation with the Convention of Scottish Local Authorities and there would continue to be a separate system of assessment reflecting Scottish needs and circumstances. The process of equalisation would be similar to that used at present for needs element of RSG with grant being given to meet the difference between the needs assessment per adult of each authority and that of the authority with the lowest assessment per adult. The standard grant would then be provided to all authorities at the same amount per adult.

S.26 With these grants and the redistributed proceeds of non-domestic rates nationally the Government will make the same total amount available to local authorities in Scotland as is available from these sources under the present system. [In 1985-86 the figures were •x from central

Government grant and by from non-domestic ratepayers. Under the new system envisaged all expenditure over needs assessment would in future have to be found from local residents.

S.27 Differences in existing levels of domestic rates in each area (para S.14 above) reflect both differences in the scale of overspending and the traditional pattern of expenditure by each authority in relation to its domestic and non-domestic rating resources. To move directly to the new grant arrangements would entail the move from domestic rates to a community charge. The Government propose to introduce a safety-net. For a base year an amount would be added to, or subtracted from, each authority's entitlement under the new grant regime to ensure that the claim on domestic taxpayers was unchanged. These amounts would be fixed in cash terms for subsequent years, changes in spending, grant provision and needs assessment would then reflect in the level of each authority's community charge in subsequent years.

S.28 In Scotland specific grants are a lower proportion of Aggregate Exchequer Grant than in England, 12% as opposed to 20% in England. In 1986-87 five specific grants will be ended after a review. While there will remain a role for specific grants the transition to a new form of local government finance will probably involve a further review of the remaining grants. Grants may however continue to be justified on the same criteria as are set out in para 4.61.

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ANNEX C: THE PRESENT LOCAL GOVERNMENT FINANCE SYSTEM: A SUMMARY

Local authority income and expenditure

C.1 In the United Kingdom, responsibility for public administration and provision of services is divided between local and central government. Local government is responsible for about 27% of total public expenditure. In England local government spent about £39bn in 1984/85. The total of local authority expenditure can be divided into three main types:

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

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

Interest payments on loans (8%).

C.2 Local authorities have two main sources of income - rates and central government grants. Other sources of income include money received from services such as school meal charges and bus fares, from housing rents, and from the sale of assets such as council houses. Local authorities can also borrow from central government or the private sector to finance expenditure. Figure C1 shows the components of local authorities' income in 1984/85.

Figure C1: Sources of local authority income (England 1984/85)

Rate support grant	22%
Other government grants and subsidies	18%
Non-domestic rates	16%
Domestic rates	11%
Sales, fees and charges	8%
Capital receipts	6%
Borrowing	5%
Rents	4%
Other	10%

C.3 There are two main tiers of local government in each area. The distribution of responsibility for services between these tiers varies. Overall the pattern of local authority expenditure by service is as shown in Figure C2.

Figure C2: Local authority capital and non-capital expenditure by service (England 1981/82)

Education	37%
Housing	22%
Local environmental services	13%
Law, order and protective services	10%
Roads and transport	8%
Personal social services	7%
Other	3%

Rates

(Version of: 3 December 1985)

C.4 In each area the lower tier authority - district or borough council - is the rating authority. This means that they issue rate demands and collect the rate payments. Upper tier authorities, like county councils, issue precepts. A precept is a demand for a specified amount which the rating authority has to collect on the upper tier authority's behalf. The precept is added to the rating authority's own rate, collected with the rating authority's rate, and passed on to the upper tier authority.

C.5 When the rating authority fixes its rate and budget for the coming year, it first estimates how much it will spend in that year. It then deducts the amount of grant it expects to receive from the government, and its income from other sources. The balance left over is raised from local ratepayers. To calculate how much each ratepayer should pay the council first estimates what a rate of 1p would produce. This is called the penny rate product. The penny rate product is reached by multiplying the total rateable value of the council's area by 1p:

Penny rate product = rateable value x 1p.

C.6 The council then divides the amount it needs to raise from ratepayers by the penny rate product. The end figure reached is the rate in the pound which has to be levied. This is called the rate poundage.

$$\text{Rate poundage} = \frac{\text{expenditure} - \text{block grant}}{\text{penny rate product}}$$

For domestic properties, the domestic rate relief grant (18.5p: see paragraph C.11) needs to be substracted from the rate poundage.

Domestic rates bill = (rateable value x rate poundage)
+ county precept
- domestic rate relief grant

Central government grant

C.7 Each year the government decides on its view of what the level of local government spending should be in the following year. It then decides how much of the spending to be funded from revenue should be met by central government grant. (There are separate arrangements for controlling the total of capital spending, whether financed from revenue or from borrowing - see paragraphs C.50-C.52 below).

C.8 Central government grant, which is known as Aggregate Exchequer Grant (AEG), consists of three elements - specific grants, supplementary grants and rate support grant. Specific and supplementary grants are paid in aid of a specific service or projects. Examples are the urban programme, derelict land grant, police grant and transport supplementary grant. Rate support grant, as the name suggests, is a non-specific grant to subsidise spending which would otherwise have to be financed by ratepayers. In 1985/86 the Government's preferred level of local government spending was £[illegible]bn. It was decided that [illegible]% of this would be met by AEG. 20% of the total of AEG would be paid as specific and supplementary grants, and 80% as rate support grant.

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Rate support grant

C.9 Rate support grant is paid in support of net revenue spending (ie spending on wages, salaries, goods and services, debt charges and revenue contributions to capital projects, less income received from other sources). This is because there is no need for the Government to support spending which is already being financed from such sources as specific grants, or fees and charges. Confusingly, this net expenditure is referred to in the relevant statutes as total expenditure (that is, the "total expenditure" for rate support grant purposes).

C.10 Rate support grant is made up of two elements: domestic rate relief grant and block grant. It is paid to local authorities in thirty-eight instalments during the financial year.

C.11 Domestic rate relief grant is by far the smaller of the two elements of Rate Support Grant (about £700m out of £11.8bn in 1985/86). It has been paid to authorities in every year since 1973 to reduce the effect of the revaluation in that year on the level of domestic rates. In England the rate of payment has for a number of years been 18.5p in the £.

C.12 Block grant makes up by far the largest part of Rate Support Grant. The aim of the block grant sytem is first to compensate for differences in the cost to authorities of providing a standard level of service (for example, because of different social, economic and geographic characteristics) and second to compensate for differences in resources. Authorities' resources are measured in terms of the rateable value of properties in their area, which in turn reflect the relative value of property in different parts of the country. In other words, block grant is distributed so as to ensure that a ratepayer in one area which may have low rateable values but considerable spending needs only has to pay the same rate in the £ for a given standard of service as a ratepayer living in another area with high rateable resources but low spending needs. This process is known as 'equalisation'.

C.13 It is worth noting that it does not equalise rate bills since the rateable value of a similar property will vary throughout the country.

C.14 In order to achieve this aim, the Government has to calculate two things - a grant related expenditure (GRE) and grant related poundage (GRP) for each authority.

C.15 The GRE is an estimate of the overall costs to an authority of providing a standard level of service. It is calculated for each authority taking into account variations in local circumstances. Each authority's GRE is built up from a number of components relating to the different services the authority provides. But it is the overall GRE for each authority which is used as a basis for distributing block grant. The amount actually to be spent on each service remains a matter for the individual local authority to decide.

C.16 For most services, the two main factors in the GRE formula are the number of people for whom the service is provided (for example, the number of primary school children) and the number of units of service which have to be provided (for example the number of premises from which refuse has to be collected).

C.17 In some cases a further set of factors has to be taken into account where these seem likely to influence the cost of providing a service. These include such considerations as a scattered population or a concentration of social problems or substandard housing conditions. London authorities also receive some allowance for higher costs - for example, London weighting payments in salaries.

C.18 Since GREs are intended to be an objective assessment of the need for spending they are not usually based on the actual expenditure by the authority on a particular service. However, in a small number of cases where an authority has no choice about how much to spend (for example, mandatory students' grants) the GRE is based on actual spending.

C.19 The total of the GRE figures for all authorities is calculated to fit in with the Government's overall spending plans for local authorities.

C.20 Each authority's GRE assessment will change from year to year to reflect changes in the way GRE components are calculated and to incorporate new data.

C.21 The GRP for an authority determines how much of its spending should be met from rates and how much from Block Grant. The GRP for authorities as a whole is calculated by dividing the amount of spending by local government as a whole in Government plans by the rateable value for all authorities, after deducting the total of block grant which is to be made available.

C.22 The national GRP, which changes from year to year, is divided between the two tiers of local government in any area in proportion to the functions they carry out. For example if the national GRP were set at 200p, in shire county areas where the county provides the bulk of services, the GRP for the county would be about 176p and for the district council about 24p.

How block grant is calculated

C.23 Block grant is paid to make up the difference between what authorities are assumed to raise by charging ratepayers at the level of their GRP and their total expenditure. This can be summed up like this:

block grant = total expenditure - (GRP x rateable value)

C.24 In practice a council with high rateable value will be able to raise more from a rate set at the GRP than a council with low rateable values. For the same level of spending in relating to its GRE, the low rateable value council will receive more block grant. This achieves the objective of equalising differences in authorities' rateable resources.

C.25 Most authorities do not spend at their GRE. If an authority's spending rises above its GRE figure, so the amount it is assumed to raise from its ratepayers (its GRP) rises according to a standard tariff. Conversely, if its spending falls, its GRP also falls. This is intended to increase local accountability by making the extra local cost of extra spending apparent to ratepayers.

C.26 This tariff is known as the <u>block grant schedule</u>.

C.27 For 1986/87 it is proposed that the amount authorities are assumed to raise from their ratepayers (the GRP) should increase by 1.1p for every £1 per head of expenditure above GRE. Of course, the figure decreases by the same amount as expenditure falls.

C.28 The amount an individual authority is assumed to raise from its ratepayers is therefore calculated like this:

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

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

C.29 This pressure against higher spending increases above a certain level which is known as the <u>threshold</u>. Above the threshold (10% above GRE) the assumed local rate will increase by 1.5p for every additional £1 per head of spending.

C.30 Figure C3 below illustrates how this works.

Figure C3: The block grant schedule (England 1986/87)

C.31 The practical effect of this schedule is now that for the great majority of authorities, their grant <u>decreases</u> as their spending rises, and vice versa.

C.32 This is because almost all authorities, except those with very low rateable values per head of population, can raise more than £1 per head by charging ratepayers the additional 1.1p (or 1.5p above the threhold) which it is assumed they will raise in order to finance each additional £1 per head of extra spending. In order that the equalising effect of block grant continues to operate the additional sum is <u>subtracted</u> from the authority's grant entitlement. Otherwise the authority would be able to take advantage of its higher rateable values.

C.33. To take an example:

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

Its block grant is therefore reduced by £50,000: the £550,000 raised less the £500,000 it wants to spend.

C.34 This effect is often referred to as a negative marginal rate of grant. Some authorities have such high rateable values per head that they would receive no block grant whatsoever.

C.35 New information about authorities' spending is constantly being received by the Government. The initial RSG announcement for the coming year, which is know as the Settlement, is made before authorities have set their budgets. Final audited figures for spending in any one year may not be received until as long as 2 years after the end of the financial year concerned.

C.36 Adjustments to grant entitlements are therefore made in a series of rate support grant Supplementary Reports.

C.37 The amount of block grant available for distribution is a fixed sum set in advance for each year by the Government. In order to match the claims for grant to this sum, the GRP for spending at GRE may have to be adjusted in a Supplementary Report in order to reduce or increase each authority's grant entitlement. This kind of adjustment is called close - ending.

C.38 Multipliers are a device for adjusting an authority's grant entitlement. They are used mainly to produce safety nets or caps which prevent authorities from having large grant changes between years. Safety nets, for example, are used to limit the effect of year on year changes in the method of calculating the GRE where these would otherwise cause large grant losses.

C.39 The multiplier works by multiplying the product of the authority's GRP and its rateable value either to increase or reduce the amount the authority is assumed to raise from its ratepayers before block grant is paid. The grant of an authority in this position is calculated like this:

Grant = total expenditure - (GRP x rateable value) x multiplier

C.40 London is subject to the normal Block Grant distribution arrangements. However, there are two differences in the treatment of London to take account of London's high rateable values.

C.41 If the normal equalising effects of the Block Grant system were to apply, these higher rateable values would considerably reduce London authorities' Block Grant. Part of the rateable value of each London authority is therefore discounted when its block grant is calculated, by the use of a special

multiplier. The discount is higher in Inner London because of particularly high rateable values there.

C.42 As a further measure of equalisation, the central London authorities with the very highest values get no block grant. Instead they make payments to other London Boroughs. This is the London rate equalisation scheme (LRES).

Expenditure guidance/targets

C.43 Between 1981/82 and 1985/86 the Government superimposed a separate system for controlling local government spending on the basic block grant system. This was done by giving every local authority an expenditure guidance or 'target'. If an authority spent more than its target, it forfeited grant on the basis of a fixed tariff. Grant lost in this way was known as holdback or penalty and was retained by the Treasury. The Secretary of State can exempt some spending from the penalty system. These exemptions are called disregards, because the spending is disregarded when holdback or penalty is calculated. So if an authority spends £10.1m against a target of £10m, but spent £100,000 on items for which expenditure was disregarded, it would not incur holdback.

C.44 Although targets have now been abandoned, their effects will continue to be felt in the implementation of holdback and disregards until the books are closed for the years during which targets were issued.

Rate limitation

C.45 Selective rate limitation or 'rate capping' was introduced by the Rates Act 1984. Rate capping has enabled the Secretary of State to concentrate efforts to reduce high spending on a small number of the highest spending authorities. It protects ratepayers in these areas from excessively high rate demands, because the Secretary of State sets a maximum on the rate in the pound which a rate capped council can raise.

C.46 Every summer, a number of authorities are selected for rate capping in the following financial year. To be selected for ratecapping, an authority's spending has to meet three criteria. First, it has to be 'excessive'. Second, it has to be higher than a level set by the Secretary of State. This level is currently fixed at £10.6m, so that councils whose spending is low in absolute terms are excluded from rate capping. And thirdly, an authority's spending has to be higher than its GRE.

C.47 When they are selected, councils are notified of their expenditure levels (ELs). The EL is the sum the Secretary of State assumes the council will spend in the following year.

C.48 Councils have the right to apply to the Secretary of State for a higher EL. This process is known as redetermination. If a council makes an application for redetermination, the Secretary of State can raise the EL, reduce it, or leave it unchanged.

C.49 When the expenditure level has been decided, the rate limit is calculated at a level which will finance the EL. The two other main factors in making this calculation are an authority's block grant entitlement and its level of reserves. The Secretary of State first calculates how much grant the authority will get for spending at its EL. He then decides how much of the rest should be

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raised from ratepayers, and how much (if any) from reserves. The figure arrived at is then divided by the penny rate product to produce the provisional rate limit.

$$RL = \frac{(EL - BG)}{PRP}$$

Councils subject to rate limitation may not raise a rate in the £ higher than their rate limit.

Capital expenditure controls

C.50 Each year the Government decides on the overall level of local authority capital expenditure which it believes to be compatible with the national economic interest. Each authority may spend an amount, known as its prescribed expenditure allocation, notified by central government, together with a proportion of the proceeds of asset sales and of repayments of grants and advances made by the authority, and the profits of trading undertakings.

C.51 In deciding on the total of allocations to be divided between authorities, the Government has regard both to the national total of spending which it wishes to see and to the extent to which authorities are able to add to their allocations from the other resources mentioned. Each authority receives allocations in up to six blocks, covering Housing, Education, Transport, Personal Social Services, Urban Aid Services and Other Services, depending on the range of services for which it is responsible. There is no obligation on an authority to match expenditure to allocations: authorities may transfer allocations both between blocks and between authorities. There is also a limited facility to carry over into or anticipate from the following year's allocation.

C.52 Authorities have freedom in choosing how to finance expenditure within the permitted level. Their borrowing for capital purposes is controlled through a block approval issued by the Government, but the amount of the approval is broadly equal to the authority's total allocations for the year, so that it should not serve as a constraint. They can also use the proceeds of asset sales and repayments of grants and advances; contributions from the rate fund; savings in special funds; and such grants as they may receive from central Government, public bodies like the Sports Council, the European Community and the private sector.

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APPENDIX C1

TYPICAL TIMETABLES FOR RATE SUPPORT GRANT AND RATE LIMITATION

RATE SUPPORT GRANT

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

RATE LIMITATION

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

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ANNEX G: ADMINISTRATION OF THE COMMUNITY CHARGE

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

The basic requirements

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

The register

G.3 Registration is not new in Great Britain. All eligible adults are required by law to be registered for electoral purposes. Virtually all adults are registered for national insurance and national health purposes. And there are other large registration schemes applying to significant proportions of the population, for example to car owners and, for rating purposes, the occupiers or owners of every home. Other countries have gone further in their registration schemes. Some have unified their separate registers and use them for several different central administrative purposes. Because many countries also have a system of national identity cards, it is often assumed that a national register requires a national identity card system to support it. But in Sweden, for example, there is a comprehensive national registration system without a compulsory national identity card scheme.

G.4 The British tradition on registration is that registers are kept separately for different purposes and they are expected to hold no more information than is reasonably necessary for the purpose for which the register exists. The Government does not propose any departure from that practice in the case of the register which will be necessary for the operation of a community charge.

Who should be registered?

G.5 In principle, all resident adults should be registered in the authority where they are normally resident. That requirement should apply to those like foreign nationals who are not presently required to register for electoral purposes. For practical administrative reasons explained below certain categories of people, however, will not be registered individually.

G.6 There is a question about the age at which individuals should start to become liable for the community charge. Individuals benefit from local services from the earliest age, but they have no say in the provision of local services until they become eligible to vote at 18. It would be possible to make them liable for the community charge from their eighteenth birthday. By then many 16 and 17 year olds are working or receiving support from the state in their own right. Many others, however, are still at school and entirely dependent on their parents. The social security system recognises this and there is provision for payment of child benefit to continue up to the age of 19 where a person is receiving full-time, non-advanced education. It would be consistent with this for liability for payment of the community charge to be linked to the cessation of payment of child benefit for those over 18. That would avoid imposing an additional burden on the many families who support their children in continuing education. It might also be desirable, for administrative simplicity, that liability to pay the charge for the first time should not arise until the start of the first full financial year after the relevant birthday.

Where should people register?

G.7 The community charge will continue to be collected by the authorities which are presently responsible for collecting rates - district or borough councils in England and Wales and Regional Councils in Scotland. Individuals should therefore be registered with the district or borough council in whose area they live. The overwhelming majority of people have only one home and will register there. A minority have two or more homes and they should register where they have their main residence. This concept is familiar from assessments of eligibility for mortgage interest tax relief which is available in respect of mortgages on an individual's "main or only residence". Which residence is the main one is a matter which is usually easily established on the facts of the case. For the small minority of cases where the facts do not give a clear cut answer it may be necessary to have a simple adjudication procedure. Second homes are dealt with further in paragraph G.37 below. They will need to be separately identifiable for these purposes.

Who should be responsible for registration?

G.8 At present it is the head of the household who is responsible for registering eligible adults for electoral purposes. It is proposed that the head of household should similarly be responsible for registration for the community charge. As with electoral registration that duty will have to be backed up by fines for those who do not comply.

G.9 It is for consideration whether there should be a separate parallel duty on individuals to register, to deal with cases where, for example, there is pressure on the head of household not to register someone who is living with him or her.

What happens when people move?

G.10 A large number of people move house every year. Not all of those moves are from one local authority area to another, but many are. The register of those living in an area will have to be updated to keep track of all these moves. There are two approaches to this.

G.11 Some countries which have a system of local personal taxes specify a qualifying date for residents in an area and all those resident in an area on that date are liable to pay their local tax to that authority for the whole of the next financial year. If a similar approach were adopted in Great Britain it would be possible to run a registration system similar to that used for electoral registration. There would be an annual canvass of households for the names of those resident on the qualifying date, and the register compiled on that basis would be updated a year later to incorporate all the changes in the preceeding twelve months. That approach however has a number of shortcomings in relation to the specific proposals for the community charge.

G.12 First, the community charge will be collected directly from individuals and not through a third person who will not generally move, such as an employer. If a person moves after being registered for a year and does not notify the authority collection will be difficult.

G.13 Secondly, it would make enforcement of registration more difficult if there were large numbers of people who could legitimately claim services from a local authority without being registered there because the register would inevitably be out of date between annual revisions.

G.14 Thirdly, local authorities administer the Housing Benefit scheme. It would add to the complexity of that task if they had to take account of widely different community charge liability for those who had moved into the area after the qualifying date and who were therefore paying a community charge to another authority at the rate applying there.

G.15 The alternative approach is to maintain a rolling register. This would be similar to the arrangements which exist at present for the payment of rates. Liability to the community charge would cease when a person left the authority and the amount payable to an authority would be pro rata to the portion of the year that the individual had lived there. There would be an incentive on those leaving the area to notify the council of their move - so as to terminate their liability - and this would provide a continuing flow of information to the

authority about changes of occupation of properties which would assist enforcement. The difficulty with housing benefit administration described above would be avoided, since all residents in a local authority's area would be paying its own rate of community charge.

G.16 In order to maintain a rolling register it will be necessary for there to be a statutory requirement for individuals to register with an authority within a reasonable period of time of taking up residence there. As for the basic registration process the duty to register new arrivals should rest with the head of household.

Form of the register

G.17 The electoral register is a public document which can be examined by any member of the public. The Government proposes that the community charge register would be similarly open. An open register would be of assistance in enforcing registration.

G.18 The published register should contain no more information than is necessary. No more than the names and addresses of eligible adults is suggested though authorities may need to keep additional details for working purposes - for example, a record of who is the head of the household, or the arrangements for payment.

G.19 The coverage of the community charge register would be different from that of the electoral register. If a rolling register is adopted the character of the register will also be different since the electoral register is static and updated annually. It would not be possible, therefore, for the same register to be used for both purposes. Nor is it, in principle, desirable for it to be so. Entitlement to vote should not depend upon registration for the community charge. Nor should the community charge be avoided by those such as resident foreign nationals who enjoy local authority services but are not eligible to vote.

Enforcement of registration

G.20 For the overwhelming majority of citizens a legal obligation to be registered coupled with the existence of fines for non-registration will be sufficient to ensure compliance. For a minority it will not unless it is known that the possibility of avoiding detection for any substantial period is small.

G.21 It is one of the technical strengths of rates that, because they are tied to the occupation of immovable property, they are easy to collect and the level of evasion is relatively small. Taxes which are not linked to immovable property do have greater enforcement problems. This is true of income tax and road fund licensing for example at the national level. Even so estimates of evasion are low overall: ■

G.22 Proposals for transition to the new community charge arrangements envisage that an element of rates will continue to be paid in all authorities at least in the early years. This will carry over to the new arrangements something of the ease of collection of domestic rates by maintaining links with the head of household. This will be an important element of continuity while the new arrangements are settling down.

G.23 A successful registration process will require two elements. First, effective canvassing of households. Local authorities already have a great deal of experience in compiling electoral registers on which to build. But some additional resources and effort will be required if the ■ coverage of the present electoral roll is to be improved on. OPCS have estimated that by improved canvassing alone, the existing electoral register could achieve the ■ coverage of the Census. There will, however, be new incentives to avoid registration and further measures will be necessary.

G.24 The second ingredient will be the link between registration and the use of local services. This does not mean that authorities should be expected to require proof of registration before providing a service. In the case of emergency services for example that would be entirely inappropriate. But many authorities already require evidence of residence when providing a service to individuals. Libraries are a common example. The task for local authorities will be to develop their information systems so that where they are providing a

service to an individual it is possible to check back conveniently, either before or after the event, on whether a person is registered.

G.25 There will also be scope for schemes to encourage registration through the administration of services for which charges are made. An obvious example would be the use of membership cards or season tickets to give preferential rates for those using leisure facilities or public transport who are registered as living within the authority's area. Some authorities already have such preferential charging schemes. They are common practice, for example, in the provision of adult education classes.

Payment: who is responsible?

G.26 In order to obtain the maximum benefit from extending the tax base and make the greatest possible number of electors aware of the cost of the local services they vote for, separate bills should be sent to each registered individual.

G.27 In principle, each individual should also be individually liable for paying his or her bill. However this may be difficult where people have no independent income of their own. This situation will occur most frequently with married couples where one partner is not working. Latest estimates are that slightly more than half of all wives below retirement age do have some independent income and so could pay their own community charge. However, it would be possible to deal with the problem more generally by making husbands and wives jointly and separately liable for each other's community charges. This would be well precedented in general taxation law and would reflect the practical financial arrangements which most married couples with only one earner adopt.

Enforcement of payment

G.28 The Government envisage that the existing procedures for the enforcement of payment of rates would be carried over to the new arrangements. There may well be room for improvements, however, and practical suggestions would be welcome.

Assistance for those on low incomes

G.29 At present means tested help with rates bills (rate rebates) is available through the Housing Benefit scheme to people on low incomes. Some ■ households get a full rebate because they are receiving supplementary benefit; another ■ receive partial help, depending on the composition of the household, the size of their rates bill and their weekly income.

G.30 The White Paper on Social Security (Cmnd■) announced a number of changes to the Housing Benefit scheme, including a requirement that those on the lowest incomes should have to pay a minimum contribution of ■ towards their rates. The Government proposes to extend the application of the revised Housing Benefit to everyone liable to pay the community charge. This would mean that a maximum rebate of ■ of the community charge would be payable to people whose net income was equal to, or less than, their income support level. As net income rose the rebate would be withdrawn at the rate of ■p for every £■ of additional income.

A Collective Community Charge

G.31 So far this Annex has been concerned with the arrangements necessary to cope with the circumstances of the great majority of individuals. However a part of the population, estimated at [■], is extremely mobile. These are the group living in multiple occupation, in boarding houses, residences, or other institutions. For this group the arrangements described so far would be inappropriate and onerous to administer satisfactorily. Nevertheless the Government's view is that these people should make a contribution towards the cost of local services. At present the accommodation they occupy is generally treated as non-domestic property for rating purposes. If this practice were continued in the new arrangements, then the rates levied on those properties would form part of the national pool and would deny any direct link between these individuals and the authority in which they live.

G.32 The problem of local taxation in respect of the most mobile groups is one which occurs within the present rating system. It is dealt with by giving local authorities the power to designate classes of property for which the owners, rather than the occupiers, are liable to pay the rates. The owners are also

required to provide information when requested as to who the occupants of any such property are. It would be appropriate in the new system to build on those arrangements by designating certain classes of property as liable for a collective community charge, payable by the owner, but recoverable through rents charged to the occupants. The occupants of such properties would be eligible for housing benefit towards their share of the charge.

G.33 The amount of the collective charge would be determined by a formula for which the starting point would be the amount of accommodation provided in the property. The Government wish to consult separately on which other factors should be taken into account, for example evidence of average occupancy rates. The Government will also be consulting on the classes of property which would be covered by these arrangements and the arrangements for adjudicating disputes.

G.34 The consequence of these arrangements is that it will not be necessary for those living in designated properties to be registered individually with their local authority. The authority will, of course, keep a register of the properties covered by the collective charge so that the enforcement procedures described above can operate. The existing requirement on owners of such property to keep records of those occupying the property should be carried over to the new arrangements so that the entitlement of those living there to local services on the same basis as other residents can be established.

Special groups

G.35 Crown Property. Those occupying Crown Property - the armed forces, those living in National Health Service property and so on - do not at present pay rates. Instead the Crown makes a contribution to local authorities in lieu of rates. The convention against taxing the Crown would not apply in the same way to individuals occupying property owned by the Crown. Nevertheless many of those occupying such property are very mobile and it would be sensible to continue the arrangements whereby a single contribution is made by the Crown in respect of those occupying such property. The simplest way of doing so would be for the relevant Government Departments to make a contribution in lieu of a collective community charge calculated on the basis of the formula applied generally.

G.36 Students. For students who are not home-based at their college or university it would be difficult in practice to establish which is their main place of residence. It would be complex and costly to require students to register and de-register at the beginning and end of each term or to attempt to apportion liability to community charges between two authorities. The Government's view is that students should be deemed to have their main residence at their term-time address. This would be consistent with the way in which students are presently recorded for Rate Support Grant purposes. This treatment would not of course affect those who are home-based during the course of their studies. In all other respects students would be treated in the same way as any other adult resident, paying a community charge individually or through a collective charge according to the property they occupy.

G.37 Second Home Owners. Owners of second homes will make some use of local authority services in the area of their second home. At the moment these homes are subject to rates. Replacement of these by a community charge would give a large bonus to the owners of these properties. The Government considers that there should be a standard charge on second home owners and that it would be most convenient to express that in terms of a community charge liability in the area where the second home is located. A standard charge equivalent to two individual charges would leave second home owners broadly unaffected by the removal of rates. The Government's provisional view is that this neutral solution should be adopted.

CHAPTER [ ]

WALES

BACKGROUND

Development of central-local government relations in Wales

0.01. The Secretary of State for Wales has responsibility for virtually all the services provided by local government in Wales. The only important exceptions are those such as police and fire which remain the responsibility of the Home Secretary.

0.02. Following the appointment of the first Secretary of State in 1964 the Welsh Office has always provided a direct link between local and central government in Wales. It was not until 1980, however, when the Conservative government transferred responsibility for the financing of local government to the Welsh Secretary that a comprehensive dialogue on the contribution, cost and funding of local services in Wales could begin. This new function provided the vehicle for the often unique needs and circumstances of Welsh councils to be reflected in the arrangements for distributing grant and capital resources to individual authorities.

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

Local authority performance in Wales

0.04. As in the rest of the United Kingdom local authorities in Wales throughout the 1960s and 1970s, absorbed an increasing share of national income. Spending on services grew by 3 to 3½ percent per annum more than inflation, and by about 1 to 1½ percent more than the economy as a whole. Manpower grew by leaps and bounds. In 1960 Welsh local authorities employed about 80,000 people, in full-time equivalent terms. By 1979, employment had risen by 55% to 125,000 - almost 1 in 6 of the total labour force in Wales.

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

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

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

0.08. Since 1979:

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

- local authority manpower has been reduced by over 6,000 (5%), though this is well below the proportionate fall in central government bodies such as the Welsh Office (15-16%);

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

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

0.09 These changes have not been easy to achieve. But the effort has been worthwhile. Local government is now leaner, more effective and cost conscious. Furthermore, key services have been developed. Education spending per pupil is now at a record level in both cash and real terms and spending on other priority activities such as the police and personal social services has grown by 18% and 9% respectively more than inflation since 1979. Relatively new services such as recreation have improved almost beyond recognition in the 6 years since 1979. This does not mean that councils are yet in a position to claim that they are even close to securing full value for money from the resources entrusted to them by the community. But a good start has been made.

The case for change in Wales

0.10. In short, if the case for a thoroughgoing reform of local government finance rested solely on the need for a more effective means of achieving a fair measure of local authority compliance with the government's expenditure plans the impetus for change in Wales would not be a strong one.

0.11. However, the case for a radical reform is far more widely based than this. In particular:

- the need to create a climate in which a better balance can be struck locally between the demand for services and the cost of providing them is as strong in Wales as in the other countries;

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

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

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- although central and local government have made strenuous efforts in Wales to maintain the inherent simplicity of the existing block grant arrangements the case for further simplification and greater clarity and predictability is a powerful one.

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

Need the reforms be the same in Wales?

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

LOCAL NON-DOMESTIC TAXES

0.14. As Figure [ ] shows 60% of the rate income of local authorities in Wales is drawn from the non-domestic sector, [a rather lower - higher proportion than in England?]. The balance represents the domestic sector's contribution, net of rate rebates.

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

0.15. National averages often conceal sharp differences between areas. Within Wales the non-domestic share of the rate burden varies from 47% in Colwyn to over 80% in Port Talbot. Put another way, in areas such as Port Talbot for every £1.00 contributed by domestic ratepayers, who have a vote, non-domestic ratepayers, who do not, are charged as much as £3.90. The true cost of extra spending is not therefore apparent to a good proportion of the electorate in Wales. Until it is no one can be confident that greater local accountability can be achieved; and no one can claim that the non-domestic ratepayer has the measure of protection that his vulnerable position so clearly demands.

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The options

0.16. Chapter 2 identifies two options for improving the way in which the non-domestic sectors contribution to local services is assessed, collected and distributed to individual authorities. The first would involve freezing or "capping" the present pattern of non-domestic rate poundages between authorities. The second would eliminate this variation and replace it with a national poundage which would apply in all areas. Under both schemes annual increases in the non-domestic charge would be linked to the projected rate of inflation for the following year, although this calculation would need to take account of the underlying growth of non-domestic rateable values. In the case of the national rate option individual authorities could top-up the yield by levying a small supplement which could be retained locally. This local flexibility would be allowed for when setting the national rate. The annual yield of the non-domestic rate, on either model, would be estimated by the Government and distributed to local authorities by reference to their adult population. For the purposes of this Green Paper it has been assumed that the national non-industrial rate would be the same in at least England and Wales. This would mean the rate in Wales would fall by about 3 pence in the pound.

0.17 As in the other countries both solutions would allow the ratepayers involved to predict far more accurately their contribution to the funding of local services; and both would ensure that the entire cost of spending in excess of the amount allowed for in the Government's expenditure plans would be borne by those with a vote - the domestic sector.

Losers and gainers

0.18. In the present financial year (1985/86) the highest non-domestic rate poundage is 36% above the lowest, compared with 270% in England. As Figure (   ) shows, this relatively narrow range means that, although a move to a national rate could not be accomplished overnight (see paragraph [ ] below), the shift in the burden of non-domestic rates from heavily to lowly rated areas would not be as great as some might imagine. This analysis does not, however, measure the additional impact of the revaluation of non-domestic rateable values which would be an integral part of the reforms. (See Chapter 2 and Annex [   ] for further details.)

Figure [   ]: Shift in non-domestic rate burden (Wales: 1984-85)

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0.19. The largest gainers in percentage terms - taking into account the general fall in Welsh non-domestic poundages needed to bring the level in Wales down to the England and Wales average - would be non-domestic ratepayers in the heavily rated areas of Clwyd, Mid and West Glamorgan. The cash switch from relatively low to relatively high poundage areas amounts to £15m, only 9% of the total non-domestic rate income of the areas concerned.

0.20. There are, of course, reasonable arguments for and against each scheme, but the balance of advantage lies with the national standard rate approach, with local councils being given the option of supplementing the national levy by a fixed percentage - possibly 5% initially. There could, however, be a case for increasing this, at some stage, to 10% in Wales given the relatively low average level of non-domestic rateable values.

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

0.22. The views of non-domestic interests in Wales will, of course, be sought and taken into account before a final decision is taken on which approach would best suit Welsh circumstances.

LOCAL DOMESTIC TAXES

0.23. The case for abandoning domestic rates in Wales is every bit as strong as it is in England and Scotland; and the anomalies thrown up by rating are just as unacceptable. The Government is therefore firmly commited to replacing domestic rates in Wales with an alternative and far more broadly based charge.

0.24. [Paragraph on assistance to those with low incomes will be drafted when the policy issues involved have been decided.]

0.25. The effect of moving to a community charge in Wales would be to increase the number of persons contributing to local services from X, the number of householders paying at least some rates, to Y, the total number of adults - or broadly the same number as those eligible to vote. The distributional effects of a community charge in Wales are discussed later in this chapter.

GRANTS TO LOCAL AUTHORITIES

0.26. Chapter 4 examines the role of grants within the present local government finance system and sets out the Government's proposals for change, although in some respects these are quite clearly set in the context of England. A section within Annex B describes the existing grant regime in Wales.

0.27. In 1984-85 local authority revenue spending in Wales amounted to £610 per adult. Of this £125 was met by non-domestic ratepayers, and £75 by domestic rates. The balance, £410 per adult, and by far the largest contribution, came from the national taxpayer in the form of grants. How this grant is paid has an important impact on the way in which local authorities plan their spending and on how much local domestic taxpayers contribute to the cost of services in their area.

0.28. In order for the reform of local government finances in Wales to stand a chance of meeting its objectives it is vital that the arrangements for distributing grant are effective and capable of commanding a good measure of support.

Basis of the new lump sum grant

0.29. The Government proposes that under the new financial structure the existing block grant element of rate support grant - which is paid in support of local services in general, and dependent on what individual local authorities actually spend - should be replaced by a fixed or lump sum grant made up of 2 parts. A variable element which would compensate authorities for differences in the local cost of providing services to a typical or average standard, and a simple population based grant - standard grant - which would provide an appropriate top-up contribution from central taxes towards the cost of services. Had the reforms taken effect in 1985-86 the variable grant would have amounted to £ [ ] million, and the standard grant to £ [ ] million - X% and Y% respectively of the combined total of block and domestic rate relief grant.

Simplifying the present assessment of local spending

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

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

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

0.33. At an early stage in the consultation period the Welsh Office will come forward with a range of proposals for simplifying the present GRE formulae. The aim will be for local and central government to agree on mutually acceptable formulae for deriving the new assessments.

Resource equalisation

0.34. One feature of the existing grant arrangements - the compensation paid to individual authorities for variations in rateable resources - would be dispensed with under the proposed new financial regime. The reasons why it is possible and right to do so are explained in detail in Chapter [ ]. Exactly the same considerations apply in Wales and precisely the same sort of anomalies arise. For example, the present emphasis on equalising rate poundages between areas rather than rate bills conceals wide variations between what people actually pay for their services in different parts of Wales. Figure ( ) illustrates the point.

Figure [ ]

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

0.35. The Government therefore proposes that resource equalisation should not be a feature of the new grant arrangements in Wales.

The role of specific grants

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

THE COMBINED EFFECT OF CHANGES TO LOCAL TAXATION AND GRANT

0.37. Any attempt to estimate the overall impact of the Government's proposals needs to distinguish between the short and long term consequences for local authorities, households and individuals.

0.38. Chapter 5 assesses the general effect of the proposed changes using as a framework the position in England. Annex H examines the effect of the reforms on household incomes.

Impact on local authorities

0.39. In essence the move to a lump sum grant would allow every council in Wales to levy the same community charge provided it spent in line with its assessed expenditure. This contrasts sharply with the present position where the emphasis is on the nebulous concept of equalising rate poundages rather than rate bills - the amount people actually pay.

0.40. Had the whole package of reforms taken effect, in their pure form, in 1984/85 community charges in Wales would have ranged from £69 in authorities spending well below their spending assessments - GREs - to over £145 in relatively high spending areas. As a result local domestic taxes would have fallen in the low spending areas by as much as £49 per adult, 41%. Conversely, local domestic taxes would have needed to rise in high spending authorities, particularly those with low domestic rateable values. The largest rise could have been £79, over double the present average domestic rate payment per adult in the area concerned. Figure [ ] shows the impact at the rating authority level of the changes arising from the shifts in grant and non-domestic rate income.

Figure [ ]. Effect of grant and non-domestic rate proposals on average domestic tax bills (Wales 1984-85)

Change in average domestic tax bills £ per annum per adult	Number of rating authorities	Number of adults in these authorities
Increases		
More than £50		
£25 - £50		
£0 - £25		
Decreases		
£0 - £25		
£25 - £50		
More than £50		

0.41. As a general rule a fixed grant would lead to those authorities which chose to spend above their assessed spending receiving less grant than at present, while those spending below would gain, although variations in average domestic rateable values also have an effect. High spending councils would face a choice. They could either reduce spending in line with grant, thereby holding their residents' contribution down, or attempt to maintain spending by seeking additional cash from their electorate.

0.42. As total spending and grant is unaffected by the proposed changes, the community charge at the Wales level would have amounted to precisely the same total as domestic rates.

Impact on households

0.43. The impact of the proposed move to a community charge would necessarily vary from household to household, and from person to person depending on their circumstances and, equally important, on the expenditure decisions of their local authorities.

0.44. If every authority in Wales had spent in line with its GRE in 1984/85, the full community charge on every adult would have been about £105. One adult households would therefore have paid about £105. Households with 2 adults would have paid £210, and so on. [Those eligible for housing benefit under the new rules proposed by the Government following the Social Security Review, would have to pay at least 20% of their community charge. In 1984/85 a 20% minimum contribution would typically have amounted to £21 per adult.]

0.45. To put these charges into perspective, the full community charge in 1984-85 would have typically cost each adult less than £2 per week. [For those entitled to the maximum rate of housing benefit the weekly cost would have been reduced to an average of only 40 pence - well below the price of a packet of cigarettes or a pint of beer.]

0.46. In the real world, of course, some councils will always choose to spend less than their formula-based spending assessments, and others will spend more. When this variation is taken into account, had rates been abandoned in 1984-85, community charges would have ranged, as noted above, from £69 to £145 per adult. However, within each rating authority the same general pattern of single adult households paying less and those with 3 or more adults paying more would have applied. [Also, as emphasised above, those on housing benefits would, in many cases, have had to contribute only 20% of the full charge.]

0.47. This analysis illustrates what the final effect of the new community charge would be on individuals and households. It is important, however, to identify the losers and gainers compared with the present position. As each household is a unique unit any analysis which seeks to identify changes at the household level can naturally only be illustrative.

0.48. There is a further factor to consider in Wales. The information used to assess the household effects is drawn from a sample survey which includes only a very small number of Welsh households (about 400 per year). Although a number of years surveys have been rolled together in order to increase the accuracy of the analysis, the results for Wales cannot be as reliable a guide to the changes as they are for regions where sample sizes are larger. While they are undoubtedly indicative of the broad effects, not too much weight should be placed on some of the more detailed elements of the Welsh results.

0.49 Households would be affected in two ways. As already emphasised size would be a key factor. In general, single person households would gain from the shift away from a tax on property to one on people. Households with three or more adults would pay more. The other factor is the rateable value of each property. For a given household size, those living in relatively high rateable values houses will pay less, and those in houses with relatively low values will contribute more.

0.50 The net effect of these changes is that [ ]% of all households would ultimately gain from the package of reforms (including over [ ]% of all pensioner households) and [ ]% would stand to lose.

0.51 The scale of the gains and losses is generally small. In cash terms, it is estimated that [ ]% of Welsh households would face changes of less than £[ ] a week. Only [ ]% would pay £[ ] more a week, while [ ]% would pay £[ ] less. Virtually all the larger gains and losses are estimated to be smaller than £[ ] a week.

0.52 Looked at in relation to income, [ ]% of households in Wales would face changes which would be the equivalent of less than [ ]% of their net income; [ ]% of two-person households would experience a change of less than [ ]%; and, on average, the [ ]% of single pensioner households who would pay more under the new arrangements would lose less than [ ]% of their net income.

0.53 This analysis confirms that for the great majority of households in Wales the financial impact of the reforms would not be disruptive, or even very significant. Nonetheless, the Government fully accepts that a period of transition will be needed to allow people to get used to the new arrangements, and for them to adjust their budgets accordingly. The transitional arrangements are discussed below.

TRANSITIONAL ARRANGEMENTS

0.54. Throughout this Green Paper it has been stressed that the proposals for reform could not be fully implemented in just one year. They would need to be phased in over a period. In the case of the community charge the period of transition would probably need to be fairly lengthy - possibly even as long as 9 to 10 years.

Easing in the non-domestic changes

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

Easing in the community charge

0.56. The arrangements for easing in the community charge and phasing out domestic rates in England are described in paragraphs [ ] of Chapter [ ]. The related proposals for introducing the new lump sum grant are explained in paragraphs 5.14 and 5.15 of the same chapter. While these transitional schemes would undoubtedly be as effective in Wales as in England, the relatively compact range of rate bills in the Principality means that a number of alternatives could be considered.

A standard cash cut in rates within each rating area: the only difference between this option and that proposed in Chapter [ ] is that instead of the yield from the community charge being used to reduce rate bills by a common percentage within each area, rate bills would be reduced by a common cash amount.

A national standard percentage cut in rates: the yield of the £50 initial community charge would enable domestic rates to be cut by a standard proportion throughout Wales. Had the change taken place in 1984-85, domestic rates could have been cut by nearly 50%.

A national standard cash cut in rates: the same community charge yield would enable every domestic ratepayer to have £100 deducted from his existing rate bill. Properties with rate bills of less than this sum would be given a property tax credit which would be used to pay for part of the householder's own community charge.

0.57 In all cases the new lump sum grant would be adjusted to ensure that authorities could introduce the local charge on any of the bases set out above.

Impact of the options

0.58. Each of the options for reducing domestic rates in the first year, including that described in Chapter [ ], would have a rather different effect on households and local authorities in Wales. A detailed analysis of the distributional impact of each scheme is presented at Annex [ ].

0.59 The proposed scheme for England, and the first of the possible alternatives for Wales outlined above would both have the advantage of allowing the new system to start from the present pattern of domestic rates at the rating authority level. This would considerably reduce the turbulence associated with the change to the new system. The proportional cut in domestic rates preferred in England would allow the most heavily rated households within each area to benefit from the largest cash gains. The cash cut variant which would be an option in Wales would give the largest proportionate gains to households with relatively low bills. In both cases the reduction in domestic rates - whether proportional or cash - would vary from area to area.

0.60. The principal advantage of a standard proportional cut in rate bills across Wales is that it would ensure all areas benefited immediately from the same substantial fall in the burden of domestic rates, with heavily rated properties and areas gaining the most in cash terms. A drawback of this approach is that it would necessarily involve a shift between areas in the domestic sector's contribution to spending, although only relatively few rating authorities would experience a significant change.

0.61 The impact of the national standard cash cut approach would be easy to predict and clearly understood. Furthermore, as there is, on average, about one house for every two adults in every district of Wales the effect of the change at the rating authority level would not differ significantly from that associated with the options which start from the present geographical pattern of domestic rates. One important feature of this option is that it would guarantee that every single adult household, including old age pensioner and single parent family households, would pay about £50 less than they otherwise would in the first year. Also a good number of households would find that, from the very beginning, they were no longer liable for rates at all, but just for the new community charge.

0.62 All the options identified have their strengths. But in the context of Wales it is possible that the two national standard rate cut schemes have the edge over the rather more complex arrangements under which the reduction in rates - either in proportional or cash terms - would vary from area to area. However, as with all the Green Paper proposals a decision on which transitional scheme will be adopted in Wales will not be made until the views of all those concerned have been fully weighed.

0.63 Under any of the options domestic rate bills would be reduced in the very first year. In order to allow the system to establish itself, and to enhance the electorates perceptibility of local spending decisions, and their effect on the community charge, rate bills would be frozen for a three year period. As a result the community charge would, from the outset, bear the cost of any new local authority spending. At the end of this period there would be a further significant shift from rates to the community charge. A third and, possibly, final shift would occur three years later. The aim in Wales would thus be to replace rates with the community charge within six years of the new arrangements coming into effect.

LOCAL AUTHORITY CAPITAL EXPENDITURE

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

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

The options

0.66. The options for reforming the existing capital control system are discussed in Chapter [ ].

0.67. Two basic options for reform are identified in Chapter [ ]. First, the control of local authority net external borrowing - their contribution to the Public Sector Borrowing Requirement; and secondly, the control of expenditure, either all expenditure (gross capital spending) or spending net of capital receipts (the net spending approach).

0.68. The net external borrowing approach is very attractive from a theoretical standpoint, particularly as it would involve much less detailed control at its local level - but would pose major practical problems for both central and local government. It is unlikely that these problems could ever be completely overcome.

0.69. There is little to choose between the two expenditure options. The essential difference between them is the treatment of capital receipts. The gross spending option would build into individual authorities capital allocations an allowance for the spending power of their capital receipts over, say, the last three years, and freeze the use of these receipts locally. The net spending approach would set allocations at a rather lower level, with authorities continuing to have access to their capital receipts over a period of time.

0.70. On balance, the radically modified form of the existing net expenditure approach would appear to come closest to meeting the main

criticisms of the Welsh local authority associations. However, the views of all those concerned with this important sector of local authority activity will be carefully considered before a final decision is made.

OTHER ISSUES

Second Homes

0.71. The move to replace domestic rates with a community charge raises the issue of how second homes should be treated within the new arrangements.

0.72. It has been estimated that there are anywhere between 20,000 and 30,000 second home in Wales, with the largest concentration being in North West Wales. The treatment of second homes will therefore be of considerable concern not only to owners but also to the authorities most affected.

0.73. Paragraph [ ] of Annex [ ] discusses the second homes issue in detail.

0.74. The Government's proposal for the second home sector is founded on the principle that, as far as is practically possible, the impact of the reforms should neither advantage nor disadvantage the owner of a second home in relation to those with their main residence in the community. The best way of achieving this would be to assume, for the purposes of calculating the community charge, that each second home was occupied by the average number of adults, two.

0.75. This proposal would guarantee that owners would continue to make a realistic contribution to the cost of providing local services, and that local councils, particularly those with a relatively high proportion of such homes, would not experience a significant change in their income from this source.

The role of fees and charges

0.76. The case for increasing the contribution made by fees and charges to the cost of running local services is as strong in Wales as elsewhere. Indeed, the generally low level of income from this source in Wales, particularly in the realm of leisure activities, should heighten interest in the outcome of the on-going review of fees and charges referred to in Chapter [ ], paragraph [ ].

SUMMARY AND CONCLUSIONS

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

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