

PRIME MINISTER

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LOCAL TAXATION

MS 15/2

The Disadvantages of Rates

It is tempting to cling to the hope that, in an era of lower inflation, the objections to the present rating system will die down. Outside the Metropolitan Councils, it is said, the savage, unpredictable rises of the past five years will in future devastate fewer household budgets.

This is highly dubious. It would be dangerous complacency to imagine either that the unpopularity of the rates is fading or that the shortcomings of the recent situation have miraculously disappeared. On the contrary, it is more likely that quite soon the rating system as it now is will finally collapse.

(a) At present levels, rates offer very poor accountability because so many people cannot afford to pay and have to be given rebates. "Representation without Taxation" on such a scale is a continuing scandal.

(b) So is "Taxation without representation", from which industry and commerce suffer. Rates constitute the worst single unavoidable tax on business - and one which rises inexorably, quite regardless of a firm's ability to pay.

(c) The functions of local government have grown far beyond the ability of the rates to finance them. As a cheap-to-collect, inelastic but highly visible property tax, the rating system worked well enough when it had only to pay for the modest assortment of functions which local councils carried out before the war. It cannot and should not be expected to finance half the welfare state.

(d) Even if rates only increased at five per cent a year from now on, they would still double in 14 years - another huge tax on commerce and a further bewildering blow to householders on fixed incomes.

Tom King's Scheme

The first advantage of the new scheme is that it sets out to deal with the historical reality. Unlike previous efforts, it does not sweep away the ancient system of property taxation.

It offers instead a supplementary tax which, like most expenditure taxes, is related to the ability to pay - thus beginning to remedy the most obvious defect of the rates.

As rates came to take up a smaller proportion of the family budget, fewer people would need rebates and accountability would be increased.

Local Sales Tax

The virtues of a VAT-based Local Sales Tax are

- (i) it is indirect, and does not affect incentives;
- (ii) it produces a high and buoyant yield;
- (iii) it is based on an existing tax.

No other supplementary tax combines these advantages.

The fact that LST received negligible support in public consultations on the Green Paper may say more about the consultations than about public feeling. Those official lobbies which opted for a replacement for the rates tended to opt for local income tax, but income tax deductions are far more unpopular than VAT, and rates are more unpopular than either.

The disadvantages of LST are discussed in paragraphs 10-13 (I follow Tom King's numbering).

10-11. Precepting poses a problem of accountability already under the existing system. But so long as all the tiers are composed of elected representatives, the problem is no worse with LST.

Cross-boundary shopping, by contrast, may well increase the pressure of accountability. Shoppers will be attracted by towns which have a low LST rate or none at all.

B.R.

Revenue yields from LST and rates combined will doubtless bear no closer relation to a local authority's needs (whether measured by GRE or any other assessment) than rate revenue alone bears at present. That is what RSG is for.

12. To keep LST rates stable and to avoid making LST excessively complex, there is a case for allowing rates to fluctuate below the ceiling.

Interim Scheme

18. If we want to capture the prize of putting a ceiling on the rates now, then we have inevitably to control rates in the interim until LST can be introduced.

The problems of control are considerable. The one which unhorsed the Chief Secretary in MISC 79 was the necessity to give the S of S for the Environment an override over his colleagues. But even this would be tolerable because it would be temporary.

19. We must base the ceiling on 1 April 1983. If we then announce our scheme at any time after 2 April 1983, we shall block off most possibilities of mischievous upratings. For the subsequent 2/3 years of interim control, we should offer only austere provision for inflation.

Exchequer Funding of Teachers' Pay

20-23. Transfer of teachers' pay to the Exchequer certainly would not be worthwhile for the interim period alone. Its purpose is long-term: to reduce the scope of functions which are to be financed, in whole or part, by locally raised revenue, and so to reduce the "gearing" which has enabled Councils like Camden to raise such vast sums from their ratepayers.

The transfer cannot be effected without spending control, to prevent diversion of money saved to other services. It ought therefore to be effected during the interim period of expenditure control.

24. No interim?

The option of dispensing with the interim control period and pressing on with the earliest possible introduction of the long-term scheme (April 1987 at the earliest) has serious disadvantages.

- (i) We should lose the prize of offering a "Rates Ceiling Now".
- (ii) Spendthrift authorities would have four more years to milk their ratepayers.

It is doubtful whether the upheaval of change would be worthwhile without those advantages.

The Long Term

After the change - towards the end of the next, Parliament - we would be able to show the people:

- (i) Local property taxes which were stable and predictable. When you bought a house, you would know just what you were taking on.
- (ii) A supplementary Local Sales Tax which would provide a source of revenue that would increase with inflation and national wealth. Thrifty authorities would be rewarded by attracting industry and commerce.
- (iii) A system of local revenue and expenditure which was more limited in extent. The thirty-year-long tendency of Governments to thrust more and more services into the lap of usually incompetent and occasionally malign local authorities would be brought to a halt. On the one hand, we would privatise and contract out. On the other hand, the State would take specific responsibility for half the schools budget - which is only fitting in "a national system locally administered".

We would have stopped what Arthur Seldon calls "municipal imperialism" dead in its tracks.