



Minister for Local Government

Department of the Environment  
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cc BC  
15 April 1988

Dear Paul

Thank you for your letter of 13 April requesting a note on the basis of the estimate that the top 10% of the population by income contribute 15 times as much towards the cost of local services as the bottom 10%. *prop.*

I attach a note prepared by officials and cleared with Treasury and CSO. It has not yet been seen by Ministers here.

I am copying this letter and attachment to Moira Wallace (Chancellor of the Exchequer's Office), Simon Judge (Paymaster General's Office), Roger Bright (Department of the Environment) and Jack Hibbert (Central Statistical Office).

Yours sincerely  
Alan Ridzell

ALAN RIDDELL  
Private Secretary

(X) I am afraid it has not yet been possible to secure official Treasury clearance, but I think you will want to have it for the weekend anyway.

Paul Gray Esq



## RELATIVE CONTRIBUTIONS OF HOUSEHOLDS TO LOCAL AUTHORITY SPENDING

1. There are two elements to the assessment of the relative contributions of different households to local spending:

(i) Direct contribution through community charge

Latest estimates suggest that households with the highest 10% of net incomes will pay six times more in community charge than the 10% with the lowest net incomes. This estimate is made from a computer model of the tax benefit system, and reflects the benefit to the 10% of households of the lowest incomes from the rebate system and the fact that the highest income households tend to be those with 2 or more adults which pay more community charges than those in the lowest 10% which are predominantly single pensioner households.

(ii) Contribution from central taxation

Central taxation funds local authority spending through grant paid to local authorities and through rate rebates. The top 10% of households obviously pay more than the bottom 10% in central taxes. CSO make projections of the amount of tax paid by households in different income groups. These projections cover indirect taxes such as VAT and car tax as well as direct taxes such as income tax and national insurance contributions. In addition, an allowance is made for intermediate taxes like employers national insurance contributions and business rates, to take account of the fact that these taxes are partly passed onto households in the form of higher prices. The estimates are derived from the Family Expenditure Survey, a regular sample survey. The 1985 figures showed that the top 10% of households paid some 20 times more in central taxes than the lowest 10%.

The combination of figures calculated at (i) and (ii) above provides the estimate for the combined ratio of contributions by the top and bottom 10% of households to local spending. The calculation which produced the estimate of a ratio of 16 times in August last year is attached. While there is no single right way of calculating this figure, it is agreed that this methodology is defensible.

### Sensitivity

A large number of factors go into the calculation of the ratio. Some analysis was therefore undertaken to establish how sensitive the estimates were to changes in the underlying data. The position seems to be that the ratio can be made to move by more than 1 point by changes in the distribution of income. These are occurring but they are taking place over a number of years and should not produce short term volatility. The ratio is also sensitive to the definition of income used. The calculations have been done on the basis of gross income. This is entirely defensible and does not cause any problem so long as the definition is not changed and it is clear which definition we

are using. The ratio may not, however, be sensitive to changes in individual aspects of the tax regime. A reduction in direct taxation for one group may be largely replaced by an increase in indirect taxes or be made up by other behavioural responses.

Following this year's budget, the opportunity has been taken to shade the ratio of contributions to local spending from 16:1 to 15:1. Because the estimates of total tax payments are made retrospectively - to take account of the way in which people actually dispose of their net income - no attempt has been made to make a detailed assessment of the effect of the budget changes on the ratio. The change, therefore, partly reflects the fact that a figure of 16:1 gave a spurious air of precision to a necessarily imprecise figure and recognised the possibility that the radical nature of the budget might show up ultimately as a reduction in the ratio, though on the basis of the sensitivity analysis carried out it is unlikely to have made a difference of more than 1 point.

# CONTRIBUTION OF RICH AND POOR TO LOCAL AUTHORITY SPENDING

The attached table sets out the basic data used to estimate that the highest paid 10% of the population will, after the introduction of the community charge, contribute 16 times as much to local authority spending as the lowest paid 10%. The derivation is as follows (rounding errors apply):-

a) The government contribution to local authority expenditure is through grants and rate rebates. In 1985/86 these amounted to

GRANT	£11,780m
RATE REBATES	<u>£ 1,290m</u>
TOTAL	£13,070m

b) in 1985/86 <sup>domestic</sup> rate income, net of rebates, amounted to £5,140m. Therefore government contributes from central taxation about 2.5 times the amount raised locally.

c) Assuming in table one that only one household exists in each decile, the total raised from households by the community charge equals the sum of the ten values, that is £2,550. Hence the assumed government contribution provided by these households is just over 2.5 times this amount (see b) and equals £6,480.

d) The total amount of tax paid by these ten households is found by summing the individual tax payments, £37,410. The £6,480 which finances local authority spending represents over 17% of this tax payment.

e) Assume 17% of each tax payment is accounted for by Local Authority spending. Thus the contribution to local spending for the highest and lowest decile is calculated as

	HIGHEST	LOWEST
17% OF NATIONAL TAXATION	1840	90
COMMUNITY CHARGE	460	50
TOTAL CONTRIBUTION	2300	140

f) Hence the decile of population with the highest gross income contributes over 16 times ( $2300 \div 140$ ) as much to local authority spending as the lowest gross income decile.

T DAVIS

FLT

21 August 1987

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TABLE ONE

DECILE	ANNUAL TAXES PAID BY AVERAGE HOUSEHOLD	AVERAGE REBATED COMMUNITY CHARGE
1 (LOWEST)	501	53
2	750	95
3	1157	158
4	1931	210
5	2750	263
6	3488	289
7	4245	315
8	5422	336
9	6642	368
10 (HIGHEST)	10603	462

SOURCE : ECONOMIC TRENDS NOVEMBER 1986, 108, TABLE 6.

"AVERAGE INCOMES, TAXES AND BENEFITS, 1985

By decile groups of household ranked by gross income.

Taxes paid included income tax and employees NIC; Indirect taxes except rates; and intermediate taxes.

Community Charge figures from Green Paper, Cmnd 9714,

"PAYING FOR LOCAL GOVERNMENT" - Figures increased by 5% to roll forward to 1985/86.

## Average incomes, taxes and benefits, 1985

By decile groups of households ranked by gross income

TABLE 6

	£ per year										Average over all decile groups
	Decile group										
	1st	2nd	3rd	4th	5th	6th	7th	8th	9th	10th	
Decile points (£)	2 904	4 024	5 343	7 218	9 042	11 007	13 181	15 885	20 547		
Number of households in the sample	701	701	702	701	701	701	701	702	701	701	7 012
Original income	241	697	1 544	3 962	6 560	8 710	10 972	13 560	17 012	27 429	9 066
Direct benefits in cash											
Contributory											
Retirement pension	1 300	1 473	1 431	912	480	381	280	217	290	200	696
Unemployment benefit	37	53	92	81	97	78	63	40	50	33	62
Sickness/ injury related	67	89	179	248	174	157	128	78	97	57	128
Other contributory benefits	67	85	69	102	69	95	55	53	33	30	66
Total contributory benefits	1 471	1 699	1 771	1 343	820	711	526	388	470	320	952
Non-contributory											
Supplementary benefit	265	440	593	380	221	156	103	71	65	80	238
Child benefit	24	97	192	236	292	288	303	341	281	279	233
Rent rebates/ allowances	345	413	355	145	76	32	26	19	2	4	142
Sickness/ disablement related	20	64	102	151	107	50	77	53	62	58	74
Other non-contributory benefits	35	37	61	77	83	82	41	59	58	47	58
Total non-contributory benefits	689	1 051	1 303	989	780	608	551	544	468	468	745
Total cash benefits	2 160	2 750	3 074	2 332	1 600	1 319	1 077	931	939	789	1 697
Gross income	2 401	3 447	4 618	6 294	8 160	10 029	12 049	14 491	17 950	28 218	10 765
Income tax and Employees' NIC											
Income tax	19	70	154	502	944	1 315	1 807	2 335	3 178	5 871	1 620
National insurance contributions	6	11	50	196	390	547	698	866	1 048	1 358	517
less: Tax relief at source <sup>1</sup>	15	21	35	77	150	221	289	350	379	491	203
Total	10	60	169	621	1 184	1 641	2 216	2 851	3 846	6 738	1 934
Disposable income	2 391	3 387	4 449	5 672	6 975	8 388	9 833	11 641	14 104	21 480	8 832
Indirect taxes											
Domestic rate <sup>2</sup>	131	171	221	292	337	369	389	445	465	577	340
Taxes on final goods and services											
VAT	146	211	309	435	534	637	723	932	1 063	1 520	651
Duty on tobacco	79	122	167	201	206	238	220	220	228	251	193
Duty on beer	17	23	40	58	73	99	100	134	140	185	87
Duty on wines	5	5	9	12	19	19	28	34	49	91	27
Duty on spirits	17	19	37	43	54	56	57	94	98	147	62
Duty on hydrocarbon oils	19	28	49	81	109	138	160	202	237	308	133
Car tax	2	2	8	9	18	20	30	34	43	67	23
Vehicle excise duty	9	19	32	44	60	69	78	91	106	133	64
Television licences	29	35	38	39	42	44	45	46	47	48	41
Stamp duty on house purchase	2	1	2	4	7	8	11	18	22	30	11
Customs' duties	7	11	16	20	26	30	34	41	47	62	29
Betting taxes	7	18	23	32	34	39	49	41	34	56	33
Other	9	11	13	14	15	18	19	25	23	29	18
Intermediate taxes											
Commercial and industrial rates	45	58	75	97	114	132	145	178	203	288	133
Employers' NI contributions	50	65	86	112	132	154	170	208	238	340	156
Duty on hydrocarbon oils	22	29	38	48	56	65	71	85	96	137	65
Vehicle excise duty	6	7	10	13	15	18	19	24	27	39	18
Other	20	27	36	46	54	63	70	85	95	134	63
Total indirect taxes	622	861	1 209	1 602	1 903	2 216	2 418	2 936	3 261	4 442	2 147
Income after cash benefits and all taxes	1 768	2 526	3 241	4 070	5 072	6 173	7 415	8 704	10 844	17 038	6 685
Benefits in kind											
Education	113	187	403	535	619	674	687	796	768	818	560
National health service	644	795	879	770	701	722	700	695	686	731	732
Housing subsidy	90	106	116	86	62	60	50	42	29	14	65
Rail travel subsidy	6	8	15	27	26	41	36	31	62	109	36
Bus travel subsidy	34	39	45	33	30	31	28	29	30	38	34
Welfare foods	5	25	59	49	49	25	17	23	18	15	28
Total	891	1 161	1 517	1 500	1 487	1 553	1 518	1 616	1 591	1 726	1 456
Final income	2 660	3 687	4 758	5 570	6 559	7 726	8 933	10 320	12 435	18 764	8 141

<sup>1</sup> On mortgage interest and life assurance premiums.<sup>2</sup> Net of the rate rebate element of housing benefit, but including water, etc. charges.

LOCAL GOVT: Rates Pt. 10

