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Mending Local Democracy

A Market-Driven Approach

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This document represents a somewhat different approach based on the retention of a reformed property based tax which would be more compatible with real local democracy and local accountability.

1. INTRODUCTION

This paper addresses two interrelated issues:

- Turnouts at local elections have been very low of recent years.
- Local taxation has become increasingly unpopular with the electorate..
 - We only got the Community Charge, (*a.k.a.* the poll tax), because the Rates became so unpopular and we only got the Council Tax because, in its turn, the poll tax also became unpopular.

Most of the pressure from the electorate seems to be in favour of **reducing** the share of local revenues collected locally and increasing the share contributed by central government. Paradoxically however, most people also seem to want **more** local autonomy or local democracy! These apparently contradictory views probably represent an inchoate feeling that the state is too big and that Council Tax is unfair and / or too high. These views are most definitely **not** contradictory, (although they may not necessarily be right!). The real problem would appear to be that:

- There has been a complete breakdown of the connection between local **taxation** and local **spending**. As a result the local electorate feels **disenfranchised** and that this is the cause of low turnouts at local elections.
 - It would appear that the local electorates think that whatever sort of local government they elect, it will actually make very little difference. This is probably not how people want things to be!
- The existing Council Tax system is perceived to be “unfair” in the sense that the size of any bill is insufficiently closely connected to an individual’s **ability to pay** or their **usage** of “local” services.
 - The fundamental reason for the unpopularity of the Rates, the Community Charge and the Council Tax is probably that the bills faced by many taxpayers appear(ed) to them to be **too high**. If these bills were to be significantly lower, one doubts whether many people would be much concerned about the “fairness” or “unfairness” of any of these taxes.
 - Local taxation is too **high** in the sense that it funds more than just the **discretionary** spending of local authorities.

Obviously, these points are all interconnected. For example: if local taxation matched local discretionary spending, then the local electorate would not feel disenfranchised; if local taxation were not so high, then people’s ability to pay it would be greater and it would not then be seen as so “unfair”; if local taxation only funded the current level of discretionary spending then local tax bills would, on average, be lower.

This paper addresses the issues of local taxation and local democracy and proposes a solution adopting a market-driven approach based on the premise that **true** local democracy is only possible when we have **true** local taxation: “*He who pays the piper calls the tune*” - or at least he who calls the tune should pay, (at least some of), the piper’s wages.

2. SYMPTOMS AND DIAGNOSIS

2.1 Local electorates are disenfranchised

The American War of Independence was fought on the slogan: “*No taxation without representation*”. An exhaustive regression analysis, (carried out by the author of this document), of every single tax collecting local authority in England has shown that

There is no statistically significant correlation between the average Council Tax per head collected by each local authority and that local authority’s spending per head.

In fact, what little correlation that does exist is a **negative** one - councils which tend to spend **less** tend to have **higher** levels of Council Tax.

However, there is a large and statistically very significant positive correlation between a local authority’s spending per head and the amount of grant per head that it receives from central government

The uncharitable might suggest that these two statements taken together merely show that it is much easier to spend the money of those taxpayers who do not vote in those elections in which one is standing oneself than it is to spend money collected from one’s own taxpayers. The more charitable might suggest that local authority spending was driven mainly by **need** and that the size of government grants were also driven by the same need. Which “explanation” is right? If **need** were the main determinant of spend as well as of government grant, we would expect to find a strong **negative** correlation between average income per head in an area and the relevant local authority’s spending per head. We do indeed find a negative correlation - but the effect is **small** and only just about statistically significant. Thus, although there is some support for both explanations, the overwhelming conclusion is that local government is less frugal with other people’s money than it is with its “own”.

This view is consistent with the Audit Commission’s observation, (in its report into Council Tax rises for the year 2003/04) to the effect that: “*We found that increases tend to be higher in authorities that are not directly elected – 13 of the 20 highest increases were agreed by police authorities*”.

In a sense, democracy is really a form of market where everyone has the same purchasing power: “*One man one vote*”. If we like what local government does with our money, we tend to re-elect them. If we don’t, then we tend to see if anyone else can do better. We treat supermarkets in exactly the same way. With the breakdown of any connection between what purports to be a “local” tax and what purports to be “local” spending, local electorates are, in effect, **disenfranchised**. Central government funds, **on average** some 75% of “local authority” spending and dictates how around 80% of **total** local authority funds must be spent. If central government perceives that Council Tax is too high, then it can “cap” local authority spending. In such a situation, what is the point of local democracy? Aren’t “local” democracy and “local” taxation simply charades?

This is again beautifully illustrated by what the Audit Commission said in its same report on Council Tax for the year 2003/04: *“One of the difficulties in carrying out this analysis is that the government itself does not set out the basis on which it comes to its decisions on what to allow for in the local government finance settlement”*. If the Audit Commission can't find out how central government determines local authority grants, what scope has the taxpayer for doing so - and hence of judging his local authority's performance? This problem is exacerbated by the complexity of the system. Once again, the Audit Commission noted that *“The system is too complex for citizens – and many involved in the decision making processes – to understand, and there is no direct relationship between decisions to spend and increases in local taxation. The consequences are a lack of accountability”*.

2.2 Council Tax is too high - and this makes it unpopular

Nobody likes paying taxes, but Council Tax really only started to become seriously unpopular as a result of the **large percentage rises** faced by many people in the financial year 2003/04. Even on **average**, and there were many **above average** rises, these increases were far ahead of increases in retail prices or average earnings. (See figure 1 which shows the cumulative percentage increases in Council Tax, average earnings and the Retail Price Index since 1997/98 up until 2003/04).

Entity	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04
RPI	4.00%	5.66%	8.83%	10.79%	12.45%	15.94%
Council Tax	8.59%	15.96%	23.00%	30.93%	41.72%	60.05%
Average Earnings	3.00%	7.12%	10.65%	14.86%	21.52%	26.50%

Fig 1

It is obvious from this that Council Tax must be taking an increased portion of most people's incomes. This can cause real hardship for those at the bottom end of the income distribution. People just above the Council Tax Benefit threshold can be paying up to 25% of their income in Council Tax. Indeed, the former, (Labour), Minister for Local Government, Nick Raynsford, has acknowledged that the trend in Council Tax rises is unsustainable.

Faced with rises of this sort of magnitude, the reaction of most ordinary people is:

If the local council managed before, why do they need to increase spending and / or my taxes so much?

Indeed, the spending increases were **not** always necessary. As the Audit Commission report notes: *“Work by council auditors found the increases in spending in local government – which averaged 9 per cent – justifiable; but they were not in all cases unavoidable”*

Residents of the South East and East of England Regions were particularly hard hit by these rises. Figure 2 shows the cumulative percentage increases in Council Tax for the English Government Office Regions since 1997/1998, (the base year), up until 2003/04

Region	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04
North East	7.66%	14.48%	20.27%	26.24%	36.65%	48.59%
North West	7.23%	12.89%	18.18%	24.26%	30.83%	42.22%
Yorks & Humber	8.28%	14.07%	19.99%	27.69%	36.80%	50.86%
East Midlands	10.11%	18.29%	25.82%	33.21%	46.13%	59.54%
West Midlands	7.99%	15.82%	22.82%	31.51%	41.78%	56.03%
East of England	10.93%	20.24%	28.67%	37.37%	51.63%	74.54%
London	5.42%	12.20%	19.50%	29.16%	37.48%	62.45%
South East	10.74%	19.24%	26.86%	35.06%	48.08%	71.35%
South West	9.61%	17.23%	25.35%	32.77%	46.64%	66.89%
England	8.59%	15.96%	23.00%	30.93%	41.72%	60.05%

Fig. 2

Given that the basic State pension is linked to the RPI, (up only 15.94% in the same period), and that many pensions, (for example those private pensions secured by buying annuities), are not inflation linked at all, the severity of the problem is easy to appreciate. Pensions in the South East or the East of England go up no faster than those anywhere else!

2.3 Council Tax bills are not sufficiently closely linked to ability to pay

As we have just argued in the previous section, pensioners in some parts of the country are harder hit than those in other parts. However, pensioners are only part of the problem. Not **all** pensioners are poor - nor are all poor people pensioners! As can be seen from figure 3 below, there are significant levels of poverty in all regions of England whether or not these people are pensioners.

	NE	NW	Y & H	E Mid	W Mid	E of E	Lond	SE	SW
Percentage of housing in band A	59%	44%	46%	39%	32%	14%	3%	9%	17%
Percentage living in relative poverty	28%	24%	23%	22%	26%	17%	23%	16%	22%
Ratio of band A to paupers	2.09	1.82	1.99	1.76	1.25	0.85	0.15	0.54	0.78

Fig. 3

The figures on relative poverty are taken from the Department for Work and Pensions and refer to **individuals** living in **households** whose **household** income was 60% or less than the **national** median household income in the year 2000/01. The really disturbing thing about the data shown in figure 3 is that only 15% **at the very most** of the “statistically poor” in London can live in housing subject to the lowest rates of Council Tax, (band A), only 54% of the “poor” in the South East can do so along with 78% in the South West and 85% in the East of England. Everywhere else there is plenty of “cheap”, (in

Council Tax terms), housing to accommodate the relative paupers - although, of course, they do not all necessarily live in the cheapest property.

The underlying assumption of the Council Tax is that an individual's means are linked to the value of the property they occupy so that people who live in higher valued properties can afford to pay more than those who live in lower valued ones. This is no doubt true in most instances. In fact, as figure 4 shows, the average Council Tax bill does indeed rise monotonically as gross household income rises, (Data taken from Table 2.3 Family Spending 2005 Edition published by the ONS).

Average council tax bills (£ p.w.) by gross income deciles									
Low	2	3	4	5	6	7	8	9	Top
5.50	8.40	11.00	15.10	16.70	17.80	18.50	20.00	21.50	25.30

Fig. 4

However this relationship is based on **averages**. It does not always hold for individuals - and it is in the **exceptions** to the rule, (which amount to something between two and three million households), where the real hardship is experienced.

Many people bought their current houses when their real incomes, (or at least their real incomes relative to other people), were much higher, and the real price of their property relative to other properties and other prices were much lower, than they are today. Such people could not now afford to buy their own houses out of their current incomes or their other savings. This must, at the very least, call into question their ability to pay a tax designed to raise substantial amounts of revenue when the amount of their liability is based upon the value of something that they could no longer afford!

The normal market solution, that of selling up and moving to a cheaper property, is not really applicable. The transaction costs, (which include legal fees, stamp duty, estate agent's fees, removal costs and so on), would probably make the exercise futile - especially for those coming to the end of their lives. People on lower incomes and with small or negative equity in their properties - e.g. the young who have just been made redundant - can not adopt this solution either. Such people can be in an even worse position than pensioners.

2.4 Council Tax is rising because of the “inadequacy” of central government grants

On average the Council Tax only covers around 25% of local authority spending. The rest is made up of grants from central government. In 1993, when it was introduced, Council Tax only accounted for 21.13% of local government revenues. However, by the financial year 2004/05 it was expected to contribute 25.79% - which represented an increased share, (up by 22.05%), of a much larger number. The reason for this is not hard to identify. As figure 5 shows, Council Tax rose by a cumulative 94.04% between 1996/97 and 2004/5 whereas, during the same period, grants from central government rose by only 63.41%.

Year	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05
C Tax	7.46%	17.89%	26.93%	35.74%	45.74%	59.14%	81.11%	94.04%
Grants	0.36%	5.81%	12.01%	20.90%	30.40%	37.84%	59.50%	63.41%

Fig. 5

These grants also vary widely from region to region as shown in figure 6 which illustrates how central government grant per head of population, local authority spending per head of population and average Council Tax per head varied from one region to another for the financial year 2001/02.

Grants, local authority spend and council tax per head 2001/02									
Region	NE	NW	Y& H	E Mid	W Mid	E of E	Lond	SE	SW
Spend	1,335	1,335	1,247	1,112	1,215	1,102	1,688	1,076	1,066
Grants	1,041	1,014	973	823	923	782	1,367	753	757
CT	275	290	266	284	280	301	319	320	301
% Local	21%	22%	21%	26%	23%	28%	19%	30%	28%

Fig. 6

It is immediately apparent that, despite the South East region being the second most frugal region in terms of local authority expenditure per head, it nevertheless has the highest level of Council Tax per dwelling. It is easy to see why this is so. Not only does the South East receive the lowest central government grant per head, but the central government grant also finances the lowest proportion of the total local authority expenditure.

It is not the local authorities in the South East who are to blame for high Council Taxes. It is the central government

2.5 Resource Equalisation converts “local” taxes into national taxes

With the exception of London, personal incomes in Surrey are on average higher than in any other part of the country. At the same time, Surrey receives by far the lowest central government grant per head of any authority. Many people’s reactions to these two statements would be: “*and quite right too!*”. But is it? Where is the sense in using what purports to be **local** taxation to fulfil **national** objectives? Isn’t that the purpose of **national** taxation? If the incomes of Surrey residents are higher than those of people elsewhere, our progressive income tax system already means that they contribute more to the national exchequer than others. Why double count? Can any government even **know** what the effect of such double counting really is? If we need to collect more money from the “rich”, then let us at least be honest and collect it via income tax! At least the money would be collected from those people who really **are** richer. Under the present system poorer people in Surrey are being asked to subsidise people in other parts of the country who are richer than themselves simply because some of their neighbours are even richer still. Where is the sense in that?

In the previous section we saw how, in 2001/02, (figure 6), the South East “suffered” in terms of central government grant. Since then, the situation has got even worse - from a Council Tax payer’s point of view, (as confirmed by the quotation from the Audit Commission’s report above)! The percentage of local authority revenues that Council Tax is expected to raise has increased in all regions, but in the South East, which already received the lowest contribution, it has increased more than anywhere else except for London, (which used to have the lowest local contribution but now only has the second lowest!). Figure 7 shows the percentage local contribution in each region and how this has changed between 2001/02 and 2005/06.

Changes in Council Tax contribution to local revenues 2001/02 - 2005/06									
Region	NE	NW	Y& H	E Mid	W Mid	E of E	Lond	SE	SW
2001/02	20.89%	22.26%	21.47%	25.64%	23.24%	27.81%	18.91%	29.79%	28.46%
2005/06	24.83%	25.49%	25.75%	29.80%	26.41%	33.62%	25.18%	36.37%	34.70%
% Increase	18.85%	14.53%	19.97%	16.23%	13.64%	20.92%	33.15%	22.08%	21.94%

Fig. 7

It is obvious from figures 6 and 7 that the predominantly Labour voting regions, the North East, the North West and the Midlands do best out of government grants whereas those regions that do not tend to vote Labour, namely the South East, the South West and the East of England tend to do worst. Whether or not this amounts to political manipulation is difficult to determine. However, it certainly arises in part from a “convenient” misconception.

The government appears to believe, (conveniently?), that there is somehow something magical about property banding. Most of the so-called “Resource Equalisation” seems to be designed to achieve a state of affairs where a property in any given band pays roughly the same amount of Council Tax regardless of where it is in the country.

For example, in figure 8 we show the average Band D Council Tax for each local government region in 2005/06 as well as the average Council Tax **per dwelling** for the same year.

	NE	NW	Y& H	E Mid	W Mid	E of E	Lond	SE	SW
Per Dwelling	891	918	876	952	939	1,079	1,078	1,147	1,055
Band D	1,280	1,235	1,182	1,242	1,197	1,234	1,162	1,218	1,237

Fig. 8

As can be seen, the variation in Council Tax per band D is small and much lower than the variability in Council Tax per dwelling. The percentage difference between the highest band D Council Tax, (in the North East at £1,280), and the lowest, (in London at £1,162), is only 10.17% whereas the percentage difference between the highest Council Tax per dwelling, (in the South East at £1,147) and the lowest, (in the Deputy Prime Minister’s area of Yorkshire and Humberside at £876), is much higher being 30.88%. Back in 1997/98, the situation was rather different. Then the difference between the highest average Council Tax per dwelling, (in the South East at £599) and the lowest, (in Yorkshire and the Humber at £520), was only 14.9% whereas the difference between average Council Tax on a Band D

property was much greater. The most expensive area was the North West, (at £798), with the cheapest being the East of England, (at £639). This represents a difference of 24.9%.

Our regression analyses have shown beyond any reasonable doubt that Resource Equalisation has indeed “improved” the correlation between the **average** income of the population in a local authority’s area and the **average** Council Tax per head levied by that local authority. This is because, as the Audit Commission noted in its report from which we have already quoted, the most obvious effect was to move money from the South, (where average money incomes are higher), to the North, (where average incomes are lower): *“But grant distribution – which moved grant from London and the South to the Midlands and the North – led to some councils putting up Council Tax more than others. We found a clear association between the size of grant increase a council received and their increase in Council Tax”*.

Was this political manipulation / gerrymandering? The Audit Commission notes, rather coyly, in its report that: *“There was, however, no causal relationship between budget and Council Tax increase and the political parties running the councils. Councils which received lower grant increases generally increased Council Tax more than those that received higher grant increases regardless of the political party running the council”*.

The idea of making the Council Tax the same for any given band in all areas seems far more rational when one looks at the situation from the local authority’s, (as opposed to the taxpayer’s), point of view. The amount of tax that any local authority can raise is always limited by the amount that it can take, (or that it feels that it can take), from the poorest potential taxpayers. If the “poor” pay exactly as much tax as the “rich”, (as, in theory, they did with the Community Charge), then the maximum capacity for raising revenue is less than if the “rich” were to pay more than the “poor”.

As an extreme example, let us suppose that **all** the properties within a given local authority are to be found in the lowest Council Tax band, (band A). If we were to take no account of how many people actually live in any particular property, then this would mean that, everybody, regardless of their relative abilities to pay, would end up paying much the same amounts in Council Tax - just like the old poll tax! Whether or not one regards this as “fair” or “unfair” depends upon one’s own political persuasion. There are no real local authorities where such an extreme position actually applies, but, Easington, in County Durham, where 80.62% of all properties fall into band A, comes pretty close. We would, of course, face exactly the same problem if, in our hypothetical local authority, all the properties were to fall into the highest Council Tax band, (band H), instead.

In the North East local government region **as a whole**, over 58% of all dwellings fall into the single lowest band, (band A). This means that, on average, people up to and beyond (local) median means, (income or wealth), all pay much the same amount in Council Tax. In complete contrast to the situation in the North East, only 3.4% of properties in London are in this same bottom band, band A. **Both** regions suffer from a lack of sufficient **differentiation** to enable revenue to be raised easily. This may well be why London, (the most expensive housing area), and the North East, (the cheapest area), received the largest and second largest government grants per head in both 2001/02, (see figure 6), and 2005/06, (see figure 9 below).

Central government grants per head (£) by region 2005/06								
NE	NW	Y& H	E Mid	W Mid	E of E	Lond	SE	SW
1090	1062	1010	887	1014	841	1325	793	801

Fig. 9

Not only does the current banding system for Council Tax purposes result in too little differentiation between properties **within** some regions, (with the consequent limitations on how much revenue it can yield, as just discussed), it also provides **too much** differentiation between similar properties, (and people on similar incomes), located in **different** regions.

The essential problem is that the band into which any property falls is determined by its market value, (in 1991!), and not by its physical accommodation or other facilities. Unfortunately, property prices can be very volatile - as we saw in the late '80s, early '90s and again very recently - with “hot spots” occurring in different regions at different times. This means that a snapshot of values taken at any one particular point in time may not be representative of the underlying situation as time goes on. Moreover prices for what are otherwise similar properties vary enormously between regions, (as the estate agents say: “location, location, location”). One can buy something almost palatial in some areas for a sum which in other areas would buy little more than a hovel. At the extremes a “standard” three bedroom semi could differ by as much as four bands according to which region it is in. Figure 10 shows the average prices in the final quarter of 2000 for different types of property in the North East, (the cheapest region), London, (the most expensive region), and the South East, (the most highly taxed region).

Average dwelling prices by region and type of accommodation, 2000					
Region	Detached	Semis	Terraced	Flats	All Types
North East	111,374	57,417	43,255	47,401	62,945
London	446,615	212,068	194,967	171,771	177,949
South East	250,531	132,132	104,242	87,581	147,271
Ratio: NE/Lon	4.01	3.69	4.51	3.62	2.83

Fig. 10

As we can see, London property costs, on average, 2.83 times as much as property in the North East, with the average terraced house being more than four and a half times as much. Although average incomes in London, (or the South East), are certainly higher than those in the North East, they don't differ by anything like as much as property prices do. The average weekly **household** incomes for the three regions is shown in figure 11.

Average household incomes and house prices: 2000				
Region	Income £ / week	Indexed to NE=1	House Price £	Indexed to NE=1
North East	370	1.00	62,945	1.00
London	570	1.54	177,949	2.83
South East	580	1.57	147,271	2.34

Fig. 11

Once again, this demonstrates how badly the South East is treated when compared with other regions. Why, for example, should the South East receive £532, (40%), less government grant per head than London, (see figure 9), when the difference in average weekly **household** income is only around £10 and when a typical household consists of **more** than one person? This is an effective “marginal tax rate” of more than 100%!!

What, in effect, is happening is that poorer people in the “richer” areas are being forced to subsidise people in the “poorer” areas who are actually richer than they themselves are. One doubts whether **any** government of **any** political persuasion would regard this as a “good thing”. It is simply an inevitable result of too little differentiation within regions and too much between regions.

Figure 12 shows how widely the average Council tax varies for each quintile, (based on house prices in 2000), of the housing stock for each region.

Average council tax for each quintile of house prices: 2005/06 (quintiles based on prices in 2000)					
Region	Bottom	2nd	3rd	4th	Top
North East	853	853	864	1049	1377
North West	824	824	935	1081	1479
Yorks & Humber	788	788	881	1016	1386
East Midlands	828	836	966	1105	1489
West Midlands	798	849	949	1088	1488
East of England	861	989	1097	1228	1717
London	901	1033	1138	1303	1757
South East	888	1048	1143	1340	1818
South West	843	962	1087	1203	1679
Maximum	901	1048	1143	1340	1818
Minimum	788	788	864	1016	1377
Ratio: max / min	1.14	1.33	1.32	1.32	1.32
Difference	113	260	280	324	440

Fig. 12

2.6 The Council Tax bills paid by individuals bear little, if any, relationship to the services from which they themselves benefit

In any welfare state funded by taxation where public services are provided free at the point of delivery it is inevitable that there will be virtually no connection between taxes paid and services consumed. While there does not seem to be much disquiet about such a situation at the national level, there does seem to be much more concern at the local level. The perception is that many local residents, who benefit from council services and who could easily afford to pay more, contribute little or nothing to those services while others, whose ability to pay is much less, can end up having to pay as much as 25% of their income in Council Tax. The problem is that many of those who vote for local services do not have to pay for them, whereas others, who make little or no use of those same local services have to foot the bill.

This can result in a perverse incentive towards high spending, high taxation and wasteful provision of services. Anybody who only pays for (say) 25% of the cost of the services that he uses will still get very good value for **his** money even if the services cost twice what they “should” do. He will be getting services of twice the value of his own contribution. Meanwhile someone **else** will be paying the difference. This a problem with any progressive tax system. The situation is of course even worse where a voter makes **no** contribution to the cost of the services that he votes for.

Although the numbers of voters who escape Council Tax is much smaller than many of the complainants believe, (many of these “non-payers” are in fact the partners of householders who do pay), there remains a substantial minority of people with the vote who make no real contribution at all.

- Students in full time education have the right to vote but are exempt from paying Council Tax
- People in receipt of 100% Council Tax Benefit in effect make no contribution either.
 - There has to be something seriously wrong with any system of taxation in which the bills can only be met by resorting to benefits. At the very least, CTB should be independent of the **actual** levels of Council Tax being faced by the individual recipients. If the level of benefit were fixed for all recipients at the **average** level of tax over **all** local authorities, then individual beneficiaries would have a very real incentive to vote for frugal local authorities. They would be able to pocket the difference, or, in the case of extravagant ones, have to fork out the extra themselves!
- Households with more than two adults pay no more Council Tax than two adult households, yet services are largely consumed by people.
 - This problem is mainly associated with young people - young professionals sharing a larger house or adult children still living with their parents.
 - It is perhaps worth noting that there is another perverse incentive at work here. Large houses that are “officially” sub-divided count as separate residences for Council Tax purposes. Those where the sub-division is “unofficial” do not. This problem is particularly acute in areas of expensive property, like London. A properly sub-divided house might well convert what would have been a single band H property into (say) three band G properties. The difference in overall Council Tax payable would be

150% if none of the smaller properties benefited from the 25% reduction for single occupancy and it would still be 100% even if all of them did.

One of the (very few) advantages of the poll tax, at least **in theory**, was that everybody who had the right to vote had to make a contribution to funding what they voted for. The main problem with the poll tax was that it was simply asked to take too great a share of the revenue raising burden. Since, in addition, the poll tax took no account, (again in theory), of people's ability to pay there really were some genuine cases where it caused real hardship - in addition to those people who could really pay but resented being asked to make a contribution to local expenditure when they had previously escaped scot free.

3. PRESCRIPTION AND CURE

We may summarise the issues that we have so far discussed as being caused by

- A serious mismatch between local authority **power** and local authority **responsibility** on the one hand, and between central government **power** and central government **responsibility** on the other.
- An analogous mismatch between power and responsibility at the **electoral** level.
 - As mentioned earlier, the American War of Independence was fought on the slogan: “*No taxation without representation*”. Today we might do well to consider reversing this slogan to read: “*No representation without taxation*”. When people have to pay themselves for the consequences of the preferences that they display at the ballot box, they have a much greater incentive to vote responsibly than when their preferences are paid for by somebody else.
- Too **little** differentiation between the banding of properties **within** each region and too **much** differentiation **between** the banding of properties in different regions.

3.1 Solving the banding problem

It is somewhat ironic that many of the problems of “unfairness” and the breakdown of the relationship between the taxes charged and the ability to pay them have been caused by well meaning attempts to protect the poorer sections of society. For example, the furore over the Scottish 1985 revaluation, which led to the introduction of the Community Charge, was caused by business rateable values falling relative to domestic rateable values. This was a direct consequence of subsidising the rents of poorer households. This kept rents, and hence rateable values, **up**, whereas business rateable values went **down** because business rents went down, (in real terms), since the recession of the early 1980s hit Scotland particularly hard. In a similar way, many of the hardships caused by the Council Tax are a direct result of central government redistributing its grant in a way intended to help poorer **regions** with the result that the tax charged to poorer **people** in the richer regions is increased. Any serious proposals for reform need to ensure that the law of unintended consequences does not apply!

Banding for Council Tax purposes is currently based on values relative to **national** average values rather than to **local** average values. This is the cause of both the lack of adequate differentiation **within** regions and the excessive differentiation **between** regions. It would seem to be more logical to base what is supposed to be a **local** tax on **local** conditions instead of national ones!

The expected revaluation of properties, (originally supposed to take place in 2005), provides an excellent opportunity for reforming the Council Tax. Unfortunately, because of past experience - where politicians from both central and local government **appear** to have used past revaluations, (of the Rates), and changes to the system, (the introduction of the Community Charge), as an opportunity to extract more taxes from the population while blaming the increases on the change - the prospect of revaluation is already causing concern. This **ought** not to be the case. **IF** politicians were honest (?!?!), they would have to admit that revaluation, in itself, does not cause either central government’s or local government’s costs to increase. This means that revaluation does not provide any excuse whatever for raising more revenue by way of the Council Tax or for cutting back on central government grants.

If properties were to be banded with reference to their value relative to other **local** property, (say within each Government Office Region), then the problems associated with too little differentiation within each region and too much differentiation between the different regions would **both** disappear.

There are two main questions that need to be addressed in any proposed re-banding exercise:

- What is the **ideal profile** that we should be aiming for, (i.e. how many properties should fall into each band)?
- Does the real situation **on the ground** enable anything like this ideal profile to be achieved, (sensibly)?

The following subsections address these two key issues.

3.1.1 *Defining the ideal banding profile*

The **purpose** behind any possible re-banding of property on the basis of relative prices, physical facilities, or indeed any other criterion within each region / district etc. is to end up with a situation where there is **more** differentiation **within** regions, and **less** differentiation **between** regions than there is at present. Any scheme that fails to achieve this is simply not worth considering. With this proviso the two criteria that our ideal profile should probably fulfil are:

- All regions should have much the same profile / distribution of property bands with much the same percentage of property in every band as every other region.
- The profile should represent people's real relative **abilities to pay** the tax. This probably means that the banding profile should look very much like the income distribution curve.

In figure 13 we superimpose the **national** household income distribution curve on the current profile of the **national** distribution of property bands spaced according to the average Council Tax in each band. In this diagram, the horizontal axis is money and the vertical axis is relative population / frequency.

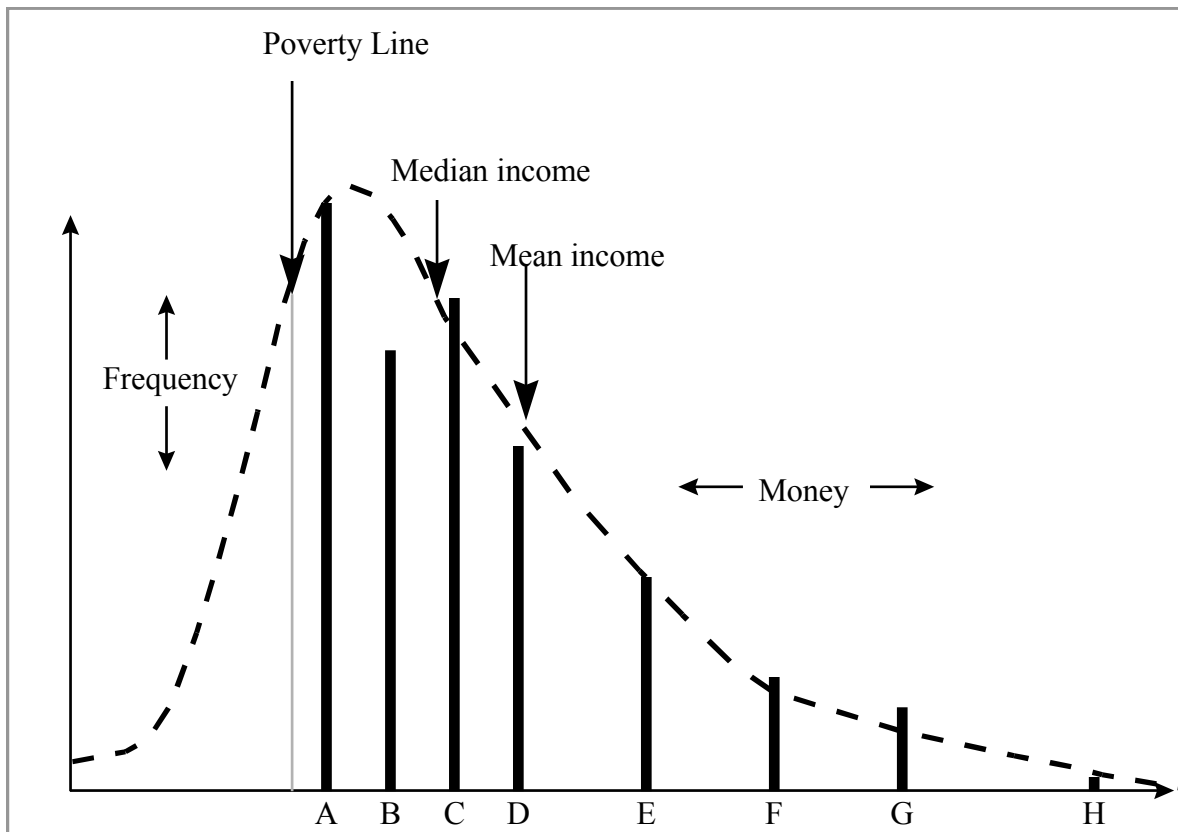


Fig. 13

It is immediately apparent from this diagram that, whereas there is a reasonably good fit at the upper income / more expensive property end of the distributions, the fit at levels below the median income and especially the fit near and below the poverty line, (defined as 60% of median income), leaves something to be desired. It is also noticeable that the mean, (average), income falls almost exactly in the same position as a band D property, which is often, (but totally erroneously), described as the average property band.

As can be seen from figure 14, which shows the number of properties above, below and at band D in each Government Office Region, **nowhere** are there as many properties above band D as there are below it. In fact, only in London are there less than half the properties below band D!

	NE	NW	Y& H	E Mid	W Mid	E of E	Lond	SE	SW
BelowD	86.5%	79.9%	81.3%	78.8%	76.4%	62.1%	43.7%	51.0%	64.8%
Band D	7.3%	9.6%	8.7%	10.3%	10.7%	17.3%	25.4%	20.0%	15.7%
Above D	6.3%	10.5%	9.9%	10.9%	12.9%	20.6%	30.9%	29.1%	19.4%

Fig. 14

Band D is not even the commonest band in any region. In the North East, the North West, Yorkshire and the Humber, the East Midlands and the West Midlands the commonest property band is A. In the East of England, London and the South East C is the commonest property band whereas in the South West the commonest property band is B. Even if we weight the number of properties by according to

their taxable capacity, even then the average band in money terms is still below D. This is demonstrated in figure 15 which shows what the effective average band is in each region in terms of taxable capacity. (The percentages in the bottom row are the percentage of the lower band in the range shown in the penultimate row. Thus, for example, in the West Midlands the average band in money terms lies between B and C. 22.2% of B and 77.8% of C would give the taxable capacity for the average West Midlands property.)

Average property band in money terms									
NE	NW	Y&H	EM	WM	E of E	Lond	SE	SW	Engld
B-C	B-C	B-C	B-C	B-C	C-D	D-E	D-E	C-D	C-D
97.5%	50.9%	60.0%	42.9%	22.2%	40.7%	75.1%	88.9%	59.2%	72.3%

Fig. 15

This apparent digression is actually very important. It is the failure of property banding to be properly centred that is the source of virtually all the problems causing so much grief. If the higher bands were used more in the poorer regions, (as they would be under **any** regional re-banding scheme), then the banding distribution would match the income distribution more closely and hence Council Tax would be aligned more closely with ability to pay. This is illustrated in figure 16 where we have superimposed the London banding distribution on the national income distribution. Just compare this with figure 13!

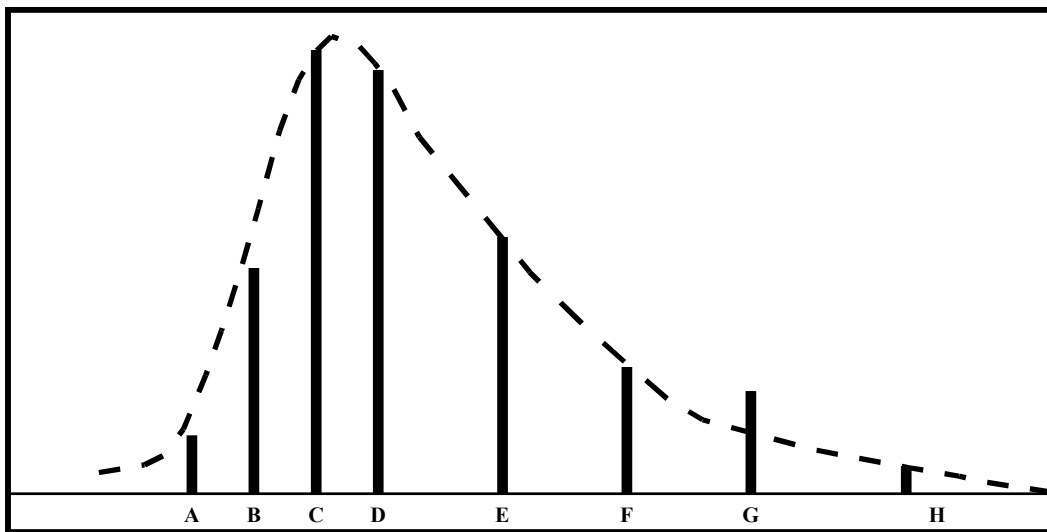


Fig. 16

Only in the case of band G do we fail to get an almost perfect match! The reason is that, in London, adequate usage is made of the higher bands, (as it is in the South East where the results are similar). This is just what does **not** happen in most of the other regions.

Although, (as we shall see in the next sub section), London is something of a special case in terms of its property mix, this is in a manner which would potentially make it **more difficult** to include in a revamped local banding scheme. If we can cope with London, (and we have just seen that we can!), then the real situation on the ground should make it relatively easy to cope in all other regions.

3.1.2 Examining the real situation on the ground

The key parameters affecting the practicability of any proposed property re-banding are:

- The range of **prices** for dwellings in each region. Is there sufficient variability within each region to provide the differentiation that we are seeking in order to achieve taxing raising flexibility?
- The **physical** housing stock in each region. Is there sufficient variability within each region to provide the differentiation that we are seeking in order to achieve taxing raising flexibility?
- The current band distribution / profile, (i.e. the number of properties in each band), in each region. Does it represent the best that we can do in terms of **appropriate** differentiation?

Figure 17 shows the **range** of dwelling prices **within** each region. This shows that not only is there a sufficient range of prices within each region, (as expressed by the ratio between the **average** prices for the most expensive and the cheapest types of property - and remember that there will normally be a distribution about the average as well so that the **actual** spread is even **greater**), but that different regions also have broadly similar spreads.

Ratios between prices for different types of housing 1=costliest, 4 = cheapest etc.						
Region	1-2	1-3	1-4	2-3	2-4	3-4
North East	1.94	2.35	2.57	1.21	1.33	1.10
North West	1.94	1.96	3.10	1.01	1.60	1.58
Yorks & Humber	1.71	1.88	2.58	1.10	1.51	1.37
East Midlands	1.92	2.22	2.39	1.16	1.24	1.08
West Midlands	2.04	2.49	2.58	1.22	1.26	1.04
East of England	1.73	2.10	2.51	1.22	1.45	1.19
London	2.11	2.29	2.60	1.09	1.23	1.14
South East	1.90	2.40	2.86	1.27	1.51	1.19
South West	1.76	2.11	2.25	1.20	1.28	1.06

Fig. 17

This point is illustrated rather more graphically in figure 18 where we show the average price of the cheapest type of property, (which varies between flats and terraced property according to the region concerned), in each region as a percentage of the average price of the most expensive type of property, (which is always a detached house), in the same region.

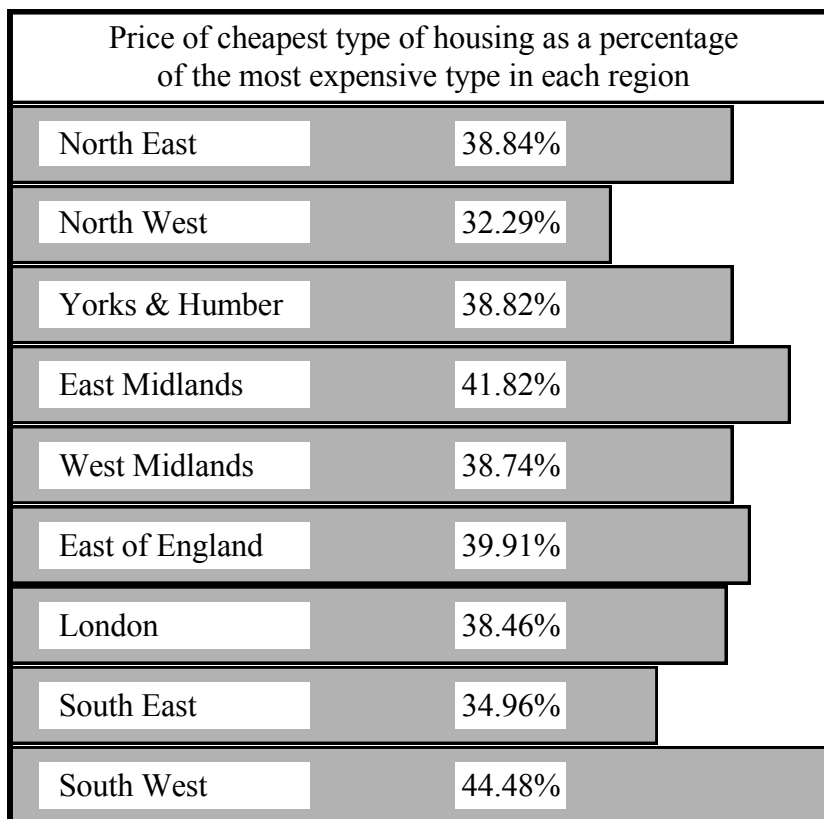


Fig. 18

As we can see, although there is some variation, (between the maximum of 44.48% in the South West and a minimum of 32.29% in the North West), this is not so great, in itself, so as to act as a major impediment to getting roughly the same distribution of bands within each region.

Having established that there is sufficient price variation within each region, we now need to examine whether there is sufficient property within each potential price band to enable a sensible regional re-banding scheme to be implemented. Normally, when conducting any banding exercise, we would wish to ensure that most property fell within one of the middle bands leaving the lower and upper Council Tax bands for the exceptional property. (This is not what we have at the moment) We therefore need to examine how the stock of the most common types of property as well as the stock of property within the middle price range varies from region to region.

The commonest type of property within England as a whole is the semi-detached dwelling. On average, this also happens to be the second most expensive type of housing. Figure 19 shows how the percentage of the housing stock represented by semi-detached property varies from region to region.



Fig. 19

Although the variation is greater than that found on the price front, it would appear that, (with the possible exception of London), the distribution of semi-detached property around the country is sufficiently similar so as not to provide an insuperable obstacle to having similar banding regimes across all regions - at least in this particular part of the property spectrum.

The second commonest type of dwelling in England is terraced housing. This also happens to be the second cheapest type of housing on average. The spread between the minimum percentage, (25.65% in the East Midlands), and the maximum percentage, (37.38% in the North East), is probably not too great to make any regionally based re-banding totally impracticable. Figure 20 shows this particular spread for the various regions.

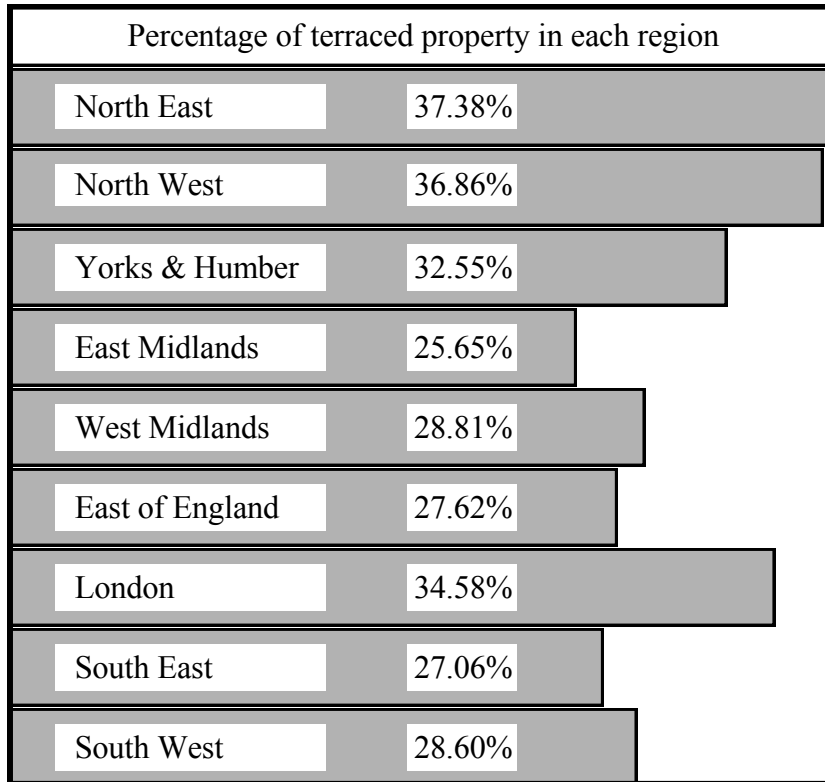


Fig. 20

The spread in the outer regions of the distribution is somewhat larger. The figures for detached property and flats are given in figure 21

	NE	NW	Y& H	E Mid	W Mid	E of E	Lond	SE	SW
Detached	10.82%	14.98%	16.95%	29.70%	21.28%	28.87%	5.94%	29.48%	31.39%
Flat	14.36%	12.50%	11.96%	8.55%	13.40%	12.60%	40.11%	14.66%	11.70%

Fig. 21

Apart from London, (which may have to be treated differently from other regions), the distribution of flats is certainly sufficiently uniform to enable regional re-banding. However, the distribution of detached houses is rather more uneven. It is worth noting, however, that the highest percentages of detached housing are not always to be found in those areas that are generally considered to be the most prosperous and which receive the least help from central government grants.

For example, on a **physical** basis, the East Midlands and the South East are remarkably similar. Not only is the ratio of detached house prices to terraced house prices virtually identical, (2.39 in the East Midlands and 2.40 in the South East), the property mix is remarkably similar too, (see figure 22).

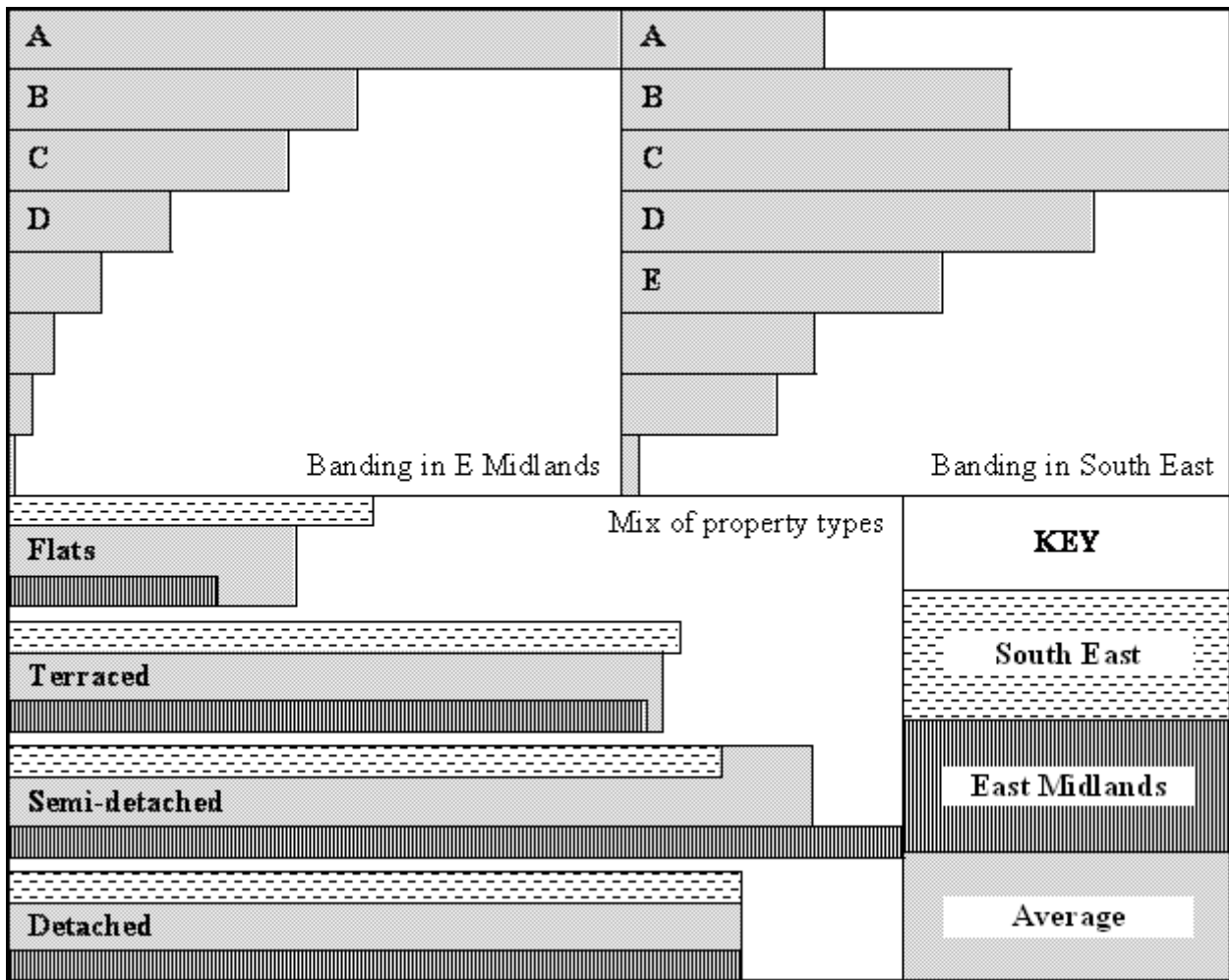


Fig. 22

Despite the obvious similarity in the property mix shown in the bottom half of figure 22, the top half shows that the banding for Council Tax purposes is anything but similar. Even the **shape** of the profile is different!

In fact the East Midlands has slightly more detached properties, (29.7% vs 29.48%), as well as slightly more semi-detached houses, (36.09% vs 28.8%), than the South East. It is the South East that actually has more of the cheaper types of housing! Yet we find that the average Council Tax per dwelling in the South East is £1,147 which is £195, or 20.48%, more than that in the East Midlands which stands at £952. The detailed figures for housing types in each region are shown in figure 23.

Housing types: % of each in total stock				
Region	Detached	Semis	Terraced	Flats
East Midlands	29.70%	36.09%	25.65%	8.55%
South East	29.48%	28.80%	27.06%	14.66%

Fig. 23

This rather anomalous situation arises because Council Tax bands are determined by **prices** relative to **national** averages rather than **local** averages. This rather peculiar system leads to the distribution of Council Tax bands both within and between regions looking very different from the distribution of types of property. The current distribution of Council Tax bands in each LGO regions along with the picture for England as a whole is shown in figure 24.

Region	Council Tax Band							
	A	B	C	D	E	F	G	H
North East	58.6%	13.9%	14.0%	7.3%	3.6%	1.6%	0.9%	0.1%
North West	43.8%	18.9%	17.2%	9.6%	5.7%	2.8%	1.9%	0.2%
Yorks & Humber	45.8%	19.4%	16.1%	8.7%	5.6%	2.7%	1.6%	0.1%
East Midlands	38.8%	22.3%	17.7%	10.3%	6.1%	2.9%	1.7%	0.2%
West Midlands	32.4%	24.9%	19.1%	10.7%	6.8%	3.7%	2.3%	0.2%
East of England	14.4%	21.2%	26.4%	17.3%	10.5%	5.7%	3.9%	0.5%
London	3.4%	13.6%	26.7%	25.4%	15.3%	7.6%	6.3%	1.7%
South East	8.7%	16.4%	25.9%	20.0%	13.5%	8.1%	6.6%	0.9%
South West	17.2%	24.5%	23.1%	15.7%	10.6%	5.4%	3.2%	0.3%
England	25.8%	19.3%	21.5%	15.0%	9.4%	5.0%	3.5%	0.6%

Fig. 24

It is difficult to believe that **all** of the 58.6% of North Eastern properties in band A are “much of a muchness”. In fact we **know** that they can’t be. The cheapest **type** of property in the North East is terraced housing, (with an average value in 2000 of £43,255). However, this type of housing only accounts for 37.38% of the total housing stock there. **At the very least**, the remaining 21.18% of properties that fall into band A must consist of a more expensive **type** of property. The second cheapest type of property in the North East, (with an average price in 2000 of £47,401) consists of flats. These however account for only 14.36% of the North East’s housing stock, which still leaves at least 6.82% of the band A houses to be accounted for by even more expensive property - in this case the semi-detached property.

It is not as though there is very little price differential between terraced property in the North East and semi-detached property there. In fact, on average, semi-detached property is 33% more expensive than terraced property, (the national average is 22% and the figure for London is only 9%). Clearly we **can** achieve a much wider spread of Council Tax bands in the North East than that which we currently have.

We can not, of course, assume that all terraced property in the North East is either more lowly banded or is in the same band as any flats, nor can we assume that all flats are either more lowly banded or are in the same band as any semi-detached houses and so on. Indeed it is important to recognise that we have **not** made any such assumption when discussing the North East’s situation. All that we have done is to recognise that any unusually expensive terraced housing will be displaced in the lower band(s) by housing which is normally of a more expensive type. The same goes for flats, semis or whatever. This means that the figures given above for the North East show the **minimum** amounts of the more expensive **types** of housing that must fall into the lower bands. If more of the expensive types housing

than the minimum does indeed fall into lower bands this would mean that the real degree of differentiation between housing within at least two types is actually **greater** than that implied by looking at the crude figures for the housing stock alone.

Indeed, by looking at the figures for England as a whole, we can see that there is substantial evidence to support the view that flats, terraced housing, semis and so on are anything but homogeneous. Figure 25, which shows which ranks each type of housing in each region according to their average prices within each region demonstrates this.

Ranking of properties within each region by relative price				
Region	Cheapest	2nd Cheapest	3rd Cheapest	Costliest
North East	Terraced	Flat	Semi-det	Detached
North West	Terraced	Semi-det	Flat	Detached
Yorks & Humber	Terraced	Semi-det	Flat	Detached
East Midlands	Terraced	Flat	Semi-det	Detached
West Midlands	Terraced	Flat	Semi-det	Detached
East of England	Flat	Terraced	Semi-det	Detached
London	Flat	Terraced	Semi-det	Detached
South East	Flat	Terraced	Semi-det	Detached
South West	Flat	Terraced	Semi-det	Detached

Fig. 25

As we can see, although the most expensive type of housing in all regions is the detached property, there is no such uniformity in ranking as regards properties of the other three types. The cheapest can be either terraced housing or flats, whereas the second cheapest type can be any of flats, terraced housing or semi-detached dwellings and the third cheapest could be either a flat or a semi.

It is almost inconceivable that all the flats in (say) the North East are inferior to all the semis in that region and at the same time that all the semis in the North West are inferior to all the flats there! It is much more likely that there is a pretty good mix of both types of property in both regions and that there just happens to be rather more good semis and poor flats in the North East and rather fewer good semis and rather more good flats in the North West. This view is supported by the price differentials we find within each region.

We have now provided sufficient evidence to suggest that there is indeed enough differentiation on the ground between properties in each region to achieve a realistic and broader distribution of banding. All the anomalies that we have identified derive from making too little use of the upper bands in the poorer regions and, to a lesser extent, too little use of the lower bands in the richer ones. Of course, it would always be possible to introduce more bands at each end of the spectrum. However, this is completely unnecessary and could easily result in the perpetuation of the absurd idea that similarly **banded** properties, rather than properties that are **really** similar should all pay much the same level of Council Tax.

3.1.3 Consequences of regional re-banding

The consequences of any re-banding exercise depend upon what profile the banding distribution takes. If we were to aim at the ideal profile, (as investigated in the previous section), then we would, in effect be mimicking the banding profile of London or the South East. Since these are the most extreme

regions in terms of the usage of the higher property bands, one can well imagine what consternation this might cause elsewhere! Actually, of course, most of any such reaction would be completely irrational. Unless central government changed the way in which it distributed its grants, any re-balancing of the burden would lie entirely within each region - and hopefully would be much "fairer".

However, determining the best banding structure, which would probably be some compromise between the ideal structure and the present one, (perhaps arranged so each region had virtually the same percentage of properties in each band as the national average), would require much more detailed information and study. This information **will** become available, (although not necessarily to the general public), as result of the revaluation exercise currently in progress.

The winners and losers **in real terms** from any re-banding exercise would be concentrated in those areas where the existing banding distribution is narrow and is skewed towards either the high bands, (as in London ?), or the low bands, (as in the North East), when compared with the overall profile chosen. In what were, (in 1991), the **cheaper** housing areas, (i.e. the North East, the North West, Yorkshire and Humberside, the East Midlands and the West Midlands), the predominant banding change would be **upwards**. In the more **expensive** areas, (i.e. London, the South East and the South West), the predominant banding change would be **downwards**.

One can well imagine that such wholesale changes might cause consternation. However, other things being equal, the main practical effect of re-banding **upwards** would be that the Council Tax charged for any particular band would go **down**, - since the taxable base has now increased. Conversely, the main effect of re-banding **downwards** would be that the Council Tax on any property remaining in the same band would **increase**.

On its own, this reform would only redistribute the burden **within** local authorities. It would do nothing to redistribute the burden **between** local authorities. However this might not be what is **perceived**. The North might well feel that it is losing out with respect to the South, even though this would be untrue. Redistribution between regions would only occur as a result of central government deciding to change the amount of grant that it provides for any region, (as it probably should). What it would do is to remove the (inaccurate and misleading) excuse of using grants to equalise Band D Council Tax across the country. Most local authorities would have much the same taxable base as each other. This would leave any differences in the Revenue Support Grant, (or the Police Grant), to be based on some assessment of real **need**.

3.2 Matching power and responsibility at the government level

3.2.1 *The purpose of local government*

Any proposals for the reform of the relationship between central and local government need to begin by addressing the question of what local government is really **for**. Is the purpose of local government simply to manage, (the **how** of), local services or is it to prioritise and choose which services to offer, (the **what**)?

If the purpose of local government is **management** of local affairs, then there is little point in either local elections or local democracy. The history of elected management is pretty discouraging, (consider what happened to the Co-op and compare this with the performance of the supermarket and other retail chains). Indeed, for reasons of **clarity** of accountability, local people should know who to blame when things are not to their liking. If they elect local managers then central government can say that it was all

the fault of the local electors for choosing such idiots. On the other hand the local managers can say that central government gave them an impossible job given the constraints and so on. If central government selects its local managers for itself, then there is only “one bottom to kick”. On the other hand, there is much to be said for electing local **advisors**. If we elect such local advisors and they **publish** their advice, then local people will know who to blame when they are dissatisfied. If the advice was followed, then it is the locals; if not, then it is central government

On the other hand if local government is expected to **choose**, then one of the choices that they must be allowed to make is between high tax and high spending on the one hand and lower tax and lower spending on the other. Equally they need to be able to choose what to **prioritise** for any spending. This is not something that central government can choose for them. It is something where local democracy is **vital**. Unfortunately if we mix up management with policy, we tend to get the worst of both worlds. If central government funds are mixed up with local funds then local taxation becomes a myth. All that we have is locally **collected** tax but not locally **determined** tax. Central government can always adjust its portion of the funding so as to make a choice of how much tax to raise locally irrelevant to the services that can be delivered, (as has now happened). If central government funding is to continue, then it should probably bear a **direct** relationship to the funds collected locally, (and not an inverse one)! This is essential if we are to have a truly local tax.

Local taxes not only have to be **collected** locally, the **tax base** should also be local and the tax rates need to be **set** locally as well. Unless there are **some** taxes which are collected locally and particularly whose **rates are set locally**, then any local autonomy that still remains is likely to become a sham. Only if those who decide how to spend the money are able to decide **how much** to spend and collect by way of tax are they truly **accountable**.

3.2.2 *Achieving accountability*

The present system of local authority financing may be best described as one of **muddle**. With huge variations in the amount of funding raised locally and the amount raised centrally, there is very little relationship between levels of, or increases in, Council Tax and local expenditures. There is a lack of **accountability**. When the electorate complains about Council Tax, central government blames local government and local government blames central government.

There are really only three basic approaches to **clarifying** the muddle surrounding **who**, (i.e. central government or local government), is responsible for **what**. Without this clarification there can be very little true **accountability**. The three basic approaches available are:

- **Basic approach 1** - Central government collects all the taxes for local services and distributes the resulting funds according to some measure of “need”
 - This would make it absolutely clear who was responsible for any underfunding or waste and put accountability where it belongs - with central government in this instance.

Unfortunately, under any arrangement of this sort, if local people or local councils were to have any say at all they would have a perverse incentive to inflate their budgets / statements of need in competition with others. As a local you would get all the benefit but only part of the costs - unless others play the game as well as , or better than, you do. This is likely to lead to local profligacy - and higher taxes overall. This is consistent with our earlier quotation from the report of the Audit Commission: “*We found that increases tend to be*

higher in authorities that are not directly elected – 13 of the 20 highest increases in Council Tax were agreed by police authorities.”

One would suspect that the reason that unelected bodies are responsible for the largest Council Tax precepts is that they have no real accountability. They do not collect the taxes and can not be dismissed when the taxpayers find the corresponding tax bills too high. This solution really does remove local accountability.

This type of approach is **not** what the Local Government Association wants. They recognise that the balance of funding is inseparable from the balance of power - “*He who pays the piper calls the tune*”. Local governments want more power and so, quite logically, they want more of the tax burden to be determined and collected locally - e.g. by “repatriation” of the business rates, (the NNDR). This is very much a **political** issue - and in the end it won't be possible to fudge it. In many ways it resembles, on a smaller scale, the current unease over what was the proposed European Constitution.

- **Basic approach 2** - Local government collects all the taxes for local services and decides how the proceeds should be spent
 - Once again this would make it absolutely clear who was responsible for any underfunding or waste and put accountability where it belongs - with local government in this instance.

Unfortunately under any arrangement of this sort local taxes would have to increase quite sharply. The increases would be largest in those local authority areas which currently receive the largest subventions from central government.

- **Basic approach 3** - Local government sets a local tax rate and central government provides additional funds to local authorities according to some multiplier of local taxes. Local government would decide on all local spending priorities. The multiplier could be different for different local authorities according to some measure of “need”
 - In this situation accountability would belong with local government. However, unless the multiplier could be varied, there would be little accountability to the general, non-local taxpayer who would be providing the additional funds.

Unfortunately if the multiplier could be varied, there would be a real and perverse incentive for central government to manipulate this multiplier for political purposes. (Many people believe that this already happens under the existing FSS and Resource Equalisation systems). This would remove **local** accountability - without replacing it with **national** accountability

On the other hand, if the local multiplier were fixed, then those local authorities which raised the smallest proportion of total expenditure locally would have an incentive towards extravagance - particularly if they could return much of the locally raised money to their electorates in cash or near-cash forms, (e.g. in vouchers). This problem would also be exacerbated if much of the locally raised tax were actually paid for by a specifically targeted benefit - like CTB!

From the above it is clear that none of the basic solutions is ideal. What we need is some sort of hybrid. The existing Council Tax system is, of course, a hybrid - but a peculiarly bad one!

There are some fundamental problems associated with any system that is reliant on central government grants. These become more apparent the larger the proportion of total expenditure financed by central government becomes. The extreme case would be where the government collected all the funds and decided what should be done with them, (basic approach 1).

- It is obvious that the greater the proportion of local expenditure that is funded by central government then the greater is the scope for redistribution.. Areas which meet with central government approval, (perhaps because they vote the “right” way), can always be subsidised by other areas.
- Local authorities tend to become less efficient It is true that councils are required under the 1999 Local Government Act to deliver continuous improvement through the application of best value, including the identification of savings through more economic, efficient and effective ways of delivering services. However this seems to be a law more honoured in the breach than in the observance! To rely on a law of this sort when removing some of the sanctions on inefficiency looks to be optimistic in the extreme! Most of those who have worked with both public and private sectors believe that there is enormous scope for efficiency savings in the former.
- Whenever there are problems with the national finances, central government can simply reduce the amount that they give to local government. This is particularly tempting when there is an elected local authority in a position to take any flak. “Ring fencing” specific central taxes for local government is not really much of an answer to this.
 - Ring fencing (hypothecating taxes) is really an illusion. When new taxes are introduced they are often presented as though they are hypothecated to something of which the tax-payer will approve in order to soften the blow. However such hypothecation rarely survives. As long as the majority of taxes are unhypothecated, hypothecation itself is really an illusion. The government can always divert general taxes that would have been spent on the hypothecated activity to other purposes, (look at what they have done with respect to funds from the national lottery). Only when the total take from the supposedly hypothecated tax exceeds the amount spent on the service, (for example: roads and the taxes on motorists; NHS expenditure on smoking related diseases and tobacco tax), to which it is sometimes presented as if it were hypothecated, is the hypocrisy of the government clear for all to see.

The only ring fencing mechanism that is bound to work is when:

- Those who spend the taxes also collect them
- Those who collect and spend these taxes have no other responsibilities. Central government does not tell them what services they must provide
- Those who collect and spend these taxes receive no subventions or funding from any other source, nor do they have to pass on any of the revenue raised to anyone else.

It would appear that there needs to be a complete **separation** between local and central government: a complete separation of **powers**; a complete separation of **funds**; and a complete separation of **people**, (councillors as well as civil servants). If councils and central government each had separate and well

defined responsibilities and separate sources of funds, then councils would have to **manage** and fund **their** decisions and central government would have to do likewise.

In such a situation central government would be responsible for fully **funding** and **managing** all “essential” services, like education, social care and policing. Local people could be represented through elected advisory bodies, (as used to happen in Hong Kong - where it worked well), which would be quite separate from the local council. However it would be central government that would have the final say. Even then, there will always be a requirement for local input. Central government on its own can not provide this. An advisory body and a separate executive body would appear to be the way forward. The executive body could then make local choices and decisions.

Local government would be responsible for providing all those little “extras”, like culture, sport, parks, car parking, local traffic management (?) and local planning, that make communities what they are. At one extreme they could even do nothing and spend nothing- if that is what the local electorate wanted! Some increases in local spending are desirable but the choice about whether those are to be met by reducing spending on other services, increasing charges or increasing local taxes are decisions elected local councils should make.

Given that currently central government dictates around 80% of local authority spending, it would seem appropriate that, in fiscal terms, local government responsibilities for management and finances should be reduced to something like 20% of what they are now. On average, this would reduce locally funded taxation by about 20%. An average reduction of around this magnitude would do much to defuse the ill feeling surrounding Council Tax.

3.3 Matching power and responsibility in the electorate

The rating system worked reasonably well for several hundred years. This must be, in part, because only householders paid the rates and only householders had the vote. It was only after the broadening of the franchise without a corresponding broadening of the tax base that led to the rates becoming unpopular. In the early days, even though businesses paid rates, most businesses were still local so that, although businesses did not have votes as such, their proprietors were usually local householders who did have a vote. However, as businesses became less local, many local politicians saw voteless businesses as a politically painless source of revenue, (“taxation without representation”). It was excesses of this nature that caused the Conservatives to “nationalise” business rates. Some Council Tax payers, i.e. those with second properties, also suffer from “taxation without representation”. Whilst it is easy to see why people should not have more than one vote at **national** elections, it is much harder to see why they should not be allowed to vote in any, (including more than one), **local** election when they pay significant taxes to the local authority concerned.

Despite the problems experienced last time around there really does seem to be some benefit in considering a reintroduction of some sort of poll tax - but only as a **supplementary** tax to any other local tax.

In order to prevent local politicians from seeking electoral advantage by playing off one section of the population against another, the author would suggest that the rate of any poll tax should be rigidly **indexed** to, and therefore completely determined by, the rate of whatever is the **main** local tax, (e.g. the Council Tax). If the poll tax were to be levied at a rate which approximately funded a 25% decrease in Council Tax, and we were to allow **just one** occupant of any property to offset their poll tax liability against their Council Tax bill, then the 25% discount for single occupancy properties could be

eliminated without (typical) single occupants being any the worse off. Generally only those households with more than two adults would see an increase in their overall tax bills. There are obvious administrative gains from such a proposal.

A somewhat more radical alternative would be to make any poll tax **voluntary**. This would immediately remove any concerns about its affordability or “fairness”. Only those who chose to pay the poll tax would have the right to vote at **local** elections. In addition we could introduce a system whereby anybody who paid the tax would also receive a sort of identity card which would entitle them to use some local authority provided services, such as car parking, sports and leisure centres, theatres, libraries or whatever at preferential rates.

3.4 Integrating the proposed solutions

The reforms advocated in this paper really need to be seen as a coherent whole. Only the revised poll tax can be treated as a separable option. There is little point in reforming local taxes unless we also reform the relationship between local and central government. If central government can dictate spending and / or subsidise, (or tax), local authorities, then all local tax becomes, in effect, a national tax. Equally, if local government does not have its own independent tax revenues, then it really becomes no more than a subsidiary of central government. The only advantage of the proposed local / regional re-banding without reforms to the relationship between local and central governments is that a more rational, or at least more transparent, means of determining central government grants would simply have to be devised. Just as most people today think it not unreasonable, (at least until they think it through), that similar banded properties should pay similar amounts of tax, they would tend to believe the same after any re-banding exercise.

If we are to have what are, in effect, national taxes, (i.e. no proper match between power and responsibility), then there is not really much point in considering the “fairness”, or indeed the impact, of any individual one of them. What really matters for “fairness”, “social justice” or any other considerations in determining the distribution of the tax burden is how **all** taxes, taken as a whole, impact on different types of individual. Only if local and national taxes are truly different and collected for different purposes does it become possible to consider the taxation burdens separately. Equally, it is probably futile to consider altering the overall distribution of the burden of taxation without also considering the benefits system. What does it matter if a person receives £1,000 more in benefit than they “should” do if, at the same time, they also pay £1,000 more in tax than was actually intended? These are much bigger issues than the much more limited scope of this particular paper is intended to address. The only comments that would seem to be appropriate would be that means tested benefits encourage poverty traps, (especially when there is more than one of them), and that targeted benefits, like Council Tax Benefit, remove the incentive to responsible voting. Targeted benefits also tend to incentive the very behaviour whose consequences they are designed to relieve.

4. COMMENTS ON SOME ALTERNATIVE APPROACHES

Obviously, the simplest way to overcome the problems associated with the Council Tax would be to abolish it altogether - replacing the lost revenue in some other way. Were we to replace the Council Tax with (true) **national** taxes, the main contenders would undoubtedly be income tax and VAT. Both of these taxes have a clear relationship to people's ability to pay them. However, such a policy would almost inevitably lead to the final and complete disappearance of local democracy. It is difficult to see how a central government responsible for paying all the "piper's wages" would not also insist upon "calling the tune". This is probably not what the electorate really wants. Certainly the Local Government Association doesn't. They have called for **more** taxes to be collected locally. It does not seem to be the policy of any of the major political parties either. In short, this is a policy that is unlikely to be realised.

The Liberal Democrats have proposed levying a local income tax to pay for local services. Quite apart from the argument that a "local" income tax which merely supplemented **national** funding of local government would very rapidly become merely another, more bureaucratic, **national** income tax, (unless the equivalent of "Resource Equalisation" were to be abandoned), it is not clear **which** local authority should receive the money. Is it the one in which the money was earned or is it the one in which the earner resides? One can adduce plausible arguments for both. There is also the potential problem of **displacement** to be considered. Whether this displacement is **real**, or whether it merely happens "on paper" is immaterial. For example, in the case of local income taxes, what is to stop a person with a large income from registering his residence in whatever local authority charges the lowest tax rates, (while presumably no longer "officially" cohabiting with an (officially) penniless partner who continues to reside where both **really** live)? Indeed, what is to stop a local authority from adopting the Channel Islands or Isle of Man strategy and deliberately encouraging the wealthy to live there, (on paper)? Low taxes charged to wealthy outsiders would raise very substantial revenues to the benefit of truly local residents! Local income taxes would appear to encourage beggar my neighbour policies. This might well lead to lower taxation overall, but it would also tend to lead to a decline in public services.

Local sales taxes, (proposed in one paper by the Adam Smith Institute), also suffer from the potential problem of **displacement** of the activity on which the taxes are charged. What is there to stop people from doing their shopping in whatever convenient nearby local authority area levies the lowest sales taxes? Indeed, what is to stop many transactions **appearing** to take place (on paper) somewhere other than where they really took place? In any case, would it not be better to ensure that any revenue went to the areas where the purchaser and / or the vendor actually **lived**. After all, it is **people** who consume local services! Achieving such a distribution of funds would be fiendishly complicated. However, if local authorities were to be much bigger than they are today, (say the size of the regions as defined by the Office of the Deputy Prime Minister), then many of the problems of sales displacement and distribution according to where people lived would disappear. (The percentage of people near the borders relative to the population of the region as a whole would be much smaller). However, such an approach is hardly compatible with **very** local democracy!

Apart from the very brief interlude of the Community Charge, local taxation in England has been property based ever since the Rates were first introduced in 1601. There are probably good reasons for this. Property taxes are very difficult to avoid - real estate cannot be moved away or be made to appear to be somewhere else! In fact, in view of our brief commentary on so-called "local" income taxes and "local" sales taxes, only "**presence**" taxes would appear to be sufficiently local to be viable. Presence

taxes include residency, (the Poll Tax), so-called “congestion charging”, and property taxes, (including taxes on business property and possibly inheritance tax, development levies, capital gains tax and stamp duties on changes in local property ownership).

There is a generic problem with all **transaction** based taxes, (which include income taxes, VAT, customs and excise duties, stamp duties, capital gains taxes and development levies). In a free market transactions only occur when both parties believe that they will gain. If the government taxes these transactions, then the potential gains for at least one of the parties will be reduced. At the margin, this will mean that many otherwise desirable and wealth creating transactions will simply not occur. The national economy will thereby be damaged. Death duties / inheritance taxes are based on one of the very few involuntary transactions. Taxing them is, on this basis, unlikely to do as much economic harm as other transaction based taxes.

With only occasional grumbles, (for example, the Conservatives in their manifesto for the second general election of 1974 promised to abolish the Rates, but, after losing that election, they did not reintroduce the idea in their 1979 manifesto), the rating system remained broadly unchallenged until the legally required quinquennial revaluation of Scottish rateable values in 1985 led to a real increase in domestic rate bills of the order of 20%. Since then, local taxation has been something of a political hot potato. Despite the arguments against property taxes or poll taxes, the arguments against other forms of tax are even stronger. We probably can not devise a **perfect** system - but we can certainly devise a **better** one than we have at present!