
Economic Perspective 2

THE FORGOTTEN DIMENSIONS OF LOCAL FISCAL REFORM IN SCOTLAND

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INTRODUCTION

The abolition of domestic rates and the introduction of the Community Charge are intended by the Government to lead to a fairer, more accountable, local tax system. All adults (with a few exceptions) will contribute to the cost of local services, forcing local authorities to be more sensitive to the costs of their expenditure on local people. Similarly, the electorate should more clearly appreciate the link between the level of the Community Charge and the spending patterns of authorities.

In the Government's view (1), the new system will more properly reflect the use of local services by a household and therefore provide a more equitable basis for paying for local services. Moreover, the new system will be less regressive than rates, with Community Charges comprising a smaller proportion of household budgets in low income families.

Both these assumptions are highly contestable. For example, adults who live in their parent's home who at present are not eligible to pay rates, will be required to pay the new charge. In the case of young adults, their consumption of local services is minimal. As regards the more progressive nature of the new tax, it is only so at low levels of income because of the rebate scheme. A recent analysis by the Scottish Local Government Information Unit, concluded that families, pensioners and single people will all be expected to pay the full charge at low income levels (2).

For single pensioners with incomes of £45 per week, the tax would consume 3.3% of their income. At £60 per week, the figure becomes 6.2%, and at £100 per week, 5.8%. At higher levels of income, the tax becomes clearly regressive.

The most dramatic gains are to be found at the higher end of the income and housing scale, with the extent of gain varying with the current value of the property and the size of the household. Even private households with three adults can gain financially from the changeover (3).

The Government's analysis of the distributive consequences of the Community Charge has considerable shortcomings, and ignores important dimensions. It is carried out on a national scale, and therefore conceals the variations in the ratio of winners to losers, that will occur throughout the country, both within and between local authority areas. Moreover, it is based on increasingly unrealistic assumptions about the levels of Community Charge, which ignore the fiscal dynamics of the new system. The basis of the new approach is a simplified grant system which accurately assesses local needs, thus isolating "marginal spending" above government estimates as locally determined, thereby increasing accountability.

In practice, the effect of the reform is to increase the interdependence of central and local government as central government decisions on government grants and non-domestic rating become of greater importance in local budget arithmetic. In particular, any shortfall between the permitted increase in non-domestic rates and actual increases in local expenditure will fall directly on community charge payers. This will be a real problem in periods of rising inflation, when non-domestic rates reflect the previous

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year's inflation levels. This in part explains the divergence between the government forecast of an average charge of £267 per capita for Scotland in the current year, and the actual figure of around £300. Such small differences throw into question all calculations on winners and losers for individuals on rebates.

THE DISTRIBUTIVE CONSEQUENCES OF THE COMMUNITY CHARGE

Government predictions of 52% of households losing nationally from the reforms, are tenuous, and the framework for analysis is limited. However, the Green Paper makes clear that local variations will depend on the numbers of adults per households, the ratio of high to low-rated properties in the locality, and the incidence of Community Charge rebates. In our research, we have been considering issues ignored in the framing of national policy, namely the territorial pattern of fiscal change and its potential economic consequences. Empirical analysis of the actual impact awaits the generation of data on charge and rebate levels, but we are sufficiently confident from our preliminary research to identify certain significant trends, whilst acknowledging the scale of these trends requires further research and measurement. They are produced here for illustrative purposes.

First, there is the shift in tax liabilities from urban to rural parts of individual authorities. This arises for a number of factors. In rural areas, there is a high incidence of properties with low rateable values, and a low incidence of households in receipt of rebates. In general, therefore, the more rural a local authority area, the more we would expect to find higher numbers of households losing from the changes. Preliminary estimates carried out in the Highlands and Islands of Scotland suggest that potentially 70 to 80 per cent of households could be worse-off, because of the high ratios of low to high valued properties (including the large number of crofts) and the low level of benefit receipts. (4)

Secondly, there will be a similar shift within urban areas between public and owner-occupied housing. It is certainly the case that private houses tend on average to have higher rateable values and hence higher rates, and we would therefore expect the occupants of such houses to face potentially large gains from the new flat-rate per capita tax. From our preliminary work

in the Scottish Highlands, for example, the average rates bill in private houses was £475.53, compared to £353.40 for local authority houses. Our calculations, using the governments predicted community charge levels, show an average gain in income of £90.00 per year for owner-occupiers in Inverness and a loss of £2.70 per year for tenants. This trend is maintained in the more rural areas, although in Caithness, Sutherland and Skye and Lochalsh, owner-occupiers also lose from the changes. Similar findings have been generated by R. Paddison in a study of the distributive impact of the Community Charge in Glasgow. (5)

THE POLICY IMPLICATIONS

The consequences of these illustrative changes are two-fold.

Firstly, in areas where rates reform is forecast to lead to income losses for both owner-occupiers and tenants, there will through normal multiplier processes, be broader effects on the local economy. In the research which we carried out, having quantified the changes in income which we anticipate following the changeover to the Community Charge, the Fraser Institute's multi-sectoral "intra-national" model of the Highland Region was used to measure the impact in terms of output, income and employment on sectors of the economy. The model recognises two types of industry: an industry can be classed as "local" if consumption within the local boundary is approximately met by local production; and "national" industries are defined as those industries whose products can be traded across local boundaries. There are three sources of demand for local industries: demand by final consumers; demand by national industries located in the local region; and demand from other local industries. As might be anticipated, in geographic areas where fiscal reform led to income losses, local industries were the most severely hit. If people are spending less on goods and services, then all industries are affected. However, in "national" industries, external trade is possible and so all the loss caused by a local reduction in expenditure, will not necessarily be felt since excess produce can be traded. However, with "local" industries any reduction in local spending is all passed onto the producer. In addition since part of a local industry's demand comes from other local industries, who are also going to have experienced a reduction in spending

and will consequently have reduced production, there will be further multiplied effects. Consequently, in areas where the abolition of domestic rates and the introduction of the Community Charge leads to income losses, there will be highly localised economic effects.

Secondly, we would hypothesise that these changes will lead to increased demands for services, in both rural and urban areas. In the past, households in remote areas have received lower levels of public services (albeit at higher costs) and despite the general principles underlying public service provision in Britain that these should be broadly equal throughout the UK, the compensation for rural dwellers has been in the form of low rates. The impact will be especially marked in ruralcrofting areas where public resources have been channelled to counter the logic of the market and help retain and invigorate traditional communities. In the past, the low rateable values of such properties reflected the distance from service centres and brought low rates. Now, individuals will pay the same as their urban counterparts, and no doubt place demands for equal services before councils and government.

In urban areas, the pattern of public service provision has often tended to reflect the greater articulation of middle-class residents (6). Only since local government reorganisation have sustained attempts been made to tackle the public service dimension of urban deprivation, with often limited success (7). The shift in tax liability from owner-occupiers to tenants will be regressive. The assumptions underlying the new tax system is that all adults benefit from local services, and therefore all, with the exception of those on very low incomes, should therefore make an equitable contribution to these services. On this logic, the case for a redistribution of local services and council expenditure towards these areas, is somewhat compelling for households facing large tax increases.

CONCLUSIONS

In this paper, we have argued that the Government's analysis of the distributive consequences of local fiscal reform has been unduly narrow. A wider framework of analysis is needed, to examine local variations, and in particular we have identified two significant shifts, between rural and urban areas, and between

tenants and owner-occupiers. We have argued that such analysis is illustrative rather than definitive, and precise measurement of these effect awaits further research.

In summary, the new tax system will result in significant shifts in tax burdens, from owner-occupiers to publicly rented houses, and from urban to rural areas.

It is clear that such dimensions have been ignored by government, although some local councils have begun to examine these issues. Whilst some suitable local policy responses will be possible to overcome some of these adverse consequences, eg. by targeting resources in favour of remote rural areas, tackling the full consequences of the changes is beyond the scope of local government, and would require manipulation of the financial system, for example, in the distribution of grants, rebate entitlements etc., or indeed, a more sensitive reform of local government finance in the future.

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